Cost segregation: Best kept secrets of tax-slashing heroes

A GUIDE TO PLEASING CLIENTS AND GROWING YOUR BOTTOM LINE

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About FULLERCSS

Why cost segregation makes sense (and how it makes dollars)

In our experience, way too many accounting firms shy away from performing cost segregation studies for clients that have significant real property holdings. Many forego this potential tax saving opportunity for their clients because it requires engineering and construction expertise that doesn't exist within their firm. The time required to find and coordinate the outside experts who perform these studies creates a barrier to entry that not enough accountants are willing to overcome. However, if you don't find a way to provide this valuable service to clients, somebody will.

This paper will help you understand the value that cost segregation services deliver to your clients in the form of tax savings and the value that these services deliver to your firm in the form of revenue growth. Our team of experts describes a variety of opportunities for tax savings that are often overlooked by accountants who haven't studied this practice closely. What you're about to learn will help you convert leads into clients and convert clients into enthusiastic supporters.

If your firm is interested in growing the size and loyalty of its client base, this paper provides an excellent introduction into the specialized practice of cost segregation. Once you understand the value of these studies to your clients and your firm, please contact us at [info] to see how we can help you deliver great service to your clients.

3 things that might surprise you about cost segregation's tax-slashing potential

What you don't know about tenant build-outs, asset abandonment, and bonus depreciation could cost your clients tax benefits. We performed our first cost segregation study for a property-owner 20 years ago—and my, how the discipline has evolved since those early days. We've learned quite a few things along the way. Here are a few that might surprise you and delight your commercial real estate clients and prospects.

1

Tenant build-outs reinforce tax savings.

Leasehold improvements represent a wealth of tax deductions for property owners. Because these build-outs typically do not involve the building's structural components, a high percentage of those costs typically are for tangible personal property. How can a building's owners recognize those depreciation benefits? Allocate costs to their proper asset classifications through a quality cost segregation study.

2

When asset abandonment is a good thing.

Most tenant build-outs involve replacing an asset. If the old asset is still being depreciated, then the property owner might be able to write off the remaining tax basis of the asset that is being disposed of. There are two prerequisites to take advantage of this tax benefit: First, the new asset must be capitalized (i.e., you can't deduct both the new and the old asset). Second, the net tax basis of abandoned assets must be determined most likely using our cost segregation methodology. So once again, cost segregation saves the day!

3

A bonus surprise.

You probably already know that property owners can take bonus depreciation on tangible property with a depreciable life of 20 years or less. (Currently, bonus depreciation is available only for assets placed in service in 2014 and earlier.) You also know that cost segregation identifies assets that qualify for shorter depreciable lives.

By conducting a cost segregation study, your client benefits from accelerated depreciation for newly segregated personal property AND ALSO a bonus depreciation deduction on those assets.

And there's even better news. Property owners can go all the way back to 2001, when this particular benefit came into law, to claim bonus depreciation on tangible personal property placed in service in previous years.

Tax and engineering expertise required

Capturing depreciation benefits through cost segregation is a complex area of taxation, and there are many more nuances than we can explore in this blog post. For example, bonus depreciation is one of those tax "extenders" that has come in and out of the law throughout the last 15 years at different percentages, so CPAs must be careful to apply the correct percentages to the assets in question.

Recognizing and taking advantage of depreciation benefits requires a special combination of both tax and engineering expertise. In fact, the IRS Cost Segregation Audit Technique Guide states:

The preparation of cost segregation studies requires knowledge of both the construction process and the tax law involving property classifications for depreciation purposes.

3 more things that might surprise CPAs about cost segregation

Owners of commercial property can realize 20-to-1 ROI on a cost segregation study performed by a firm with engineering and tax expertise.

You know that a cost segregation study can uncover opportunities to slash your commercial real estate clients' tax bill. But there might still be a few questions lingering in your mind about whether the benefits of cost segregation outweigh the time and expense of the study. For the right types of commercial property owners, a cost segregation study can deliver higher ROI and require less time and effort from you and your client than you might think. The key to realizing higher ROI and investing less time and effort is teaming with the right cost segregation strategic partner.

1

Surprisingly good ROI for clients and prospects

We tend to be conservative when we estimate a client's potential tax savings from cost segregation. We typically tell our CPA firm partners that their clients can expect a return on investment of at least 10 times what they pay for the study.

