



Why Can't My CPA Firm Do My Cost Segregation Work?

Savings associated with cost segregation studies are well documented. When we first started working with regional CPA firms over a decade ago many did not know what cost segregation was or the benefits a study could produce. However, in recent years the familiarity with cost segregation has increased and now firms are more commonly asking why they can't do these studies internally.

There are many reasons that most CPA firms choose to outsource cost segregation services. The biggest reason could be that depreciation law is complicated; hence the issuance of The Master Depreciation Guide each year. The complexities of depreciation law have caused this guidebook to outsize The Master Tax Guide. The Master Depreciation Guide continues to become increasingly more complicated with the passage of new regulations covering repair and capitalization.

Cost segregation is a relatively simple concept. A cost segregation expert will identify personal property and separate these assets out of the building. This process increases cash flow by moving depreciation into the early years of an investment. The concept is easy to comprehend with identifiable benefits. This simplified concept causes many to believe that cost segregation study is a commodity and can be performed by anyone. In the past year we have seen numerous people

take this approach with unfortunately not the results as expected.

Sometimes the analysis goes wrong due to lack of engineering and tax expertise. For example, we were recently asked to review a client's portfolio containing multiple properties. In the past year the owner and the CPA had completed what they called a "cost segregation study" without hiring a professional. Upon reviewing the analysis completed by the client, we saw that they had reclassified approximately 10 percent of the properties to shorter lives. In our estimation, if a proper cost segregation study had been completed, over 15 to 20 percent of the property would have been reclassified. This would have saved the client an additional \$75,000 to \$150,000 (the study would have most likely only cost them \$10,000 to \$15,000). Obviously, the savings would have more than paid for the additional work. In this case, the lack of savings was not the most troubling outcome. By doing the analysis themselves they had incorrectly classified toilets, tile flooring, paint and other items as personal property. These are considered real property by the IRS. In this case not only had the client left money on the table, but they had inadvertently become more aggressive, creating an audit issue.

As you can see from the example above, it is important to hire a professional to review properties for cost segregation. It is critical,



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// Cost Segregation & Fixed Assets

however, that the correct cost segregation provider is hired. Building technology is constantly changing, as are the rules surrounding the depreciation of the assets. A non-qualified cost segregation firm may miss areas of significant benefit.

Twice in the last year McGuire Sponsel has been hired to look at properties where a cost segregation study had been performed but the geothermal system was not broken out. Portions of the geothermal system are not only eligible for a 10 percent tax credit but they are also eligible for 5-year depreciation under Rev. Proc. 87-56. In one example a client installed a \$1.1 million geothermal system as part of their building. The cost segregation study completed did not recognize this component. By not hiring the correct firm to perform the analysis, they almost missed out on a \$110,000 tax credit as well as depreciation deductions of over \$600,000 in the first year (the property was bonus eligible). This ended up being worth over \$360,000 on the 2014 tax return.

As you can see from these analyses, it is critical that cost segregation studies are not only done by a professional, but also someone with the expertise and experience to find optimal deductions. The IRS states that there is no certification or requirements as to who can perform a cost segregation study. They go on to say that it is ideal to hire someone with both tax and engineering backgrounds to complete this work. Cost segregation studies often have a large return on investment. The upfront costs to hire a qualified professional should pay for itself with the increased savings and audit security over a non-qualified analysis.

If you have any questions or would like us to review one of your properties please contact McGuire Sponsel.

