

The Power of Cost Segregation

Courtesy of Fleischmann Holmes Bozanic & Vuong

Many owners of commercial property have been overpaying federal taxes. Why is this? It is because they have not used Internal Revenue Service (IRS) approved cost segregation. Cost Segregation can find substantial tax savings that are hidden beneath your feet, within the walls and even in the landscaping and paving outside your building.

What is Cost Segregation?

Cost segregation is a detailed financial and construction-based analysis of all purchase or construction costs associated with a property. The objective of the cost segregation study is to help building owners save money and put cash in their pocket now! The end result of the cost segregation study is a reclassification of assets that allows for a maximization of tax benefits and improved cash flow on properties. These studies are done by construction engineering professionals working with tax experts according to current IRS guidelines.

Why is it Beneficial?

A Cost Segregation Study will do three important things:

1. Creates Immediate Tax Savings
2. Increase Cash Flow—by adjusting the timing of the depreciation deductions, a property owner spends less cash paying taxes on buildings and can then redirect funds to other aspects.
3. Catch-Up Depreciation—Cost segregation allows a property owner to "catch-up" previously under-reported depreciation without filing any amended tax returns. All "catch-up" depreciation can be utilized in the tax return filed after obtaining a cost segregation study, without filing any amended tax returns.

There are many other advantages to a cost segregation studies in addition to the immediate tax savings and cash flow increase. Other potential side benefits to cost segregation studies are insurance cost savings, estate planning advantages, maximizing deferrals thru 1031 exchanges and use with sold properties.

How do I complete Cost Segregation Study?

The key to a cost segregation study is that it must be conducted by professionals with expertise in tax regulation, building, and engineering. This typically requires a team of CPA's and construction engineers to produce a report

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that will withstand the scrutiny of the IRS. The good news is that there is solid guidance compiled from court decisions, IRS revenue procedures, and IRS audit manuals that can be relied upon to produce a quality report.

The IRS has accepted cost segregation as a qualified method of allocating costs to personal property, the IRS issued its cost segregation audit techniques guide in 2004, which outlines an extensive outline of the necessary components of a quality cost segregation study and accompanying report.

A Real World Example

A commercial office building was purchased for \$10,000,000 in 2003 and a Cost Segregation Study was completed in 2008 tax year. The Cost Segregation Study reveals that they missed \$1,254,116 in depreciation that they should have taken over the last few years.

The study further reveals that their first year tax savings would be \$581,857.

This means the building owners would pay \$581,857 less in their 2008 taxes!

Conclusions

A cost segregation study provides significant benefits for most real estate owners. Accelerating the depreciation will allow current tax savings to be maximized and cash flows to be significantly increased. This translates into more cash in your pocket, which is something that all of us desire.

About the authors:

Fleischmann Holmes Bozanic & Vuong, LLP (FHBV) is a CPA firm serving individuals and small to medium sized businesses in the Los Angeles and Orange County areas. The founders, Vincent Bozanic and Nhan Vuong, each have over 15 years of accounting experience as licensed CPAs and QuickBooks Pro Advisors. During this time they have provided tax and accounting services to several industries including the real estate industry. FHBV has provided many of their real estate clients with tax saving strategies and consulting services that improve the efficiency and quality of the information their accounting records provide. If you have any questions or comments on the article, please contact Vincent Bozanic or Nhan Vuong at (562)-698-8685.