But for owners of properties with a high proportion of nonstructural elements—such as hotels, restaurants and manufacturing facilities—segregating those shorter-lived assets often generates tax deductions that add up to 20 times what they pay for the study.

Of course, the opportunity to realize that high ROI will depend on whether the cost segregation provider brings to the table both tax and construction engineering expertise.

Consider this: As a CPA, you have been trained on the proper methods and recovery periods for depreciable assets. But do you know how to read blueprints to identify all of the elements that qualify for shorter depreciable lives? Probably not.

Construction engineers know what lies behind the walls of a building—the miles of wiring, ductwork and plumbing that could qualify for 5-, 7- or 15-year depreciation. When you partner with a cost segregation provider that has the combined knowledge of cost segregation tax specialists and engineering professionals, your client or prospect is more likely to benefit from higher ROI, and you will cement that relationship for your firm.

2

Minimal disruption to you and your clients

Maybe you're worried that the cost segregation study will suck up time and resources that you and your client don't have to give. Actually, experienced cost segregation engineers know how to minimize the disruption of their site visits. Engineers who are experienced with the type of property in question often require only a quick introduction to the site by a property maintenance manager and conduct the remainder of the site survey independently.

An experienced cost segregation firm also will make the process easy for you and your tax team. Once the cost seg specialist has the final cost for the finished building, your involvement is over until you receive the final depreciation numbers to factor in to the client's tax return.

3

Higher profit potential for your firm

Here's the great news for you: Because cost segregation often generates significant ROI for commercial property owners and requires little investment of time on your part, your firm's profit potential skyrockets. Not only do you have opportunities to value bill for time you spend consulting with your client on these lucrative tax opportunities, but you have also positioned your firm as the go-to resource for progressive, tax-slashing solutions.

Don't overlook these 3 client transactions that qualify for a cost segregation study... and tax savings!

If your client owns a group of commercial buildings that has a combined cost basis of $1 million or more, you may have some good news in store for them.

So you're sold on why tax time is the perfect time to talk about cost segregation opportunities with your client. Now you just have to spot those opportunities—and, of course, bring in the right cost segregation strategic partner to deliver those tax savings.

As you're preparing your clients' tax returns, look out for these three types of transactions that generally present an opportunity to accelerate depreciation deductions to the tune of at least 10 times the cost of the cost segregation study:

1

Purchase or construction of a building with a cost basis of $1 million or more.

The cost-benefit calculation generally is most beneficial at the $1 million price point. However, in certain types of buildings with a high proportion of nonstructural components (such as hotels, restaurants, apartment buildings, retail establishments, and manufacturing facilities), a lower cost basis (such as $750,000) might also justify the cost of the study.

2

Multiple buildings of the same type that, all together, add up to a cost basis of $1 million or more.

When one entity or individual conducts cost segregation studies on multiple buildings of the same type (e.g., 2-3 quick-service restaurants), as long as those buildings are within the same geographic market, the client will see efficiencies of scale in conducting cost segregation on that group of properties.

3

Tenant build-out with a cost basis of $500,000 or more.

While new buildings tend to get all the attention, leasehold improvements are the unsung heroes of the cost segregation world. Because they are likely to involve fewer improvements to the building envelope or structural components, these construction projects likely are comprised of a higher percentage of Sec. 1245 property that qualifies for 5- and 7-year depreciation.

If you missed these opportunities in prior years—don't worry! Cost segregation can be conducted on properties that were placed in service as early as 1987. In fact, we recommend that CPAs automatically extend for all commercial property owners—not only to give them time to bring those owners into compliance with the Tangible Property Regulations, but also to perform cost segregation studies and other engineered services to minimize the tax bill.

Need help uncovering transactions that qualify for cost segregation? Contact us to schedule a Deep Dive into your commercial real estate client base to identify those tax-minimization opportunities.

5 questions accounting firms should ask to uncover cost segregation opportunities

PURCHASE, CONSTRUCTION, REHABILITATION, EXCHANGE OR INHERITANCE OF COMMERCIAL REAL ESTATE CAN ADD UP TO HUGE TAX SAVINGS.

As you finalize your clients' 2014 extended tax returns, do you find yourself wondering whether there is a way to save them even more money? A cost segregation study might just be the key to putting more cash in the pockets of many of those clients. Here are 5 questions that could result in huge tax benefits for your clients:

1

Did the client buy, build, or renovate a building with a cost basis of at least $500,000 and a high proportion of nonstructural elements?

