

Internal Revenue Service

Department of the Treasury

Number: **INFO 2005-0134**

Release Date: 9/30/05

Index Number: 168.20-00

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:PSI:6-CONEX-137773-05

Date:

August 12, 2005

Re: Cost Segregation Studies

Dear _____ :

This letter is in response to your letter dated June 6, 2005, to the Commissioner of Internal Revenue, filed on behalf of _____, asking several questions regarding cost segregation studies and related issues.

We hope the following general information addresses your concerns. Because the information we are providing is general in nature, we are not giving specific answers to all your questions.

For income tax purposes, cost segregation studies are used to allocate the total cost of a property among various segments including the land, the building, and the appropriate depreciation asset classes of any other property. The Internal Revenue Service's web site (<http://www.irs.ustreas.gov/>) has information on Audit Technique Guidelines (ATG) for Cost Segregation Studies. You may access this document directly at <http://www.irs.ustreas.gov/businesses/article/0,,id=134180,00.html>, or complete the following steps from the Service's web site. First, look under the heading of "Information for:" and click the "Businesses" link. Second, click the "Audit Techniques Guides (ATGs)" link. Finally, access the letter "C" to find costs segregation studies. If you are unable to access this ATG for any reason, please contact us and we will arrange to mail you a copy.

In response to your third question, chapter 4 of the Cost Segregation Studies ATG states that there are no prescribed credentials for cost segregation preparers. The description in this chapter of the characteristics of a quality cost segregation study should be helpful. The ATG provides that a quality study greatly expedites the Service's review, thereby minimizing audit burden on all parties.

In response to your questions regarding bonus depreciation, the 30-percent additional first year depreciation deduction allowable under § 168(k)(1) of the Internal Revenue Code is available for acquired property (as opposed to self-constructed property) if, among other requirements, the property is acquired by the taxpayer after September 10, 2001, and before January 1, 2005. See § 1.168(k)-1T(b)(4)(i)(A)(1) of the Income Tax Regulations. The 50-percent additional first year depreciation deduction allowable under § 168(k)(4) is available for acquired property if, among other requirements, the property is acquired by the taxpayer after May 5, 2003, and before January 1, 2005. See § 1.168(k)-1T(b)(4)(i)(B). To qualify for 30-percent or 50-percent additional first year depreciation, property must satisfy the requirements of § 1.168k-1T(b)(1). Land and most buildings do not qualify for additional first year depreciation.

If a taxpayer manufactures, constructs, or produces property for use by the taxpayer in its trade or business (or for its production of income), the acquisition rules § 1.168(k)-1T(b)(4)(i) are treated as met for qualified property if the taxpayer begins manufacturing, constructing, or producing the property after September 10, 2001, and before January 1, 2005. For 50-percent bonus depreciation property, the acquisition rules are treated as met if the taxpayer begins manufacturing, constructing, or producing the property after May 5, 2003, and before January 1, 2005. Property that is manufactured, constructed, or produced for the taxpayer by another person under a written binding contract (as defined in § 1.168(k)-1T(b)(4)(ii)) that is entered into prior to the manufacture, construction, or production of the property for use by the taxpayer in its trade or business (or for its production of income) is considered to be manufactured, constructed, or produced by the taxpayer.

Section 168(k)(2)(A) and (B) provides that certain property having longer production periods is treated as qualified property for purposes of section 168(k) if placed in service before January 1, 2006.

A brief example may be helpful. A taxpayer purchases land on January 1, 2003, but does not start construction until July 1, 2003, at which time the taxpayer self constructs a plant for which the taxpayer's engineer prepares a cost segregation study. The taxpayer places the plant in service on December 31, 2004. To determine if the 30-percent or the 50-percent additional first year depreciation deduction is allowable, the taxpayer must look to the acquisition date, which is deemed to be the date when construction begins. Since the taxpayer in this example commenced construction on July 1, 2003 (which is after May 5, 2003), 50-percent bonus depreciation is allowable for qualified property. However, if

some of the plant's components were acquired before May 6, 2003, and were not self-constructed, these components are only eligible for 30-percent bonus depreciation, and then only if the components were acquired after September 10, 2001, and not pursuant to a written binding contract that was entered into before September 11, 2001. See § 1.168(k)-1T(b)(4)(iii)(C).

Furthermore, if the plant in the above example is placed in service after December 31, 2004, bonus depreciation is only allowable for the portion of the depreciable basis of the property that is "longer production period" property that is described in § 168(k)(2)(B), and then only to the extent of the pre-January 1, 2005, basis. See § 168(k)(2)(B)(ii).

I hope this information is helpful. If you have any questions or would like to discuss this matter further, please call me or _____ at _____.

Sincerely yours,

(signed) Charles B. Ramsey

CHARLES B. RAMSEY
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