What Is **Reverse Cost Segregation**?

Cost segregation is a tax strategy that accelerates depreciation deductions, saving you a significant amount of money in the early years of property ownership. However, it can potentially lead to higher capital gains taxes when you sell the property.

Engineered Tax Services (ETS) offers a solution to this problem: the sales allocation study (SAS), also known as reverse cost segregation. This niche strategy can help minimize your tax burden when selling a property that has undergone cost segregation.

The Problem

A cost segregation study reclassifies long-lived assets as personal property with shorter depreciation schedules. While this is good for immediate tax savings, it can create a future problem. When you sell the property, personal property is taxed at your higher, ordinary income tax rate, while long-term capital gains have a lower fixed rate.

The Solution

With an SAS, ETS experts meticulously analyze your assets after accumulated depreciation and strategically reallocate them back to their original, longer-lived classifications. This maximizes the proportion of assets eligible for the lower long-term capital gains tax rate, ultimately reducing your overall tax liability when you sell.

Applicable Scenarios

Reverse cost segregation isn't a universal solution. There are many factors to consider when determining if this strategy would be beneficial for you, including:

- **Your tax bracket:** If your ordinary income tax rate is below 30%, the difference in tax rates between personal property and long-term capital gains may not justify the cost of the study.
- **Expected capital gains:** Generally, a sales allocation study is most worthwhile for properties with capital gains exceeding $1 million. These properties were likely originally purchased for $5 million or more.
- **Bonus depreciation:** The more bonus depreciation you claimed when you bought the property, the shorter the holding period required for an SAS to be beneficial.
- **Holding period:** Because assets depreciate over time, properties held longer than five years may have already depreciated many assets that an SAS could reclassify. This reduces the potential benefit.
- **Asset disposition:** If you haven't conducted an asset disposition study since purchasing the property, you might benefit from an SAS even with a holding period of up to 10 years. This allows you to "catch up" on previously unrecorded depreciation.

Let's take a look at some examples to see how these factors play out in real life.

Example 1: With Bonus Depreciation | Held for 1 Year | $2 Million Gain

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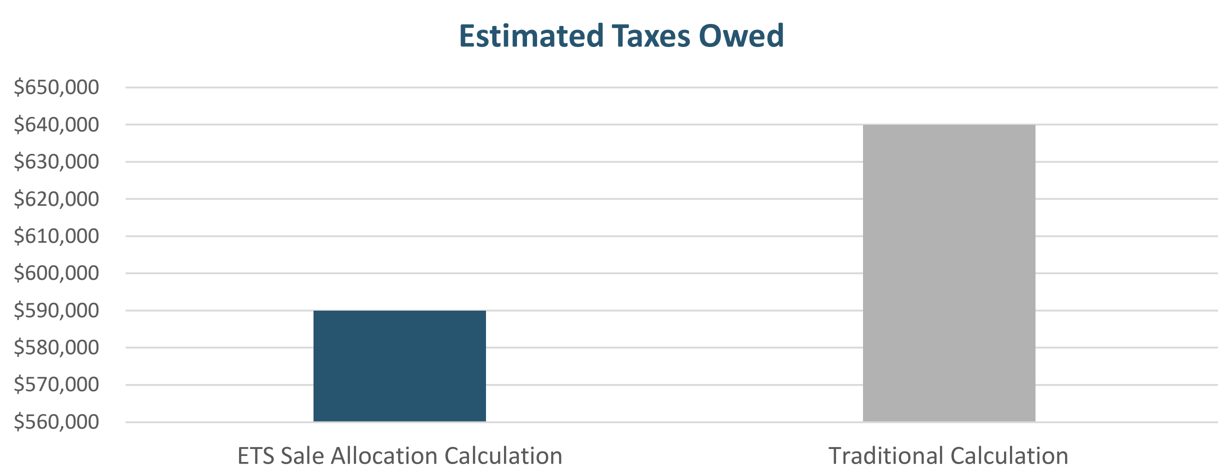
Sale Allocation Estimated Benefit Analysis

Property Information	
Entity:	*ABC, LLC*
Address:	*123 ABC Lane, Alpha, BE 12345*
Sale Information	
Sale Date:	*12/31/2023*
Sale Price:	*$ 3,000,000.00*
Cost of Sale:	*$ 140,000.00*
Booked Assets	
Purchase Date:	*12/31/2022*
Land:	*$ 100,000.00*
27.5 Year Property:	*$ 500,000.00*
15 Year Property:	*$ 32,225.00*
7 Year Property:	*$ 3,622.45*
5 Year Property:	*$ 54,040.00*

Projected Capital Gains Tax **Savings**
$30,000.00 - $40,000.00



**This is an estimate for demonstration purposes only*

This is one example of a scenario in which an SAS would be beneficial. This property owner can save around 5% on capital gains tax—for a total tax savings of $30,000 to $40,000. Although the percentage itself is small, the amount of money involved makes reverse cost segregation worthwhile in this specific situation.