The good news for your clients is that a cost segregation study can be conducted on property that was purchased, constructed, or renovated all the way back to 1987. Hotels, restaurants, apartment buildings, golf clubs, retail establishments, manufacturing facilities, auto dealerships, and office buildings are among the types of buildings that generally provide a high proportion of nonstructural components needed to justify the cost of the study through accelerated depreciation deductions.

We generally find that about 20% to 35% of the purchase price of these types of properties can be classified as 5-, 7- or 15-year property. However, the true answer can only be revealed through a cost segregation study conducted by specialists with tax and engineering expertise.

2

Does the purchase agreement include an allocation of purchase price?

If so, proceed carefully. Ask for a copy of the purchase agreement and review it with your firm's cost segregation strategic partner. If you don't have a strategic partner, click here to learn more.

If the agreement specifies an allocation of the purchase price between real and personal property, the client might not be able to re-allocate those costs after the fact. Why? Because in Peco Foods, Inc. v. Commissioner, the Tax Court ruled that the parties were bound by the allocation of the purchase price within the agreement, which could not be altered by a cost segregation study.

While your hands may be tied with regards to that specific property, it is still worthwhile to discuss this lost opportunity with any client who is looking to purchase additional commercial property. In the future, if your client seeks your counsel up front, then you bring in your cost segregation strategic partner to advise the client on how to leave the door open for a cost segregation study. Or better yet, you can encourage the client to negotiate a cost segregation study on the property before the sale closes.

▼ CONTINUED

3

Is the client considering building commercial property?

Accelerated depreciation deductions can drastically improve the cost-benefit calculation of new building projects. Consider a construction project with a cost basis of $1 million. If 20% to 35% of the costs can be allocated to 5-, 7- and 15-year property, then the client could accelerate tax deductions of $80,000 to $140,000 into that period, significantly lowering the total construction costs.

4

Is the client inheriting commercial real estate?

When a family member inherits rental property from another family member, that rental income has the potential to create a burdensome tax liability. But by conducting a cost segregation on the portion of property that receives a step-up in basis (i.e., IRC Sec. 754 basis adjustment), your client may see some relief from that additional tax burden.

5

Is the client conducting a 1031 like-kind exchange?

You may already know that a property owner can defer gain (and thus tax) on the exchange of like kind property. But did you know that the property owner might be able to benefit from even greater tax savings by conducting a cost segregation on the replacement property? This combination can result in increased cash flow for the property owner—and a happier client for you.

Don't despair if you missed the opportunity for 2013! Now is the perfect time to dig deep for opportunities to accelerate depreciation deductions and delight your clients with a significantly lower 2014 or 2015 tax liability.

You blew it! 3 ways CPA Firms miss out on cost segregation sales

Open your eyes to opportunities for accelerated depreciation during estate planning and like-kind exchanges.

So you think you're capturing all the cost segregation opportunities within your commercial real estate client base. We think there are a few you probably missed. Sure… anytime a client buys or builds a new building, you're bringing in your cost segregation strategic partner to segregate those costs. Those cost seg studies are realizing accelerated depreciation deductions for your clients and boosting your firm's bottom line.

What if we told you that you could be realizing even greater benefits for your clients and your firm? Here, we share three of the most common blind spots CPAs have when it comes to cost segregation—and how to open your eyes to even greater tax-minimization opportunities.

1

Hiding in plain sight

Have you won any clients in recent years that already own commercial buildings? Of course, the answer is yes. But were you so wrapped up in the details of winning the client's tax compliance, accounting and audit that you forgot about the wealth of engineering-based opportunities that could make their eyes light up?

To efficiently uncover these opportunities, take a Deep Dive through your tax software, creating a list of clients who own real property with a value of at least $1 million. You can easily identify those properties that have not already had a cost segregation study conducted on them because they will be classified as 39-year property rather than being segregated between 5-, 7-, 15- and 39-year property.

2

Step-up to accelerated depreciation deductions

So your client is about to inherit a commercial building. After you were done congratulating yourself on the solid estate planning work that ensured Junior wouldn't be facing a gargantuan estate tax bill, did you consider the huge income tax bill he would face when rental income started to flow?

The transfer of property from one family member to another represents a golden opportunity to accelerate depreciation deductions by performing a cost segregation study on the step-up in basis. Basically, the portion of the step-up in basis that is allocated to real property is depreciated as if it were new property at the time the taxpayer receives the interest, and a cost segregation study can be conducted on that portion.

