

Cost segregation

How businesses can accelerate depreciation for tax purposes

INTERVIEWED BY ROGER VOZAR

The Internal Revenue Service defines the depreciable life of a building as 27.5 to 39 years. But that doesn't mean that all assets grouped with the building have to be on the same depreciation schedule.

A cost segregation study can identify personal property assets that can be reclassified to allow for a shorter depreciable life.

"By accelerating depreciation deductions, you're deferring taxes, which creates a cash flow benefit," says Robert W. Haggerty, CPA, Partner, Tax Services at Brown Smith Wallace.

Smart Business spoke with Haggerty about what assets might qualify and the potential benefit to businesses.

How does a cost segregation study work?

Typically, blueprints or architectural drawings are used to identify what went into the building. Engineers analyze the drawings and perform site visits to identify qualifying property. Information from the general contractor or estimating manuals is used to determine the cost. A tax analysis is performed, which involves reviewing court cases and rulings that address which particular assets qualify for a shorter life.

Cost segregation studies can be performed anytime you build, acquire or expand. If the cost is \$1 million or more, it is worth looking at.

The IRS also allows you to do a 'catch-up adjustment.' For example, if you bought or built a building five years ago and didn't do a cost segregation study, you could still do one today and take the benefit on your current tax return.

With certain income tax rates rising, it's a nice time to consider a catch-up adjustment.

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What types of assets typically qualify for shorter depreciation?

Generally, property that is unique to a particular trade or business qualifies for a shorter life. An example I often use is the lights used to showcase merchandise in a retail store. Those lights are considered five-year property even though, by definition, lighting is part of the building. Not only do the light fixtures qualify, but so does the wiring and the portion of the electrical system supporting the fixtures.

Manufacturing facilities benefit the most from cost segregation studies because they typically have a lot of specialty systems or design inherent in the building that function as part of the manufacturing process. A large portion of the plumbing, electrical and HVAC systems qualify for a shorter life. Even the concrete floors can qualify. Hospitals and medical facilities are another industry with big benefits from cost segregation. Think about all of the specialty systems in a medical setting.

What are the tax benefits?

The benefit is the deferral of income taxes by accelerating depreciation expense. Moving costs from a 39 year building life to a five or seven year life can significantly increase depreciation expense for the building. Cost segregation studies can provide a permanent, time-value-of-

money benefit of 10 to 50 times the cost of the study, which typically runs \$5,000 to \$10,000. Studies for larger projects can be much more costly, but the benefit usually increases with the cost of the project.

Any new developments of interest to businesses?

Yes, businesses can also take advantage of new final 'Repair Regulations' and proposed 'Partial Disposition Regulations,' which were issued in September 2013.

Under the old rules, you could not retire a portion of a building, so taxpayers who had a roof replaced, for example, could have two layers of roofs depreciating on their books. The new rules allow you to write-off the old roof.

In situations where it may be difficult to quantify the portion of the building that relates to the old roof — there might be only one asset on the books called 'building' — we are helping clients quantify the amount of the partial disposition.

Windows, interior build-outs and elevator replacements are other examples of items that may be eligible for partial disposition.

The Repair Regulations offer some safe harbors for small businesses and include de minimis rules that can apply to all taxpayers. So, there are even opportunities for businesses to take some tax deductions with very little effort. ●