

COST SEGREGATION STRATEGY

Concept Overview & Illustrations

BEFORE WE GET STARTED...

Commercial Real Estate (CRE) refers to any/all types of property that generate taxable income regardless of the use (i.e. commercial or residential). For the purposes of depreciation, the IRS denotes “useful lives” for various property types (IRC Section 1250), the most common of which are 27.5-years and 39-years for residential-use and commercial-use properties, respectively. However, the IRS also allows for an alternative “useful life” approach in which case tangible personal property can be depreciated over 5- or 7-years (IRC Section 1245) and land improvements can be depreciated over 15-years (IRC Section 1250).

A Cost Segregation Study (CSS) is thus a process which can identify and reclassify real property assets into tangible personal property and land improvement assets for tax-reporting purposes based on criteria/guidelines established by the IRS. As such, the primary goal is to accelerate depreciation to offset taxable liability and take advantage of the time value of money.

When President Trump signed into law the Tax Cuts & Job Act (TCJA) on 12/27/2017 and the Corona Aid, Relief, and Economic Security Act (CARES) on 3/27/2020, significant opportunities were created for owners of commercial real estate. The biggest changes are as follows:

- Commercial real estate acquired after 09/27/2017 (cannot be a related-party purchase) is eligible for Bonus Depreciation
- Bonus Depreciation increased from 50% to 100% for commercial real estate placed in-service between 09/27/2017 and 12/31/2022
- Net Operating Loss (NOL) rules from the TCJA are temporarily reversed...now NOLs generated in tax years 2018-2020 are allowed a 5-year carry-back (or) carry-forward at 100% value

COMMON COST SEGREGATION MISNOMERS:

“CSS can ONLY be performed in the year the property is 1st placed in-service.”

FALSE...it can be performed on depreciable real estate built new, acquired, and/or renovated dating back to Jan. 1st 1987, including all improvements made to said real estate since ownership...it's called “Catch-Up Depreciation”

“ALL previously filed Federal Tax Returns require amending to take advantage of CSS.”

FALSE...a singular IRS Form 3115 is completed by either Cost Seg Provider (or) CPA for inclusion with current-year Federal Tax Returns...no amending of past tax returns required

“My CPA performs cost segregation IN-HOUSE for me.”

Per IRS Chief Counsel Advisory (CCA) 199921045 – “An engineering-based analysis is required by qualified professionals with the explicit knowledge of construction principals.” Most CPAs are NOT qualified to perform engineering-based CSS, which means they are either only segregating the “low-hanging” assets (i.e. – FFE) (OR) they are placing Clients at significant audit risk by not properly accounting/calculating for the eligible assets

“My property’s depreciable basis is too low to benefit from a CSS.”

FALSE...even newly acquired depreciable real estate with a basis of ~\$100,000 can yield ~\$10,000 in NPV tax-savings utilizing 100% Bonus Depreciation with a 25% yield and 40% combined tax-rate

“CSS is too expensive.”

FALSE...in the ol' days pricing was contingent on the percentage (%) of NPV tax-savings... NOW pricing is a fixed-fee based on property type (use/purpose), size (sq-ft, acreage), complexity (# bldgs., # floor plans, site/civil layout), and amenities (finishes, technology, multi-use spaces)

“Demolished property has no value, just get it to the landfill.”

FALSE...when depreciable real estate is being “improved” and assets are being demolished, the aggregate value of the remaining depreciable basis can be claimed as additional losses in the current tax year...the IRS refers to it as “Partial Asset Disposition” (several caveats for eligibility)

COST SEGREGATION STUDY CANDIDATES:

WHO – Any commercial real estate owner (i.e. developers, business owners, passive investors, etc.)

WHAT – Any commercial real estate other than a personal residence

WHEN – commercial real estate placed in-service from the early 2000's to the present day

WHY – Generate cash flow via current year tax savings

GENERAL RULE OF THUMB: Commercial real estate acquired, built new, or renovated over the past 15 years is a potential candidate for a Cost Segregation Study (CSS) and no amending of past tax returns is required.

ONE FINAL WORD: The most important decision Ownership can make when incorporating cost segregation within their real estate portfolio is selecting the right cost seg provider. If the provider does not have a Certified Cost Segregation Professional (CCSP) on-staff (certified via the American Society of Cost Segregation Professionals - ASCSP), then there's risk of a poor-quality study. This is the only rigorous cost segregation certification in the country that combines knowledge of technical issues, legal/tax issues, ethics/standards, and requires a strict level of prior work experience to be eligible. There are only ~43 individuals across the United States who hold this CCSP designation, and Bedford Cost Segregation proudly employs (8) of them.

BELOW ARE EXAMPLES OF THE 2020 TAX-SAVINGS ACHIEVED FROM PERFORMING A COST SEGREGATION STUDY (CSS)...IF YOU HAVE NOT FILED YOUR 2019 TAXES, IT IS NOT TOO LATE TO HAVE A CSS PERFORMED IN CALENDAR YEAR 2020 TO TAKE ADVANTAGE OF TAX-SAVINGS:

Property Type:	Aquired (or) New Build:	Depreciable Cost Basis:	In-Service Date:	Tax-Savings WITHOUT CSS:	Tax-Savings WITH CSS:
Office Bldg. (22% CSS yield)	Either	\$5,000,000	6/1/2020	\$27,820	\$433,880
Multi-Residential (23% CSS yield)	Either	\$15,000,000	6/1/2020	\$118,200	\$1,352,814
Multi-Family (12% CSS yield)	Either	\$500,000	6/1/2020	\$3,940	\$23,527
Hotel (25% CSS yield)	Aquired	\$5,000,000	6/1/2013	\$51,280	\$341,299
Shopping Ctr. (21% CSS yield)	New Build	\$5,000,000	6/1/2013	\$51,280	\$259,054
Restaurant (28% CSS yield)	Either	\$2,000,000	6/1/2004	\$20,512	\$128,990
Fitness Center/Gym (25% CSS yield)	Either	\$2,000,000	6/1/2004	\$20,512	\$115,170

*Results based-on a 40% combined Federal/State tax rate;

**Estimated 2020 Tax-Savings assume Taxpayer can fully utilize all depreciation deductions;

(Examples above courtesy of Bedford Cost Segregation, a national leader in the Cost Segregation industry...to learn more please go to <https://www.bedfordteam.com/>)



Contact us to learn more and find out if a Cost Segregation Strategy may be right for you.

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