Hospitality Tax Advisory

Acquiring a hospitality property? Consider these tax planning and savings opportunities

When making an acquisition of a hospitality property, tax requirements at the federal, state, and local levels need to be considered and reported. Acquirers should also be aware of opportunities for tax savings that may exist based on the scale and complexity of the property and transaction.

Hospitality property acquisitions typically involve valuation and transactional tax issues that have their own set of complex compliance and reporting requirements. However, there may also be opportunities for tax savings by performing a cost segregation, appealing property tax assessments, or enhancing tax planning.

Enhancing valuation results

Upon the acquisition of a property, the gross purchase price needs to be allocated to the acquired assets under financial statement requirements (*Accounting Standards Codification 805—Business Combinations*) and tax requirements (*Internal Revenue Code §1060—Special allocation rules for certain asset acquisitions*). Accurately allocating the purchase price to the acquired assets is critical in complying with financial statement and tax reporting requirements.

Furthermore, the purchase price allocation can also be a critical starting point in estimating the tax liability for real estate transfer tax, property tax, and sales and use tax. Additionally, any step up in tax basis related to property with a MACRS recovery period of 20 years or less would be eligible for immediate expensing under tax reform. The purchase price allocation should be planned in conjunction with other tax compliance areas to understand how the valuation results can affect the tax liability while maximizing tax benefits.

Cost segregation opportunity

Cost segregation is the analysis of building related costs, intended to identify costs and activities attributable to assets with shorter tax recovery periods and accelerate tax depreciation expense. Specifically, cost segregation identifies personal property (generally 5 or 7 year recovery), land improvements (generally 15 year recovery), and other short lived properties that have been erroneously classified as building property (39 or 27.5 year recovery), which can result in tax savings.

Furthermore, the ability to fully expense qualified new and used property under the new tax law significantly increases the potential benefits of cost segregation. Generally under the new tax law, the bonus depreciation percentage is increased to 100 percent for property (including used property) acquired and placed in service after September 27, 2017 and before 2023, as long as the acquired property has a MACRS recovery period of 20-years or less.

Based on the purchase price allocation and resulting step up in tax basis for the improvements, opportunities may exist to identify assets that can be reclassified to shorter recovery periods, and eligible for immediate expensing.

Property tax opportunity

Property tax is based on the value of taxable property within a jurisdiction. Complying with property tax requirements and recognizing areas for potential property tax savings are vital considerations with the conveyance and/or transfer of real property.

While each local jurisdiction follows their states' guidance in estimating taxable value for property tax, the purchase price allocation can be a starting point in identifying areas for property tax savings. As an example, ancillary business income from non-lodging activities is typically included when estimating the value of the property for purchase price allocation purposes. However, if the property's

ancillary business income is related to the business itself as opposed to the property, it may be excludable when determining the taxable value of the property.

Furthermore, if the value assigned to the taxable property in the purchase price allocation is lower than the property tax assessment, opportunities may exist for an appeal.

Managing real estate transfer tax compliance

Real estate transfer taxes are imposed in most states (and numerous counties and cities) on the transfer of title to real property or the transfer of entity interests that directly or indirectly own an interest in real property. Real estate transfer tax may also be referred to in various forms including deed excise tax, real estate deed recordation tax, or documentary stamp tax.

The tax rate can be a flat or graduated and may depend on the consideration paid or fair market value of the property. Many jurisdictions, can consider an appraisal based upon the value of the real property at the time of conveyance.

Many states provide different classes of property with special treatment. Furthermore, the tax may be imposed based on changes in indirect ownership, potential aggregation of sales, and restructuring transfers, etc., as opposed to the conveyance of real property. Even if a transfer tax is not triggered, many states have reporting requirements related to transfers of economic interests in entities that directly or indirectly own real estate. Lastly, the creation or assignment of leases of real property may also trigger transfer taxes depending on the jurisdiction, type of lease, and lease term.

Managing sales and use tax risk

45 states and the District of Columbia, impose a sales and use tax on the retail sale of tangible personal property and enumerated services in a property acquisition. If a lump sum amount is being paid to acquire a property, the entire purchase price will be subject to sales and use tax, unless the property acquirer can separate the purchase price into taxable and non-taxable items. The starting point of allocating and characterizing the property being transferred between taxable and non-taxable items is the purchase price allocation. Otherwise, both real estate transfer tax and sales and use tax may be imposed upon conveyance of the property. Accordingly, sales and use tax implications, successor liability, and opportunities should be considered when acquiring hospitality properties.

Managing occupancy tax

Certain states and/or local jurisdictions also impose an "occupancy-type" tax upon the rental of hotel rooms or other accommodations. Generally, these taxes are not intended to apply to long term rentals. As such, there are thresholds for occupancy tax to apply on a property that is rented for a short term period (e.g., 30, 60, or 90 days, depending upon the jurisdiction). Similar to sales and use tax, successor liability may apply for hotel occupancy tax purposes.

Why KPMG?

No two hospitality property acquisitions are the same, but most share similarities and common themes. KPMG has an established team of multi-disciplined hospitality professionals with significant experience navigating complex transactional tax issues and identifying potential tax risks and opportunities in hospitality property acquisitions. The experience of our team and deep knowledge of relevant issues gives us credibility to provide objective advice to the hospitality sector when acquiring properties.

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