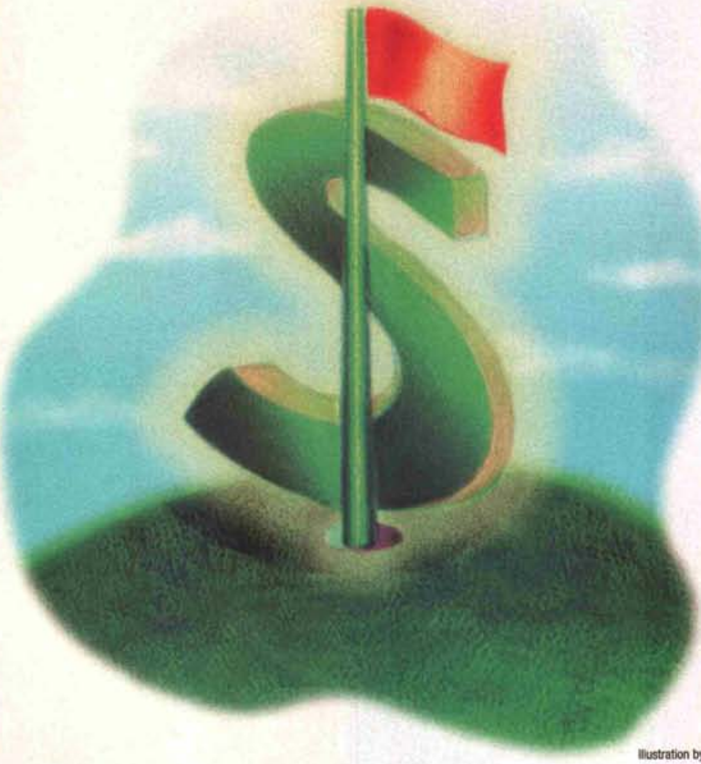

Illustration by Kelly Neis

Show your depreciation

Welcome to the first installment of "Money Talk." My name is Cleve Cleveland. I'm a golf course owner, superintendent and a certified public accountant in Upstate New York. From spring to late fall, I operate an 18-hole "mom and pop"-type golf course. I love that term since my mom and pop operated the business before me. During the winter months I run a tax practice and teach financial seminars for GCSAA. Bimonthly I will be utilizing this space to present a financial topic of personal or professional relevance. My goal in teaching and with this column is to increase and promote your value as a professional. I want you to be included in making financial decisions and, ultimately, acquire additional leverage in negotiating your professional career. My first topic will deal with the new rules regarding depreciation of greens, tees and bunkers.

New reality

In the fall of 2001, the Internal Revenue Service issued a ruling allowing the depreciation of greens, tees and bunkers that are constructed utilizing modern techniques. To depreciate means to deduct the cost of an asset over a period of years. This is an important issue since prior to this ruling, no deduction was allowed for these costs. If the cost to construct a green was $25,000, that amount could not be deducted against revenues in reducing tax liability.

The reality is that many golf course owners have incorrectly deducted the costs of greens, tee and bunker construction in prior years. In the case of an existing golf course, the costs of building a replacement green or tee were probably classified as a deductible expense such as "repairs and maintenance."

The revenue flow of the golf business (mostly in cash) and the new construction boom have increased IRS audits in the golf industry, especially in high-concentration areas such as Myrtle Beach, S.C. Historical IRS position (no depreciation) was based on "push-up" construction and follows the philosophy that land and land improvements do not wear out and thus should not be subject to depreciation deductions. Modern construction techniques (USGA, California methods) consist of components (drainage pipe) that will deteriorate and eventually will be replaced. The IRS acknowledged this fact and will now allow a deduction of costs over a 15-year period.

Playing catch-up

The good news is that the original scope of the ruling focused on greens and tees but now has been expanded to cover bunkers and possibly fairways that utilize drainage-based construction. There also is a catch-up provision that will allow owners who did not depreciate these areas in the past to deduct the corrected amounts equally over a four-year period.

The bad news concerns the cost of base preparation. When a depreciable asset such as an office building is constructed, the land preparation costs would be included in the total basis and be depreciated along with the cost of the building. This is not the case with the golf course depreciation ruling. Only the costs of the drainage element, the greens mix and the associated labor or each are to be depreciated. The shaping and base preparation costs are neither depreciable nor deductible. The only rationale for this limitation is that the IRS is concerned with allocation abuse. This would occur because of the difficulty in ascertaining at what point general shaping costs become associated with the cost of preparing the base for the greens or tees. Also, the ruling will require that depreciable costs of construction be "accountable." This means that the architect and builder will need to work together to itemize and allocate costs accurately. Owners who did not depreciate greens in prior years and are now electing to do so under the catch-up provisions, may find it difficult to allocate the depreciable costs if the builder or architect did not provide an itemized statement of construction charges.

Bottom line, what does all this mean to the superintendent? First, not all accountants read IRS Revenue Rulings, especially industry-specific ones such as this. If you're employed at a smaller operation that has drainage-based construction, bringing this ruling to the attention of your owner could be impressive. Second, at "for profit" operations of any level, the tax savings generated from depreciation may mean more money for you. Keep this in mind when negotiating your operating and capital budgets. Even at "not for profit" private clubs, the ability to increase depreciation deductions becomes more important as some private clubs may lose tax-exempt status for various reasons.

AN EXAMPLE OF POTENTIAL TAX SAVINGS

19 greens @ $25,000 per	$ 475,000
Yearly depreciation deduction	$ 31,667
Yearly tax savings @ 39% tax rate	$ 12,350

Daunting details

The National Golf Course Owners Association and the "Big Five" accounting firm that represented them have heavily publicized their success in convincing the IRS to change their historical position on golf course depreciation. While gratitude to them is certainly in order, the applause should remain tempered. In truth, lack of knowledge of our industry had led conservative accountants to adhere to the IRS position of "non-deductibility," much of the time, incorrectly. Regardless of the new ruling, the costs incurred constructing the drainage of greens, tees and bunkers have always been depreciable over the requisite 15-year period. The new ruling really only adds the cost of constructing the top mix to the allowable amount.

As with many accounting and tax transactions, the underlying details are far more complex than the basic rule itself. I hope this article provides you with a general understanding of golf course depreciation and the effect it may have on your operations.

Cleve Cleveland welcomes your questions and comments at clevec@pronetisp.net.