



ARTICLE

Cost Segregation Studies Now Crucial to Take Full Advantage of Additional Bonus Depreciation Benefits

When the CARES act was passed in March of 2020, the benefit of a cost segregation study increased significantly.

- Prior to the passage of the CARES Act, improvements to the interior portion of a nonresidential building (known as qualified improvement property) were required to be depreciated over 39 years.
- Under the new law, businesses may take advantage of bonus depreciation on property acquired and placed in service after September 27, 2017 and before January 1, 2023. Previously, only owners and investors who constructed or purchased new property were able to benefit from bonus depreciation. This is a significant and favorable benefit for owners/purchasers of used property.
- Qualified property, also known as Section 1245 property, is defined as tangible personal property with a recovery period of 20 years or less and includes property that is commonly depreciated over a period of 5, 7 or 15 years. Properties with components that fall into this category will be greatest beneficiaries of the new law.
- However, because of the now well know “retail glitch” the TCJA did not specify a useful life for QIP placed in service after December 31, 2017. As a result, following the enactment of the TCJA, QIP was classified as nonresidential real property with a useful life of 39 years, and not eligible for bonus depreciation.
- The CARES Act corrected TCJA glitch by including QIP as 15-year property retroactive to the enactment of the TCJA. This allows taxpayers to depreciate QIP over 15 years instead of 39 years. Not only does that provide a much shorter depreciation period, it allows the improvements to qualify for 100% bonus depreciation if placed in service by the Taxpayer after December 31, 2017.
- Taxpayers who have placed QIP in service after December 31, 2017 and have been depreciating the QIP over 39 years may now take advantage of the shorter 15 year recovery period (and possibly take advantage of 100% bonus depreciation in the year the QIP was placed in service).

Consideration of a cost segregation study is now more important than ever due to the CARES Act and the new regulations. A Cost Segregation study will identify all qualifying assets and reclassify them into shorter tax recovery periods. Using GDS lives, these assets are generally depreciated over 5, 7 or 15-years life.

In the example below, a taxpayer spent \$10 million on a nonresidential building "refresh" completed in June 1, 2021. A cost segregation study was performed, and the results are as follows: 20% of 5-year personal property is allocated to the basis; 1% to 7-year; 10% to 15-year and 69% to 39-year; the benefits are as follows:

- With a cost segregation study, after the passage of the 2017 Tax Act, **without Bonus Depreciation**, the taxpayer's first-year tax savings would be approximately **\$109,504**. Note significant difference without a cost segregation analysis.
- With a cost segregation study, after the passage of the 2017 Tax Act and **100% Bonus Depreciation**, the taxpayer's first-year tax savings would be approximately **\$794,264¹**; a difference of \$685,285, more than six times the value when bonus depreciation is applied.

Prior to one deciding if a cost segregation study should be completed, property owners should consider the Interest Expense Limitation. The Net Interest Expense is limited to 30% of the adjusted taxable income. Taxpayers may be exempt from the Interest Expense Limitation if the average gross receipts over the prior three years are less than \$25 million or if the taxpayer is electing real property business. The election is generally irrevocable and carries a cost. Electing taxpayers are required to depreciate using ADS for all residential and non-residential real property as well as qualified improvement property. Assets depreciated under ADS are not eligible for bonus depreciation, however assets with 20 years or less can qualify for bonus depreciation and will be depreciated using GDS.

WITH COST SEGREGATION (NO BONUS)		
LIFE	DEPRECIABLE BASIS BY LIFE	2021 DEPRECIATION
5-Year	\$2,000,000	\$400,000
7-Year	\$100,000	\$14,290
15-Year	\$1,000,000	\$50,000
39-Year	\$6,900,000	\$95,979
Total	\$10,000,000	\$560,269

W/OUT COST SEGREGATION		
LIFE	DEPRECIABLE BASIS BY LIFE	2021 DEPRECIATION
5-Year	\$0	\$0
7-Year	\$0	\$0
15-Year	\$0	\$0
39-Year	\$10,000,000	\$139,100
Total	\$10,000,000	\$139,100

CHANGE IN REPORTED ANNUAL DEPRECIATION	TAX SAVINGS
\$421,169	\$109,504

WITH COST SEGREGATION - 100% BONUS		
LIFE	DEPRECIABLE BASIS BY LIFE	2021 DEPRECIATION
5-Year	\$2,000,000	\$2,000,000
7-Year	\$100,000	\$100,000
15-Year	\$1,000,000	\$1,000,000
39-Year	\$6,900,000	\$95,979
Total	\$10,000,000	\$3,195,979

CHANGE IN REPORTED ANNUAL DEPRECIATION	TAX SAVINGS
\$3,056,879	\$794,789

¹A blended Federal and State tax rate of 26% was applied.


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