DUFF & PHELPS

Real Estate Advisory Group

Tax Reform and Its Impact on Cost Segregation

MARCH 2018

On December 22, 2017, the "Tax Cuts and Jobs Act" (H.R. 1) was passed, which enacted a wide range of reforms to our current tax laws.

Changes related to the tax treatment of building construction, building improvements and building acquisition costs provide taxpayers with new opportunities to maximize tax benefits through a cost segregation study.

Building Lives

Under the General Depreciation System, recovery periods of commercial and residential rental buildings are unchanged. The life of commercial buildings remains 39 years, and the life of residential rental properties remains 27.5 years.

Bonus Depreciation

Bonus depreciation existed in several forms over the past two decades, allowing taxpayers to claim 20%, 30%, 50% or 100% bonus depreciation of newly constructed assets over various periods of time. Under the new law, bonus depreciation is increased from 50% to 100% for assets with a MACRS life of 20 years or less.

However, in a dramatic shift from previous bonus depreciation rules, this not only applies to newly constructed assets, but also to used assets acquired by the taxpayer after September 27, 2017. The applicability of bonus depreciation to acquired property is a major shift from previous rules and significantly increases the benefit of completing cost segregation analyses on acquired buildings placed in service after September 27, 2017. Ultimately, bonus depreciation will be phased out beginning in 2022, with a 20% reduction every year until it expires in 2027.

Qualified Improvement Property

Previously, Qualified Improvement Property, Qualified Restaurant Property and Qualified Retail Property all allowed taxpayers to recover the cost of building improvements over a 15-year period utilizing a straight-line method. New law eliminates all these categories and creates a new definition of Qualified Improvement Property (QIP).

Generally, QIP is defined as improvements to an existing building that do not enlarge the building and are not a structural improvement or improvement to elevators or escalators. It was intended that QIP would be recovered over 15 years using a straight-line method and, therefore, would be eligible for 100% bonus depreciation. However, language in the final bill was incorrectly drafted and, as a result, QIP is not eligible as a 15-year asset and is not subject to 100% bonus depreciation. Instead QIP must be recovered over 39 years.

Key Takeaways

1. Bonus depreciation significantly increases the value of completing a cost segregation study, in particular on acquired buildings or building improvements that would have otherwise been considered QIP.

2. Due to the reduction of corporate tax rates in 2018, taxpayers should review their current real estate holdings to determine if a “look-back” or retroactive cost segregation study should be performed now so that they may claim missed depreciation benefits on their 2017 tax return when taxed at a higher rate.

3. Restaurateurs and retailers constructing new improvements should consider cost segregation analyses to identify other §1245 or §1250 site improvements that will qualify for 100% bonus depreciation.

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