



COST SEGREGATION STUDY – A GENUINE TAX OPPORTUNITY WORTH PURSUING



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In the current economic climate it is more important than ever for taxpayers to take advantage of every possible tax break. A frequently asked question that we hear from our clients is “What else can I write off?” If you own, construct, renovate or acquire commercial or residential rental real estate property, the answer may be a cost segregation study.

What is A Cost Segregation Study?

Typically, the cost of commercial real estate is depreciated over 39 years and residential rental real estate is depreciated over 27.5 years. Both commercial and residential real estate is depreciated using the straight-line method. A properly conducted cost segregation study will result in the identification of shorter-lived assets that are included in the “lump-sum” cost of a commercial or residential building.

For tax depreciation purposes, these shorter-lived assets can instead be classified as personal property or land improvements and shifted from 39 or 27.5 year depreciation periods to 5, 7 or 15 year depreciation lives. Certain soft cost can also be allocated to shorter-lived assets. A real estate owner will enjoy much greater depreciation expense deductions and faster write off of costs that formerly would have been included as part of a building. It is very simple for a building owner, construction contractor or even a CPA to identify some of the shorter-lived assets in a building such as carpeting or cabinets. However, only a qualified engineer who is experienced in conducting cost segregation studies is able to properly identify all costs related to 5, 7 and 15 year property. An engineer will study drawings, blue prints, AIA cost reports and other technical data and will conduct a site inspection to isolate these costs and document them.

Should You Do It?

In general, Cost Segregation Studies make sense if:

- ◆ Your property cost is at least \$1 million;
- ◆ You are in a high tax bracket;
- ◆ You have owned the property for ten years or less.
- ◆ You can utilize the deductions currently or in the future

Usually benefits are greatest if you meet these conditions. Return on investment is generally greater as the cost of the subject property increases. The benefits of a cost segregation study are derived from accelerated depreciation deductions, which result in improved cash flow. It all

boils down to a simple time value of money issue. Therefore, a study will not make sense if you are in a low tax bracket or if you pay no tax (e.g. you have a net operating loss).

The longer you own a property, the more cost you will have recovered through depreciation expense. However, even though you may have owned a building for several years you can still take advantage of missed depreciation deductions for prior years. The Internal Revenue Code and regulations allow for “catch up” of those missed deductions by filing an application for change in accounting method with the IRS. The IRS will generally automatically consent to the change, and because of a recent change in the regulations you can deduct the “catch up” entirely in your current tax year. This creates the potential for a deduction of hundreds of thousands of dollars in one year depending, of course, on the cost of the property involved and time period involved.

Conclusion:

It’s very simple for a CPA working with an engineer to calculate the potential savings that you may realize on a cost segregation study. Most firms will provide the initial cost and tax savings estimate free of charge. Cost segregation studies have always been a great way to keep cash in your pocket and out of the IRS’s hands. The current change to the regulations is a gift that makes cost segregation studies better than ever.

For further information on how you can realize significant tax savings from a Cost Segregation Study, contact Stephen Reed at 732-741-2624 ext. 216 or sreed@cowangunteski.com.



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