Cost Segregation

TAX MAVERICK

Description

This study aims to identify distinct asset classes within the building. For instance, items like carpeting, light fixtures, kitchen appliances, landscaping, driveways, sidewalks, decks, and more, which fall under personal property, can be isolated and assigned shorter class lives (5, 7 & 15 years). These shorter-lived asset classes can benefit from accelerated depreciation and may also qualify for treatment under bonus depreciation and Section 179. In contrast to the conventional straight-line depreciation over 27.5 or 39 years for the building, a cost segregation study can generate notable tax savings, particularly during the initial years of property ownership.

Key Elements

Cost segregation studies aim to accelerate depreciation deductions by classifying property components into shorter recovery periods, reducing taxable income and improving cash flow for property owners. The immediate tax savings can be reinvested, enhancing the potential for higher overall returns on the investment.

Implementation

1. **Engineering and Analysis:** Engineers or qualified professionals conduct a detailed analysis of the property to determine the appropriate classification of components. This involves reviewing construction plans, invoices, and property inspections to accurately allocate costs.

2. **Cost Allocation:** The analysis results in a breakdown of costs for each identified component. The allocated costs are then applied to the corresponding asset class, allowing for the calculation of depreciation based on shorter recovery periods.

3. **Tax Preparation:** The reclassified costs and depreciation schedules are documented and reported on the property owner's tax return using Form 3115 (Change of Accounting Method). This informs the IRS about the changes made through the cost segregation study.