Depreciation of Modular Buildings

While there is no specific IRS ruling pertaining to depreciation of modular buildings, the following are intended to be general guidelines:

1) Always consult a professional tax advisor

2) Visit the IRS Website for additional resources: http://www.irs.gov/publications/p946/index.html

3) The determination as to which depreciation recovery period to apply to the building is based upon whether the property is considered real or personal.

4) Generally speaking, the buildings (modular units) alone do qualify for a faster depreciation than real property. However, once affixed to a foundation, the decision as to whether the property is real or personal (temporary or permanent) falls within the jurisdiction of the local code official.

To help determine if a property is considered real (permanent, not intended to be moved), consider the following:

The question of real vs. personal can be answered by both investigating the original building design and a term called inherent permanency. Inherent permanency is a definition that addresses the question of "Is this structure designed and intended for permanent use?" This issue is relevant, as nearly any structure can be moved. To the extreme end of that scale, the London Bridge was moved to Arizona - but certainly no one will say that this represents relocatability. The question of inherent permanence asks at what point can you consider a structure easily movable and when is it not easily relocatable or reasonably achievable.

Utilizing the six-way test that was established in the Federal court cases of Whiteco and further used extensively in the Fox Photo case (a modular commercial structure), the courts recommend that it be viewed under the 6 way test as established in the Whiteco case:

1. Is the property capable of being moved and has it in fact been moved?

To facilitate off-site construction, modular construction requires the manufacture and transport of sectional units from the factory to another site where they will be connected together. The practice of assembly and disassembly of modular units is an everyday industry occurrence. The modular units are designed to be legally transported form the factory over the public highway before use, therefore, reuse after disassembly is commonplace in practice and intended. Further, under contractual obligation, typically

the structure must be removed at the termination of the contract of when needed. This most likely will not be the case for on-site constructed facilities.

2. Is the property designed or constructed to remain permanently in place?

Non-residential modular construction typically is designed and manufactured to be readily relocatable. Foundation systems that are used by modular structures are a function of compliance with locally prescribed model construction codes to support the structure. Depending on the prevailing local construction codes, foundation systems, not the structure, may or may not be sedentary or appear to be permanent.

For buildings leased, the term of the average original operating lease contract is, typically less than five years. At the termination of the lease, the structure must be removed from the site, relocated, and then would be utilized at another site.

Since the structure's modular units are initially intrinsically designed to be transported for highway movement from the factory to the first site, these structural units maintain their transportability for secondary, and subsequent moves. For these secondary moves, the act of disassembly typically does not substantially damage these sectional modular units. Additionally, it is common that once the modular units are removed, many of these units may be inventoried, re-configured, and reused at other sites.

3. Are there circumstances that show that the property may or will be moved?

The term of the lease or the use of the structure dictates the removal of the modular sections. At the termination of the lease or use, lessor or user is required to disassemble and transport each of the modular section to another site or return to inventory for re-use at a later time.

Since these structure are initially constructed in a remote factory, this design allows an industry-wide marketing application of short use of the structure in one location and the ready relocation to another site. This practice is prevalent in the educational, office, airport, institutional, restaurant, correctional, and medical facilities' markets to name but a few.

Since these structures have been transported over public highways at least once, the ability exists universally to disassemble and re-transport sectional units with minimal costs for permits and transit. The fees to obtain local disassembly permits are nominal in cost as well.

4. How substantial a job is removal of the property, and how time consuming?

The job of removing the modular sections of the structures is facilitated by the very initial design and manufacture of the sectional units. Because of the inherent sectional design, disassembly time is minimal. Typical of costs, including time consumed and materials for disassembly and removal, are less the 20% of the replacement costs of the total structure.

Typical disassembly time is less than the time spent in the initial assembly.

Typical removal includes disassembly and transportation to another site or to storage. Once in storage, the sectional units may again be transported and reassembled or reconfigured to suit the needs of the next lessee or owner. It is common industry practice to inventory sectional units, and re-configure on a site, as directed by the lessee of owner.

The question of cost, time and intrinsic design provide the contrast between readily relocatable and improbability and costly relocation of a structure.

5. How much damage will the property sustain upon removal?

Since these sectional units are inherently designed, manufactured, and transported in sectional format for site coupling, these units suffer minimal damage during disassembly. Typically disassembly and removal damage is less the 10% percent of replacement costs to the property. Once disassembled and transported, each sectional unit is capable of being readily re-used in another application or site.

Site restoration costs are minimal after removal, and is usually addressed in contract language, therefore the intent to remove the structure is an integral part of the design and application. Contract leases typically specify that the structure is personal property in finite land and structure leases.

6. What is the manner of affixation to the property to the land?

For the non-residential modular industry, the manner of affixation to the property is typically determined by local prevailing model construction codes. The manner of affixation to the site is not an indication of intent of permanence, rather it is a commonplace, as most states have a preemptive state-wide construction code for the structure, and local agencies determine appropriate foundation, utility, and land use issues.

The affixation between the structure and the foundation system can be varied. With pier and pad systems, it is gravity or bolted systems or tack-welded systems. The attachment to the foundation is determined by structural requirements and not by intention of permanence.

Typical foundation systems used in conjunction with modular units allow for ready return to pre-installation status with little or minor site reconstruction costs. Foundation selection factors include wind, seismic, support, use, and access requirements in determination of appropriate systems. Typically, the termination of real or personal property is not one of the factors in the selection of foundation systems.

Conclusion:

Any structure can be relocated with enough time and money. The factors of intrinsic design and the reality that every modular section has already moved over public highways proves their relocatability. Designs that are constructed on site, which might be relocated, rarely take into consideration these costly relocation factors:

The tremendous structural stress of relocation and transportation. This stresses multiples of typical earthquake stress loads. Is the site constructed building specifically designed for this stress and does it have the means to be lifted and transported by truck?

The ability to move over public highways without significant permit costs and efforts.

The destruction of the structural integrity of the building, the high cost of material loss due to disassembly, and the high costs of re-assembly.

Relocation of site constructed structures regularly requires an entirely new review process of structural and systems approval, since the design of the structure did not initially consider, and was not approved as, a relocatable structure. This frequently adds significant additional agency review time, engineering, material, and labor costs to the relocation process.

While these questions serve as a general guideline for determining “permanency” of a modular building, you should consult a professional tax advisor for specific tax advice.