

# Q&A | COST SEGREGATION STUDIES

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## SAVE SIGNIFICANT TAX DOLLARS WITH A COST SEGREGATION STUDY

The acquisition of a building, construction of a new building, expansion of an existing building, or a sizable tenant fit-out provides an opportunity to save significant tax dollars through the use of a cost segregation study (CSS). The following commonly asked questions may help you determine if a CSS is right for you.

### What is a Cost Segregation Study (CSS)?

A CSS identifies and segregates the cost to acquire, construct, expand, or renovate a property into its appropriate tax lives; thereby accelerating tax depreciation deductions.

### What properties qualify for a CSS?

Virtually all types of property with a tax basis of at least \$1 million, and subject to depreciation, can qualify for a CSS. Properties with an elaborate fit-out, such as high-end hotels, restaurants, and “Class A” office buildings, will garner a greater benefit than a warehouse or industrial building as they tend to have less interior fit out that can be allocated to shorter lived assets. But even more sparsely fit-out properties can benefit from a CSS.

### Can I still do a CSS if I purchased or constructed my property in a prior year?

Yes. Under current law, there is no limitation on how far back you can go to perform a CSS. And the benefit of performing a CSS is the catch-up of all missed depreciation in the current year. All you have to do is attach Form 3115 (Application for Change in Accounting Method) with the filing of your current year tax return. This is an automatic change with no filing fees. J.H. Cohn can prepare this form for you as part of the CSS engagement. *There is no need to amend prior year tax returns.*

### What is the holding period for a property to make a CSS cost effective?

We have generally found that the holding period should be at least two years, due to the potential for depreciation recapture on the sale of the property if sold at a gain. We can assist you with a calculation determining the minimum holding period and the benefits of a CSS.

### Can I do a CSS if I have no original cost records?

Yes. A CSS can be performed without any original cost records by using the Detailed Engineering Cost Estimate Approach as provided in the IRS Audit Techniques Guide.

### Will a CSS impact the depreciation calculation for Alternative Minimum Tax (AMT)?

Since 1998, personal property assets have the same tax life for regular depreciation and for AMT purposes. However, for AMT purposes depreciation is calculated using 150 percent declining balance method as compared to 200 percent declining balance method for regular depreciation purposes. This difference will slightly reduce the benefits of CSS for the first few years (reversing in subsequent years). This will only impact individuals subject to the AMT.

### Will assets acquired as a result of a §1031 tax deferred exchange qualify for a CSS?

§1031 exchanges are somewhat unique when it comes to a CSS. In many circumstances a CSS can provide a substantial benefit for replacement property in a §1031 exchange. J. H. Cohn has the tax experience to help you determine if a CSS is appropriate and beneficial in your particular circumstance.

### Can a CSS help me if I inherited a property?

Inherited property is generally recorded at fair market value at the date of inheritance. This new fair value is the basis for a new depreciation schedule for the property, no matter how old the property was in the hands of the deceased. A CSS will allow the new owners to accelerate their tax depreciation deductions as if they purchased the building on the date of the inheritance.



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## Will a CSS increase the likelihood of an audit?

While no one can guarantee the likelihood of an audit, in the very rare circumstances when our CSS has come under IRS scrutiny (in our experience, less than one percent), we have been extremely successful defending our work and getting a no change. We have been so successful because we follow IRS guidelines and our reports are supported by case law, IRS revenue procedures, and IRS revenue rulings.

## Why can't my tax preparer or my construction contractor perform a CSS?

Most tax preparers, even if they have the tax knowledge as to which assets qualify for shorter tax lives, do not have the requisite engineering knowledge to allocate assets into their appropriate tax lives. Both tax and engineering disciplines are needed to properly perform a quality CSS.

Analogous to the tax preparer, the construction contractor will rarely possess the requisite knowledge of the tax laws to determine which costs of construction are appropriately allocated to the proper tax lives.

## How much does a CSS cost?

The cost of a CSS will vary depending on a number of property factors, such as cost, type, size, location, availability of architectural plans, and number of tenants. With a small amount of information about your property, we will provide a free estimate of the tax benefits along with a fee quote.

## How long does it take to perform a CSS?

It typically takes four to six weeks to perform a CSS; depending on the needs of the user, that time frame can be much shorter.

## How much can I save with a CSS?

There are a number of factors that impact the savings one can expect from a CSS, such as cost of the property, the type of property, the size of the property, and the date of acquisition. We have found the savings from a CSS will generally be 10 to 30 times the cost of the study.

To request a free cost segregation analysis for your properties, contact David Grant at [dgrant@jhcohn.com](mailto:dgrant@jhcohn.com) or 877-704-3500.

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