



Taxes and Preventative Roof Maintenance

There are so many roofing materials, procedure and concepts offered today it is little wonder that contractors, building owners, architects, and anyone else involved in preparing roofing specifications find it hard to distinguish among the various systems. The problem is particularly difficult when it comes to fixing a leaky roof in that the spectrum of options is quite broad. You can try and get by with merely patching the leaks and hope for the best or go so far as to tear off the old roof and completely replace it with new insulation and roofing materials. Between these extremes there are many options including several preventative maintenance procedures designed to restore the roof to a watertight condition for an extended period of time.

Debates as to the best way to fix a given roof are what give the roofing industry its vitality. All too often, however, such discussions are limited to roofing technology and the total cost. Little attention, I suspect, is given to the total cost after taxes. When the tax ramification of the various specifications under consideration is taken into account, a strong argument arises on behalf of preventative maintenance options.

Under the Internal Revenue Code, expenditures for the repair of business property are deductible expenses, which may be written off in the current tax year. Conversely, expenditures that constitute capital improvements must be amortized over the life of the property and are recoverable only through annual depreciation deductions. In either case the amount expended will be recovered through deductions, but the difference is the period of time over which the deductions are spread. Current expenses are 100 percent recovered in the current tax year whereas capital expenses for roofing assets are recovered over 39½ years. Clearly a major tax advantage is available to the building owner if he can treat the cost of fixing his roof as a current expense rather than depreciating the cost over 39½ years.

Not all roofing specifications will receive equal tax treatment. How the work is performed will dictate whether the cost can be written off in the current year or must be capitalized.

Determining whether a given expenditure qualifies as a current expense or capital improvement is not always clear, but the Supreme Court in *Welsh V. Helvering* has offered the following guidelines: "A repair is an expenditure for the purpose of keeping the property in an ordinarily efficient operating condition. It does not add to the value of the property, nor does it appreciably prolong its life. It merely keeps the property in its operating condition over its probable useful life for the use for which it was acquired. Expenditures for that purpose are distinguishable from those for replacement, alterations, improvements or additions that prolong the life of the property, increase its value, or make it adaptable to a different use. The one is a maintenance charge, while the others are additions to capital investments which should not be applied against current earnings."

In applying this standard the tax authorities and the courts have consistently treated the cost of a new roof as a capital expenditure but the cost of repairing the existing roof as a current expense. Thus, when the contractor has torn off and replaced the old roof the building owner must capitalize the expenses. On the other hand, where the contractor has merely patched the leaks, the cost is clearly a current expense.

Many roof projects, however, go well beyond mere patchwork but stop short of tearing off and replacing the old roof. There are many products and processes that have preventative maintenance quality. They are designed not only to repair existing leaks but also to prevent the occurrence of the additional leaks. Examples include asphalt based repair products and numerous roof coatings with different levels of performance. None of these products would serve as a complete roofing system but all go beyond merely patching the existing roof. Should the building owner treat preventative maintenance costs as a capital expenditure or a current expense?

If we go back to the Supreme Court's guideline, the answer to the question lies in whether such costs increase the value of the property or extend the useful life. In 1967 the Tax Court addressed this issue in the *Oberman Manufacturing Co.* case. In that case, Oberman had taken as a current expense a \$20,791 expenditure on their plant roof in Fayetteville, Arkansas. The IRS had taken the position that the cost should be capitalized. In ruling in favor of Oberman, the court found that the company's "only purpose in having the work done to the roof was to prevent the leakage." The court further emphasized that there was no replacement or substitution of the roof "and that" this was the most economical way to repair the leaks' and

keep the property in an ordinarily efficient operating condition." As to whether the expenditure increased the value of the property, the court acknowledge that the property is more valuable once the roof is repaired but the "proper test is whether the expenditure materially enhanced the value, use, life expectance, strength, or capacity as compared with the status of the asset prior to the condition necessitating the expenditures."

Where the owner selects a preventative maintenance process for his roof, it would be proper for him to treat such expenditure as a current expense. His sole purpose is to stop the leakage and return the building to a watertight condition. The useful life of value of the building has not been materially enhanced. The old roof has not been replaced or substituted for with new insulation and roofing.

Treating preventative roof maintenance as a current expense is an aggressive tax position that might well be questioned by the IRS in the event of an audit. Nonetheless, the position is legally strong and ought to prevail. Once made aware of the tax advantages of preventative maintenance, the building owner's attitude will change drastically. Rather than bemoaning the fact that he is confronted with a large and unexpected expenditure, he'll see that his roofing work will serve not only as a rain shelter but as a tax shelter as well.