

1250 and 1245 Property as it Relates to 1031 March 2018

There have been questions about the impact on 1250 and 1245 property as it relates to 1031 on a cost segregation study. Below is our answer.

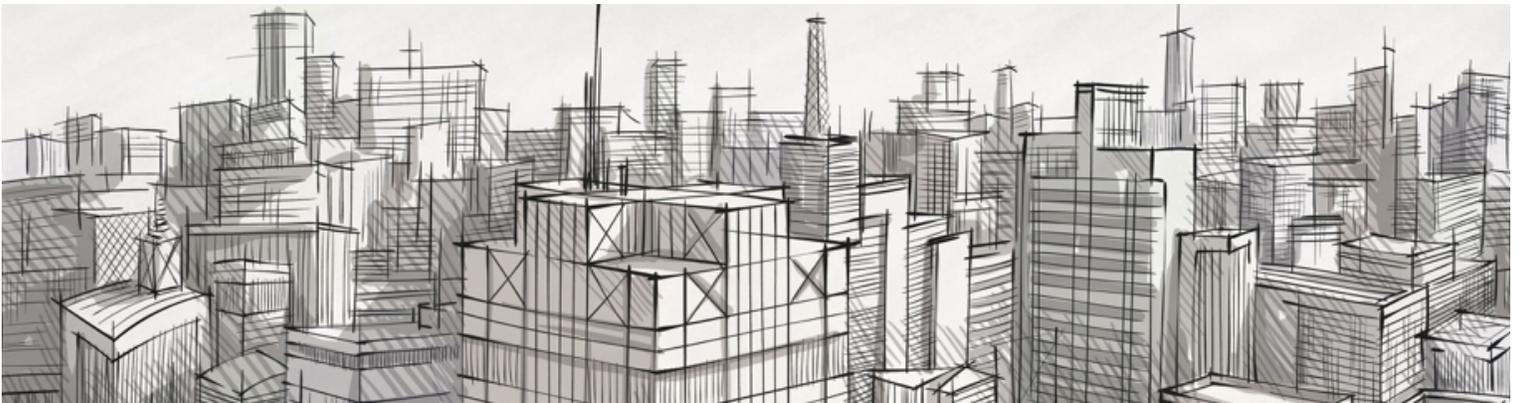
If you have additional questions
related to the new tax laws and
a cost segregation study,
please contact us:
877.410.5040

OVERVIEW

The Tax Cuts & Jobs Act §13303(c) specifies that the amendments made to §1031 apply to any exchange completed after 12/31/17 unless the property that is disposed of or received by the taxpayer in the exchange is disposed of or received on or before 12/31/17.

For any exchanges subject to the amendments, **only real property will qualify for deferral**. If a prior cost segregation study has reclassified property from real property to personal property (some §1245 property is real property, and would therefore still qualify under §1031), then the personal property would not be eligible for deferral under §1031.

The Joint Explanatory Statement of the Committee of Conference did not provide any sort of insight into why either the House or Senate decided to amend the §1031 provisions.



DEFINING UNITS OF PROPERTY

For a building, the building structure and the 9 enumerated building systems under 1.263(a)-3(e)(2)(ii)(B)(1)-(9) are real property, so they would still be eligible for a 1031 exchange.

Land improvements are also real property, whether they are Sec. 1245 or 1250 property.

And anything reclassified in a cost segregation study, other than land improvements, would likely be personal property and therefore ineligible for a 1031 exchange.

DEFINING 1245 PROPERTY

Anything that is 1245 property will likely qualify for 100% bonus, as most of those assets will have a MACRS recovery period that is 20 years or less.

Railroad grading and tunnel bores are real 1245 property with a recovery period of 50 years, so those would not qualify, but everything else should.

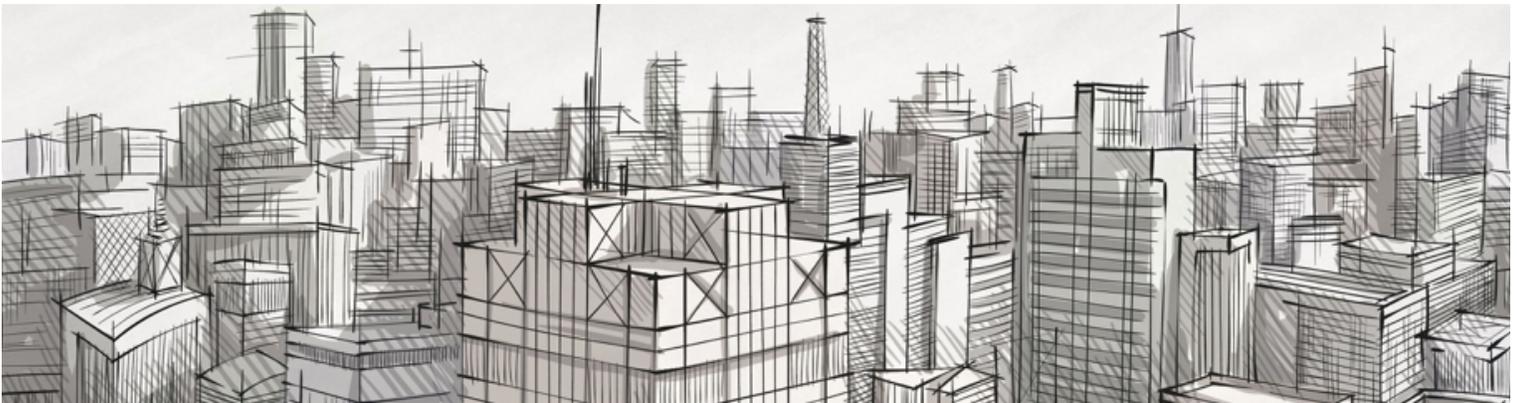
BENEFITS OF A COST SEGREGATION STUDY

To counter any negative effect this might have on the decision to pursue a cost segregation study, we would argue that time value of money saved on the deferred taxes now would likely outweigh the time value of money saved on the deferral of the taxes owed for the realized gain on the personal property under a later sale.

Additionally, in the sale of a building, the seller can minimize the gain on the disposition of the personal property by allocating more of the purchase price to the land and the building, and less to the personal property, as land generally increases in value, maintained buildings typically increase in value, and personal property generally decreases in value.

EXAMPLE

If you buy something in Year 1, and the land was worth 30% of the purchase price, the building 60%, and the personal property 10%, even after only a few years, even if the overall value of the property has increased, it's likely that the personal property is now worth substantially less than 10% of the total FMV of the property.



And of course, if you're representing the seller, you want to show that the appreciation is mostly due to the land, since there isn't a recapture concern of any kind there.

We can always go back into a study and update depreciation factors to the year of sale to account for the faster economic depreciation on the personal property, and then allocate the portion of the purchase price not allocated to the land between the real and personal property.

Start your cost segregation study today

Remember, when you partner with Scarpello Consulting, you gain access to our expert team of tax professionals and engineers for any question that may arise.

Contact us today: 877.410.5040

