Cost Segregation is an engineering-based, tax savings tool to help companies that have acquired, renovated, constructed, or expanded real estate to reduce current income tax liabilities by accelerating depreciation deductions for qualifying components.

DEPRECIATION 101

Depreciation is the allowance for the exhaustion, wear and tear, and obsolescence on certain types of property used in a trade or business for the production of income. Property is depreciable if it's used for business or held for the production of income; has a determinable life exceeding one year and it wears out, decays, becomes obsolete or loses value from natural causes.

Cost segregation is tax strategy that should be considered by nearly every taxpayer who owns, is constructing, renovating or acquiring real estate. By using an engineering- based approach to identify assets within a building that can be reclassified into much shorter depreciation recovery periods than the building itself, significant tax savings can be achieved.

Generally, an entire building would be classified with a straight-line depreciation cycle of either 39 years for commercial and industrial property or 27.5 years for residential-rental property. By applying a cost segregation study, you can maximize your inherent tax benefits by identifying, classifying, and segregating the personal property components of the building. This results in accelerated depreciable lives of 5, 7 and 15 years, thus saving thousands of tax dollars.

For example: For a new purchase placed into service the same year, $2,000,000 was reclassed to a 7-year life. In the first year alone that garnered a tax savings of $103,192. Over a 5-year period the one-time cost segregation study saved the owner over $525,000.

Properly executed cost segregation studies are designed to maximize building depreciation allowance while minimizing the risk of audit exposure. Because tax laws change constantly, you need to understand how to confidently identify improvements to building plans, quantify a property using a detailed level of cost information, and describe cost savings methods in accordance with current tax bylaws. Many times it is best to assemble a team with construction and engineering knowledge, along with segregation-related tax law expertise, to conduct a study.

SCARPELLO CONSULTING

scarpelloconsulting.com • 877.410.5040 • info@scarpelloconsulting.com

Who Can Benefit from Cost Segregation?

All properties that have been constructed, purchased or renovated since 1987 qualify for this tax benefit. This includes manufacturing plants, assisted living facilities, hotels, restaurants, multi-family buildings, and more.

To determine if a cost segregation study is appropriate, the following circumstances need to apply:

Is the cost of your building at least $750,000?
Have you purchased, constructed or renovated any property since 1987?
Do you plan on retaining your property for the next few years?
Do you have net income that is being taxed?

When to Apply a Cost Segregation Study

There are certainly ‘triggers’ that you should look for to help identify an opportunity for a Cost Segregation Study. Common events that indicate an opportunity include:

Constructing a new facility
Acquiring an existing facility
Renovating or expanding

Clients that have built or purchased buildings or facilities in the past and haven’t performed a Cost Segregation study might be able to benefit from a study which allows for correction of missed depreciation in past years.