

BDO KNOWS:

FIXED ASSETS



► SUBJECT

COST SEGREGATION STUDY RESULTS CHALLENGED WHEN SUBJECT TO A PURCHASE PRICE AGREEMENT ALLOCATION

► SUMMARY

In a recent Tax Court Memorandum decision,¹ the Tax Court ruled that, where an allocation of consideration or fair value to assets is in writing, the agreement is binding for all federal tax purposes and may not be altered by a subsequent “cost segregation” study.

The Tax Court considered the case of Peco Foods, Inc. (“Peco”), a corporation that purchased (through its subsidiaries) two poultry processing facilities in separate asset acquisitions pursuant to section 1060. The purchase agreements allocated the purchase price to specific categories of assets, including “Real Property Improvements” and “Machinery and Equipment,” among others. Further, the purchase agreements stated that the allocation was “for all purposes (including financial accounting and tax purposes).”

Several years subsequent to the acquisitions, Peco performed cost segregation analyses on the real property and filed an accounting method change to claim the accelerated depreciation deductions resulting from the reduced depreciation recovery periods. The Service and the taxpayer agreed that the acquisition transactions were applicable asset acquisitions under section 1060. However, the Service asserted, and the court agreed, pursuant to Treas. Reg. § 1.1060-1(c)(4), that Peco was not permitted to subsequently change the useful lives of assets or portions of assets originally classified as real property in the purchase agreement.

CONTACT:

MARK ZETTELL

Senior Director
616-802-3458 / mzettell@bdo.com

DOUG CURTIS

Senior Manager
616-802-3470 / dcurtis@bdo.com

JAMES SU

Senior Director
714-338-2528 / jsu@bdo.com

MIKE MOORE

Senior Manager
404-979-7119 / mmoore@bdo.com

NATHAN CLARK

Senior Director
704-887-4205 / nclark@bdo.com

MARLA MILLER

Senior Manager
215-636-5520 / mmiller@bdo.com

DAN FULLER

Senior Director
616-802-3406 / dfuller@bdo.com

CHRIS BARD

Principal
310-557-7525 / cbard@bdo.com

RAY KUIPER

Senior Manager
616-802-3472 / rkuiper@bdo.com

¹ *Peco Foods, Inc.*, T.C. Memo. 2012-18.

Peco was denied the application of the cost segregation analyses and accelerated deductions because the allocation of the purchase price among the acquired assets was already agreed to in the purchase agreement. The allocation of basis in the purchase agreement was ruled to be the final allocation because it was agreed to “for all purposes . . . including tax purposes.”

▶ OPPORTUNITIES FOR TAXPAYERS

Parties to an asset acquisition should clearly state the intent and purpose of allocations of purchase price to assets and/or classifications. Failure to specify the purpose of the allocation could result in unintended binding agreements for federal tax purposes. Where a cost segregation analysis cannot be practically implemented prior to the close of the transaction, consider omitting such an allocation or stating that the allocations and classifications in the purchase agreement are not intended to be binding for federal income tax purposes. Alternatively, as all fixed assets, both personal and real property, are classified as Class V assets on Form 8594, Asset Acquisition Statement Under Section 1060, consider limiting any allocation of the purchase agreement to this broad category and omitting any more specific allocation.

Where asset purchase transactions closed in prior years and cost segregation analyses were implemented, taxpayers should assess the language in the purchase agreements for conformity with Peco. If cost segregation studies were completed on assets acquired in a section 1060 transaction where there was a specific allocation between real and personal property in the agreement, taxpayers have the option to file Form 3115, Application for Change in Accounting Method, to change the depreciation methods as necessary, with IRS audit protection.

The Peco decision was specific to an applicable asset acquisition under section 1060. Care is also warranted in stock acquisitions where a section 338 election has been made to treat the acquisition as an asset acquisition for tax purposes. The section 338 regulations do not have a comparable provision to follow written agreements as the section 1060 regulations applied in the Peco case. However, a detailed explanation of the purpose and scope of purchase price allocations for transactions subject to section 338 is also recommended to mitigate unintended consequences.

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