

The Myths and Misinformation Surrounding Cost Segregation Studies by Paul Olson

Keep More of What is Yours

Cost segregation is the best kept secret the IRS has. No kidding! Cost segregation is that little known but tremendously powerful tax strategy that allows owners of income property to accelerate depreciation on their holdings, thus sheltering income, paying less Federal and State taxes and, thereby, significantly increasing their cash flow.

Interestingly, while this engineering/accounting concept is so little known, it does seem to have an extraordinary amount of misinformation about it in the market place. We don't exactly know why this is so. Perhaps because CPAs and other tax preparers have heard of the strategy once or twice but don't really know enough of the details, thus engendering conjecture when asked about it by a client.

Or perhaps because owners trust their CPAs and tax preparers to correctly handle the tax returns on their properties they simply assume everything about the depreciation on their property is handled properly and are skeptical when they are presented with this powerful but little known tax strategy. But in this case, what you don't know can hurt you a lot.

So in the interest of getting the truth out to all those income property owners everywhere, we have assembled a list of the most frequently heard myths that are perpetrated by those well-meaning but under-informed folks who have not studied the subject enough to know the real facts. Here are the real facts on a dandy dozen of the most frequently heard myths.

Myth	Reality
I have never heard of this.	The IRS statutes on cost segregation studies (CSS) are buried very deeply in the code and the IRS is not keen to publicize cost segregation as it reduces their tax revenue (tax revenue equals power in Washington DC.)
My CPA already did it for me.	Highly unlikely as this practice is based on finely honed engineering and construction cost accounting skills. Commercial Cashflow Advisors doesn't do tax returns and your CPA doesn't do cost segregation.

	<p>However, if you do have a depreciation schedule that shows more than two lines (building and land) it is highly likely your CPA broke out tenant improvements or other improvements on the property. This is not cost segregation. A cost segregation study goes far beyond this to generate hundreds of thousands of dollars in additional cash flow for the owner.</p>
<p>Everything inside the building belongs to the tenants and besides we already write off the tenant improvements over the life of the lease.</p>	<p>For an income property owner, cost segregation does not deal with tenant improvements, although we can and do work for tenants for the assets they purchase. However, for an income property owner cost segregation encompasses the costs of the assets inside the walls like electrical and plumbing and assets outside the walls like parking lots and shrubbery.</p>
<p>I bought the property long ago so a cost segregation study won't help me.</p>	<p>Not true. The IRS allows you to go back to properties built or bought since 1987. However, practically speaking, any property built or bought in the past 10 to 12 years can generate attractive savings for the owner.</p>
<p>I have partners, this won't work for me.</p>	<p>The benefits of a cost segregation study are easily split between partners or members of an LLC.</p>
<p>Depreciation recapture will kill me!</p>	<p>There are tax planning strategies that we can help you with that will minimize or even eliminate this issue. One simple method to solve this problem is to execute a 1031 exchange which defers taxes on any gain you might have.</p>
<p>I'm going to sell the property in a couple of years.</p>	<p>Because a CSS generates significantly increased cash flow in the first five to seven years of ownership, if you plan to keep your building for at least another two years, you can capture tremendous benefits in that short time.</p>
<p>If I go back to change depreciation on the building I have owned for several years, I will have to amend my tax returns.</p>	<p>Not true! By utilizing a cost segregation study the IRS allows the taxpayer to submit forms 481 and 3115 thereby eliminating any need to amend past tax returns.</p>

<p>A CSS doesn't generate real money, its just that funny depreciation money that only accountants can understand.</p>	<p>Not true! Increasing depreciation on your return reduces your taxable income, thereby reducing your taxes, which in turn increases your cash flow.</p>

Why wouldn't my accountant tell me about this?	Because this is not a CPA's area of expertise or focus. Therefore, they are simply not versed in this area and should not really be expected to bring it up to a client. The area of expertise involved here is engineering and construction cost accounting. These are areas into which CPA's do not delve.
I will get the full amount of my investment back in depreciation over 27.5 or 39 years. Why would I want to do it over six or seven?	Simply stated, the time value of money. A dollar today is worth more than a dollar tomorrow, therefore, you should do everything you can to maximize the cash flow you receive today, so you can invest it for tomorrow. After we complete a CSS most of clients take the increased cash flow and either buy another property or pay down the mortgage on the current one. This increases wealth significantly.
This seems like a lot of work.	No it isn't. This is turnkey for the client. We will work in close consultation with your CPA and/or CFO. You can be involved as much or as little as you want. Our clients generally are not deeply involved in the work, reviewing the final report with their CPA before it is included in their tax return.
This increases the risk of my being audited.	No it doesn't. Cost segregation studies and accelerated depreciation have been around since the 1950's and are well known to the IRS. The Fortune 1000 use these as standard operating procedure on all their properties. Your return utilizing these techniques will not be unusual at all. In fact, the report that is delivered to you strictly follows the IRS's recommended guidelines for the proper manner in which to conduct and report a cost segregation study. Our reports usually total from 125 to 150 pages in length and cover every conceivable question that could be asked by the IRS.

Given the extensive amount of misinformation about cost segregation studies, it is no wonder that this powerful technique is the IRS's best kept secret. Don't let these myths, the Dandy Dozen, deter you from availing yourself and your partners from keeping more of what is yours. Check out the power of cost segregation studies today. There is nothing to lose and everything to gain. Go ahead...keep more of what is yours.

Paul Olson is the founder and long time CEO of Commercial Cashflow Advisors, a leading national firm specializing in tax savings strategies. Mr. Olson has been involved with the commercial real estate industry for many years dating back to the days of Investment Tax Credit in the 1970's. Mr. Olson writes and speaks frequently about cost segregation, energy tax credit certification and other powerful tax saving strategies. He holds an MBA degree from the University of Cincinnati and a BS degree in finance from Indiana University. He can be reached at olson@ccashflow.com or at 408-910-1701.