

## HOW TO REDUCE CLIENT'S TAX LIABILITY: THE DOLLARS ARE WITHIN THEIR BUILDING WALLS

2019

**Financial advisors** often find it difficult or impossible to suggest methods or strategies to reduce real estate property owners' federal tax liability and apply MACRS depreciation to all assets that qualify under the IRS Rules and Procedures. In accordance with the Department of the Treasury under I.R.C. Sections 1245 and 1250, and recent US Tax Court Cases, personal property and certain land improvements may be depreciated over significantly less time than nonresidential real property by performing a Cost Segregation Study.

**A Cost Segregation Study** may prove to be a measurable solution that will reduce your client's tax liability, as well as assist in the specific and defensible identification of assets that qualify under the Cost Segregation Procedural Rules, IRS Statutes and Tax Court Cases. Cost Segregation may also identify major components of the building so that future disposition may provide significant benefit under the new Tangible Property Rules.

Performing a Cost Segregation study may be particularly beneficial for businesses following the enactment of the Tax Cuts and Jobs Act, the sweeping federal tax reform law passed in December 2017. The new law expanded the concept of bonus depreciation, which allows businesses to depreciate a certain percentage of the cost of business property during its first year in service. Traditionally, bonus depreciation was only available for new property, and businesses could only depreciate up to 50 percent of the cost of the property as of 2017.

However, the Tax Cuts and Jobs Act extended bonus depreciation to used property and allowed businesses to depreciate 100 percent of the cost through tax year 2022. Businesses will be able to depreciate the following amounts in subsequent years: 80 percent in 2023, 60 percent in 2024, 40 percent in 2025, and 20 percent in 2026. This significantly expands the number of assets that qualify for bonus depreciation and the amounts that businesses can depreciate during the asset's first year in service. As a result, businesses are now able to capture substantially more tax savings through depreciation deductions by taking advantage of bonus depreciation.

Commercial buildings are full of assets that may qualify for expanded bonus depreciation. By advising your clients to conduct a Cost Segregation study, these assets—which must have been placed into service after September 27, 2017—can be identified, and your clients will be able to claim accelerated depreciation deductions through bonus depreciation. However, in order to be defensible against an IRS audit, Cost Segregation studies should be conducted by professionals with tax and engineering expertise, such as the team at Capital Review Group.

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**Cost segregation is not for only large buildings. Could your clients benefit from \$35/k, 50/k or even \$100/k right now?**

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# Cost Segregation

**A Cost Segregation Study** is an engineering based analysis on commercial (31.5/39yr) and residential/multi-family rental (27.5yr) property that will determine whether an asset is I.R.C. Section 1245-property or Section 1250 property. Assisting in this determination, Cost Segregation specialists use a wide variety of tools for this analysis such as precedent-setting US Tax Court Cases like *Hospital Corporation of America and Subsidiaries, 109 T.C. 21 (1997)* or *Boddie-Noell Enterprises, Inc. v. United States, KTC 1996-510 (Fed.Cls.1996)*.

Another relevant tool used in the Cost Segregation process is the *Field Directive on Planning and Examining of Cost Segregation Issues in the Restaurant Industry*. This memorandum issued by the Department of The Treasury for industry directors will provide direction to effectively utilize recourses in the classification and examination of a taxpayer who is recovering costs through depreciation of tangible property used in the operation of their business. Even though this memorandum is not an official pronouncement of the law, it is used as a guideline for classification of short-lived assets.

## BENEFITS OF THE COST SEGREGATION STUDY FOR COMMERCIAL PROPERTY OWNERS

**To save time and additional fees**, the ideal time to begin a Cost Segregation Study is when your client first plans to build a new investment property, remodel, or expand an existing building. A Cost Segregation specialist can then identify, segregate and reclassify the project-related costs that qualify for a shorter depreciable life as they are incurred, instead of waiting until the project is completed. For capital construction projects and newly acquired buildings, an accurate assignment of costs will allow a taxpayer to "front load" cost recovery and cash flow, maximizing them in the immediate years following the construction or purchase.

**Cost Segregation** is not limited to newly constructed or purchased investment property. A one-year section 481(a) adjustment can be claimed for property previously placed in service. The same structured analysis using the engineering cost estimating procedures, application to judicial decisions, IRS rulings and regulations of costs associated with the construction of a building can be performed for a taxpayer who previously placed MACRS residential or nonresidential real property in service after 1986. By performing a Cost Segregation Study on these properties, a taxpayer can receive permission to change the accounting method pursuant to Rev. Proc. 2002-19, Appendix, Section 2.01. Under this revenue procedure, a taxpayer is allowed to reclassify building elements as personal property and claim a deduction for the depreciation that should have been claimed on those elements. CRG's Cost Segregation Reports automatically include the major component breakdown of the building's primary systems so that any future disposal of property prior to effective class life may be identified and expensed. Previously, the amount of unclaimed depreciation was generally taken into account as a negative (taxpayer favorable) IRC §481(a) adjustment over a four-year period. The IRS has now reduced the four-year spread for negative IRC §481(a) adjustments to one year, effective for tax years ending on or after December 31, 2001.

**A Cost Segregation Study can be a valuable pre-construction tax planning tool** that can be used to maximize the benefits of identifying elements of a building that can be designed to qualify for accelerated depreciation.

## Cost Segregation

The most effective tax experts understand the intricacies of current IRS rules and can work within regulations to obtain the maximum deductions. Performing a Cost Segregation Study is a highly specialized process that can result in significant tax benefits, but only when used in conjunction with an understanding of specific conditions within a business entity that may impact the company's long-term savings.

### Contact CRG for more information:

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