COST SEGREGATION: MISCONCEPTIONS PREVENT TAX SAVINGS AND CASH FLOW INCREASES

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In 2001, an IRS ruling allowing taxpayers to "catch up" on prior years' depreciation deductions was a significant upgrade to the benefit of cost segregation studies. Yet, as we approach mid-year 2018, it's estimated that 9 out of 10 commercial real estate owners don't take advantage of this exceptional savings tool on a regular basis.

This inaction can easily be traced to misconceptions that persist in today's marketplace. They are preventing the capture of large tax savings and increases in cash flow for commercial property owners and investors.

Misconception #1: The real property (building) depreciable value should be at least $10 million.

The size of any tax savings that results from a cost segregation study is tied directly to the value of the property. However, a building does not need to be worth several million dollars to benefit. Because the realized savings are generally 7-10% of the value, even a $500,000 property could generate a savings of $35,000-$50,000, a large sum for many small business owners. Multiply that by larger property values and the savings will quickly exceed six figures. Commercial properties valued at $500k-$5 million have been the most underserved due to this most common misconception.

Misconception #2: Cost segregation studies are just too expensive to see any real return.

For the $500,000 property, the net cost of a study would be in the $3500-$4500 range. This provides a return of 8-12 times the investment. What owner wouldn't be pleased to get their money back several times over? There are few business investments that can generate that level of return, especially on an immediate basis, in a single tax year.

Misconception #3: A cost segregation study should be done within the first 3 years of ownership, or the opportunity is lost.

This was addressed in the 2001 IRS ruling that created the single most awesome feature of cost segregation – "catch up" depreciation. In a given tax year, a study allows the taxpayer to deduct all of the depreciation they could have taken since Day One of acquisition, minus the depreciation that was taken. Accumulated over all the years of ownership, this difference, and the resulting tax savings, can be quite substantial.

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To understand how this all comes together, let's look at a real-life example:

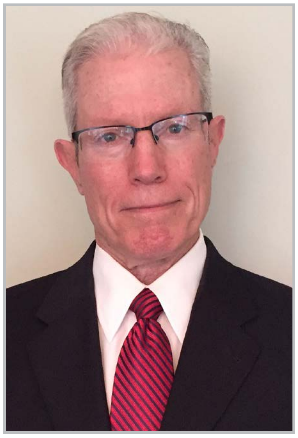
Owners of a medical services business were making plans for retirement. This included the sale of their office building which they had acquired 12 years earlier. At that time, it had a depreciable real property value of about $1,340,000. A cost segregation study was never performed during their years of ownership.

The tax advisor for a potential buyer suggested a study be completed now to "unlock" the tax savings benefit they had been sitting on. They were then able to deduct $303,000 in additional "catch up" depreciation, leading to a tax savings of $121,300. This was a very surprising and welcome boost to their retirement fund, extra money they didn't know they had.

Cost segregation companies will typically provide a free, no-obligation analysis for any commercial property. Owners are then positioned to weigh the study's cost against the possible huge financial return without wasting time or money.

About John Ottino: John is a Consultant serving the Greater Philadelphia/South Jersey region for Fuller CSS. FullerCSS, cost segregation specialists, with on-staff engineers and accountants, has completed hundreds of tax-savings studies for real estate investors and commercial property owners.

FOR MORE INFORMATION CONTACT:



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