Frequently Asked Questions about Cost Segregation

2019

For commercial building owners, the federal tax code offers several strategies to help offset the many costs associated with owning and maintaining a commercial property. One of these strategies is Cost Segregation, which allows building owners to reduce their tax burdens and boost cash flow through accelerated depreciation deductions.

Wondering if you are eligible for this powerful tax saving strategy? The following frequently asked questions will help provide clarity on Cost Segregation:

What is Cost Segregation?

Cost Segregation is an IRS-approved federal tax deferral strategy that reclassifies certain assets within a commercial building from real property to tangible personal property. The reason for this is that real property is generally depreciated over a period of 39 years, while personal property is depreciated over five, seven, or fifteen years. Therefore, changing an asset's classification from real to personal property results in a shorter depreciation life and more substantial, immediate depreciation deductions for the building owner. For optimal results, Cost Segregation studies should be performed by tax professionals with engineering expertise.

What types of buildings qualify for Cost Segregation?

Any commercial buildings placed into service after December 31, 1986 may qualify for a Cost Segregation study. Buildings of all sizes and types are eligible, but the return on investment of performing a study is generally greater with more valuable properties. The types of buildings that may qualify for Cost Segregation include:

- Multi-unit residential buildings, such as condominium or apartment complexes
- Offices
- Restaurants
- Retail centers
- Industrial buildings
- Manufacturing facilities
- Medical offices
- Hotels
- Car dealerships
- Banks
- Research and development facilities

With Cost Segregation You may even apply to have your taxes recalculated going back many years.

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Cost Segregation FAQs

What types of assets may be reclassified as personal property under Cost Segregation?

Assets that may currently be classified as real property but could potentially be reclassified as tangible personal property under a Cost Segregation study may include carpeting and other floor coverings, lighting, plumbing fixtures, electrical wiring, wall coverings, landscaping, appliances, and more.

When is the optimal time to perform a Cost Segregation study?

In order to begin maximizing depreciation deductions as soon as possible, the best time to perform a Cost Segregation study is within the first year after a building has been placed into service by the current taxpayer. However, many taxpayers unfortunately forego significant tax savings due to the misguided belief that Cost Segregation is *only* available within the first year. In reality, Cost Segregation studies may be performed at any time after a building has been purchased, constructed, or remodeled, and "look-back" studies may capture deductions that were missed in previous years.

Has Cost Segregation changed under tax reform?

Due to expanded bonus depreciation under the Tax Cuts and Jobs Act of 2017 ("tax reform"), Cost Segregation may be more beneficial to taxpayers than ever before. Prior to tax reform, bonus depreciation—which allows taxpayers to depreciate a certain percentage of the cost of qualifying business property during the asset's first year in service—was only available for new property, and a maximum of 50 percent of the property's cost could be depreciated in the first year. The new tax law extended bonus depreciation to used property and, through 2022, has allowed taxpayers to depreciate up to 100 percent of the cost of the property during its first year in service. Therefore, now is an opportune time for taxpayers to maximize bonus depreciation on qualifying business property—and Cost Segregation offers a convenient way to do so. By examining the various assets within a building, Cost Segregation may identify assets that qualify for bonus depreciation, thus helping taxpayers ensure that they are not missing any opportunities to take advantage of accelerated depreciation deductions.

What documentation is needed to complete a Cost Segregation study?

While the specific types of documentation required may vary depending on whether the building was acquired or newly constructed, Cost Segregation studies typically rely on the building's blueprints, the construction contract (including the budget), the contractor's applications for payment throughout the project, appraisals, purchase or lease agreements, and more. In addition, a site visit is required to enable the study preparer to gain a thorough understanding of the building's design and the use of specific assets.

What types of tax firms should perform Cost Segregation studies?

Some taxpayers make the mistake of relying on their CPAs alone to perform Cost Segregation. According to the IRS, a quality Cost Segregation study requires knowledge of the construction process, engineering principles, applicable tax law involving property classifications, and cost estimating and allocations. Therefore, in order to maximize the benefits of Cost Segregation and ensure that the study is defensible in the event of an IRS audit, taxpayers should only work with experienced professionals with the requisite combination of tax and engineering/construction expertise, such as the team at Capital Review Group.

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How much can taxpayers expect to save through Cost Segregation?

While the results of Cost Segregation studies vary based on several different factors, Capital Review Group has helped numerous clients achieve six-figure tax savings with this strategy alone. For example, our team recently helped the owners of a successful East Coast hotel save approximately $700,000 in taxes over a five-year period, and a Phoenix-area couple who owned a commercial building save almost $300,000 over two years (link to case studies). We routinely work with the owners of many different types of buildings to capture the benefits of Cost Segregation and other applicable tax savings strategies, including bonus depreciation.

Don't miss out on the opportunity to significantly reduce your federal tax burden and boost cash flow with Cost Segregation—contact CRG today to schedule a pro bono analysis!

(Source: https://www.irs.gov/businesses/cost-segregation-audit-technique-guide-chapter-4-principal-elements-of-a-quality-cost-segregation-study-and-report#Study_3)

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