Example 2: Without Bonus Depreciation | Held for 1 Year | $2 Million Gain

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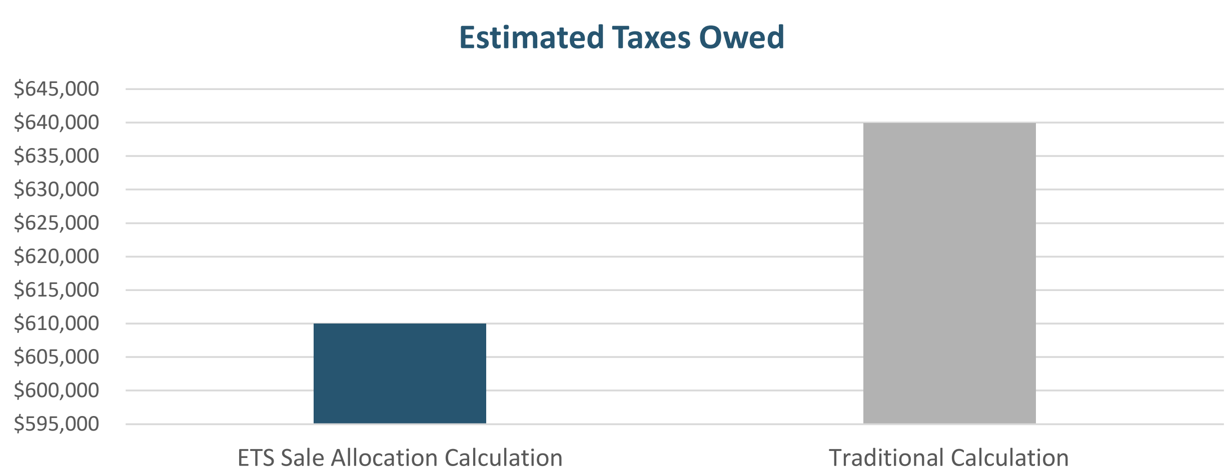
Sale Allocation Estimated Benefit Analysis

Property Information	
Entity:	*ABC, LLC*
Address:	*123 ABC Lane, Alpha, BE 12345*
Sale Information	
Sale Date:	*12/31/2023*
Sale Price:	*$ 3,000,000.00*
Cost of Sale:	*$ 140,000.00*
Booked Assets	
Purchase Date:	*12/31/2022*
Land:	*$ 100,000.00*
27.5 Year Property:	*$ 500,000.00*
15 Year Property:	*$ 5,562.50*
7 Year Property:	*$ 1,556.12*
5 Year Property:	*$ 30,100.00*

Projected Capital Gains Tax **Savings**

$10,000.00 - $20,000.00



**This is an estimate for demonstration purposes only*

Here we have a situation where reverse cost segregation isn't as useful. The numbers here are exactly the same as they were in the previous example, with the only difference being that Example 1 assumed 100% bonus depreciation whereas this example assumes zero bonus depreciation. Now the projected tax savings could be as low as $10,000, which probably isn't significant enough to warrant an SAS.

Example 3: Without Bonus Depreciation | Held for 3 Years | $2 Million Gain

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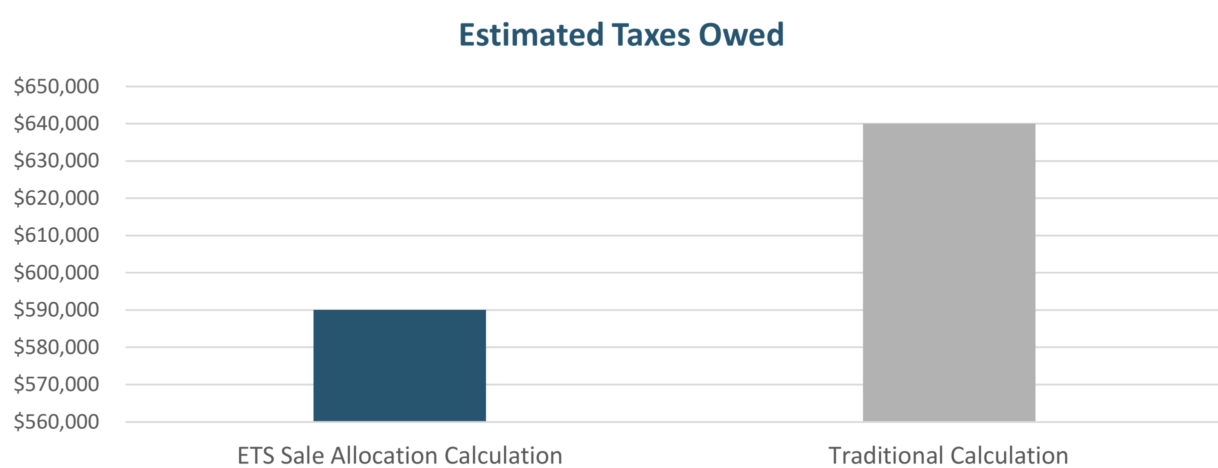
Sale Allocation Estimated Benefit Analysis

Property Information	
Entity:	*ABC, LLC*
Address:	*123 ABC Lane, Alpha, BE 12345*
Sale Information	
Sale Date:	*12/31/2023*
Sale Price:	*$ 3,000,000.00*
Cost of Sale:	*$ 140,000.00*
Booked Assets	
Purchase Date:	*12/31/2020*
Land:	*$ 100,000.00*
27.5 Year Property:	*$ 500,000.00*
15 Year Property:	*$ 14,005.63*
7 Year Property:	*$ 3,242.92*
5 Year Property:	*$ 55,636.00*

Projected Capital Gains Tax **Savings**
$30,000.00 - $40,000.00



**This is an estimate for demonstration purposes only*

This is an example of an SAS that generates significant savings even with zero bonus depreciation. Again, most of the numbers from the previous example haven't changed at all. The only difference here is that Example 2 assumed the property was held for one year, and this example assumes the property was held for three years. These two extra years are enough to bring the projected tax savings back up to as much as $40,000.

The Bottom Line

Reverse cost segregation is a unique solution developed to address a unique problem. At ETS, we are committed to providing the most value possible to each and every one of our clients, including high income earners. That's why we've developed an advanced tax strategy that no other firm can offer: the sales allocation study. If you want to receive maximum tax savings for your cost segregation study, ETS is the firm to trust.