

# Real Estate Journal

COVERING ALL OF LONG ISLAND, NEW YORK CITY AND UPSTATE NEW YORK

## Cost segregation tips for property owners to yield substantial financial benefits

**el Eli Loebenberg**



**Madison  
SPECS LLC**

Cost segregation can yield substantial financial benefits. Generally, you can expect about \$200,000 in net present value tax savings for every \$1 million of assets you reclassify from a 39-year (standard for commercial properties) to a 5-year depreciation period. That's a tax benefit worth exploring!

If you're unfamiliar with the concept, a cost segregation study analyzes real estate from an engineering and tax perspective with an eye toward creating a tax benefit by reclassifying certain assets to make them eligible for accelerated depreciation. Faster depreciation translates into larger tax deductions, which in turn mean lower tax payments.

### The Expanding Market Poses a Challenge

The major accounting firms began introducing cost segregation to their large clients in the late 1980s. These firms had the resources to invest in experienced accountants, monitor developments in Washington, and train

engineers in the relevant tax issues. So, they were able to garner national recognition as cost segregation specialists.

By the mid 1990s, however, the accumulation of taxpayer favorable case law and IRS rulings, increased the opportunities and opened the door for smaller firms. Since then there's been a virtual explosion of small firms and consultants entering the cost segregation business. The diverse marketplace favors the property owner because it offers wider choice and greater price competition. But, it also complicates the vendor selection process.

### Look for a Dual Discipline Approach

The IRS released its *Audit Technique Guide for Performing Cost Segregation Studies* in 2005, making it clear that their preferred approach toward cost segregation is a dual discipline approach—combining both tax and engineering expertise.

Many (though, certainly not all) of the boutique firms are either tax firms who form alliances with engineering firms or vice versa. With this structure, one expertise tends to overshadow the other. If you're in the market for a cost segregation firm, you need to explore just how balanced the vendor's approach is—what you're looking for is a true marriage of tax and engineering expertise.

### Ask about Documentation

Documentation (technically, contemporaneous documentation and audit support) that will stand up to IRS scrutiny is a crucial component of a cost segregation study. For example, if you accelerate depreciation for certain portions of an electrical system, the IRS will expect a description of which circuit breakers control basic building functions and which circuit breakers control specific processes or equipment.

A reputable cost segregation firm will know the IRS guidelines thoroughly and ensure that you have complete, accurate records to provide a successful defense in the event of an IRS audit.

### Test Accounting Relationships

Your cost segregation consultant must be able to work effectively with your accountant. The two must share information so you can take full advantage of the cost segregation opportunities. For example, if you file a Form 3115, *Change in Accounting Method*, along with your tax return, you can realize tax savings for past building construction, purchases, expansions, renovations and leasehold improvements. In short, you can recapture "missed" depreciation.

If you're considering a cost segregation company that is primarily an accounting firm, make sure they

are truly focused on the cost segregation project and not simply using it as a strategy to gain another accounting client.

### Request Suggestions for New Construction

Although you can recapture "missed" depreciation on existing structures, the ideal situation is to bring the cost segregation firm in to work in the design phase of a new structure. In this scenario your cost segregation expert must work with the architect and the construction firm to suggest certain building materials and construction methods that are more tax-advantageous.

So, when you're interviewing cost segregation vendors, ask about their experience in this area. Better yet, ask for specific recommendations they would make for a structure like yours. They should easily offer several ideas.

### Take Advantage of the Opportunity

A careful and thorough cost segregation study can make a significant difference in your tax situation. So, while you need to do your homework before you select a vendor, you should take advantage of the opportunity.

**Eli Loebenberg is the CEO of Madison SPECS LLC, a Madison Commercial Real Estate Services company, Lakewood, N.J.**