



DOWNEY & COMPANY, LLP

Tax Benefits from Performing a Cost Segregation Study

The tax code provides a range of tax benefits for real estate investors, and not one of them is as important as the allowance for depreciation. Under the current tax rules, a real estate investor can depreciate residential real estate over a 27.5 year life and commercial property over a 39 year life. However, savvy investors can accelerate some of their allowable depreciation deductions by initiating a cost segregation study.

In many cases, a real estate investor will take his or her total investment in a property and depreciate the entire cost (save for the land value) over either its 27.5 or 39 year life. A cost segregation study looks at the various components of a building and categorizes certain components as “personal property” or “land improvements.” The benefit of this to the investor is that personal property and land improvement usually have a significantly shorter depreciable life under the US tax code. Most personal property and land improvement are depreciated over 5, 7 or 15 years. Additionally, most personal property has been eligible for bonus depreciation in recent years. Consequently, the goal of the cost segregation study is to take items that if grouped with the overall structure would be depreciated over 39 years, and re-characterize those items to be depreciated over a much shorter period. This generates larger deductions in the early years of owning the real estate investment. In a typical study, 15 to 30% of the overall cost of the property might be eligible for shorter depreciable lives.

There are complex rules that must be followed in order to properly re-characterize building components as personal property or land improvements. To ensure this is done properly, one should engage a qualified business that conducts cost segregation studies. This will eliminate much of uncertainty with the rules and reduce the likelihood of a challenge from the IRS.

If you would like more information on this topic, please contact Jamie Downey at 800-849-6022 or jmdowney@downeycocpa.com.