

APPENDIX - CHAPTER 6.3 - DEPRECIATION OVERVIEW

INTRODUCTION

In order to compute depreciation using proper class lives and recovery periods, assets must be assigned to the proper asset classes. Cost segregation studies generally produce listings or groups of assets, based on asset classes under ACRS (Accelerated Cost Recovery System) or MACRS (Modified Accelerated Cost Recovery System). This chapter provides a summary of the applicable authorities and available guidelines for classifying property into its appropriate class.

HISTORICAL BACKGROUND - A BRIEF RECAP

Pre-ACRS/ MACRS Depreciation Methods - Prior to 1981

Prior to the enactment of ACRS in 1981, depreciation deductions were generally calculated by applying the appropriate depreciation method to the basis, useful life, and salvage value of the asset. Taxpayers were permitted to use component depreciation, whereby assets were segregated into separate components with different useful lives, which were depreciated separately. Alternatively, taxpayers could elect to use the Asset Depreciation Range (ADR) system for computing depreciation deductions. Property was generally classified as either $\text{Å}\text{§}$ 1245 or $\text{Å}\text{§}$ 1250 property, based on the rules governing Investment Tax Credit (ITC), pursuant to Code $\text{Å}\text{§}$ 48 and the regulations thereunder.

ACRS /MACRS Depreciation Methods - Post-1980

Following the enactment of the ACRS depreciation system in 1981, component depreciation was specifically prohibited. The Service position has been that this prohibition continued under the MACRS depreciation system, enacted in 1986. Generally, ACRS is effective for property placed in use between 1981 and 1986, and MACRS is effective for property placed in use after 1986. *Hospital Corporation of America, Inc. v. Commissioner*, 109 T.C. 21 (1997) ("HCA")

In HCA, the Tax Court concluded that the taxpayer was permitted to apply ITC principles to classify property as either $\text{Å}\text{§}$ 1245 property or $\text{Å}\text{§}$ 1250 property for purposes of determining asset classes and recovery periods under ACRS and MACRS. In effect, the HCA decision has reinstated a form of component depreciation.

Action on Decision (AOD) Number CC-1999-008 02d7

In Action on Decision (AOD) Number CC-1999-008, the Service acquiesced to the application of ITC principles in the HCA case. However, the Service did not acquiesce to the particular results in this case (i.e., the Service did not agree with the classification of specific assets as qualifying $\text{Å}\text{§}$ 1245 property).

Use of Cost Segregation Studies to Compute Depreciation Deductions

Based on these developments, the use of cost segregation studies by taxpayers to accelerate depreciation deductions is expected to increase. The assignment of assets to the appropriate asset class is critical in determining the proper recovery period and, accordingly, the amount of depreciation.