There is no better time for Junior to come into some accelerated deductions than when he is inheriting property with a step-up in tax basis. Those deductions will reduce his taxable income just when he's getting hit with increased property taxes on a significantly higher property value.

3

Joined at the hip: 1031 exchange and cost seg

With the commercial real estate market heating up—especially in high-end markets—1031 exchanges are once again becoming popular tax-deferral strategies. In many cases, your clients are trading up to bigger and better properties to generate even more rental income. Along with that increased income comes markedly higher taxes. But by segregating the building costs into classes that qualify for shorter depreciable lives, you could significantly mitigate that tax increase, freeing up cash that can be used to purchase more or better real estate.

But beware! Because of the precedent set by the Peco Foods, Inc. v. Commissioner case, any purchase price allocation agreed to in writing at the time of the transaction will likely be binding and could negate or significantly limit the opportunity to accelerate depreciation deductions through cost segregation. The lesson here is that timing is critical. If possible, seek to perform the cost segregation prior to the purchase.

Leverage cost segregation to fill your client pipeline with commercial property owners

TREMENDOUS ROI ON COST SEG STUDY OPENS THE DOOR WITH PROFITABLE NEW CLIENTS.

Every CPA firm thrives on serving dynamic, growing businesses. Because one of the barometers of business success is the acquisition of real property, cost segregation provides the perfect door opener with commercial real estate owners who also require a variety of other sophisticated tax planning and annual audit services.

Many commercial property owners may not be aware of the tremendous cost-saving potential of a cost segregation study because their current CPAs are not bringing these opportunities to their attention. Small CPA firms may lack the expertise to perform these studies, while Big Four and other national firms are often focused on other service opportunities.

10-to-1 ROI on cost seg studies

This lack of attention provides just the right opening for mid-sized local and regional CPA firms to educate commercial property-owning prospects about the incredible return on investment they can attain by accelerating depreciation on building components.

Generally, about 20% to 35% of the purchase price can be classified as 5-, 7- or 15-year property, resulting in tax savings of between 8% and 14% of the cost of the building. This tax savings is typically around 10 times the price of the cost segregation study.

A golden ticket to tax minimization

The potential for such tremendous tax savings enables CPA firms to request and receive a prospect's prior year tax returns—which is kind of like being handed a Golden Ticket to a wonderland of potential tax-minimization opportunities.

Once your firm has helped that commercial property owner achieve tens or even hundreds of thousands of dollars in tax savings through cost seg and other specialty tax services, you are in an ideal position to bid on the annual audit and tax work for the owner's business entities.

Enhanced tax planning for current clients

Cost segregation studies are also valuable retention tools with existing clients who are considering buying, building or rehabilitating real property. Often, the projected tax savings means that the final acquisition or construction costs will be less than anticipated, which puts more money in your clients' pockets and enhances their satisfaction with your firm.

In addition to the ROI on the study itself, cost segregation also can enhance other tax planning opportunities, such as:

- **Estate planning.** As property passes from one family member to other family members, the interplay between cost segregation and the Sec. 754 depreciation adjustment can create significant cost savings. The portion of the step-up in basis that is allocated to real property is depreciated as if it were new property at the time the taxpayer receives the interest, and a cost segregation study can be conducted on that portion.
- **Like-kind exchange.** There is a similar interplay between Sec. 1031 and cost segregation. When a 1031 like-kind exchange includes cash for other property, or "boot," the property owner stands to gain significant tax savings when a cost segregation study is conducted on the boot.

The upshot: For firms that are already taking advantage of Sec. 754 and Sec. 1031 on behalf of their clients, adding cost segregation capabilities can increase the tax-saving potential for those clients exponentially.

About FULLERCSS

We created Fullercss to enable all accounting firms to provide cost segregation services to their clients. Our team combines the talents and experience of professionals from a variety of disciplines, including:

- CPAs,
- Engineers,
- Appraisers, and
- Tax specialists

We focus exclusively on the regulations and case law that govern this lucrative but constantly changing practice. Our team has performed over 3,500 cost segregation studies in many different industries, helping our CPA firm clients to save their clients millions of dollars. We are the only firm that offers all of the following services:

- Engineered tax solutions with tax credit / incentive discovery programs,
- Private labeling, and
- Comprehensive business development assistance.

We not only increase the range of services that you offer your existing clients. We provide business development assistance that helps you reach new clients in the real estate niche. Our services help firms increase billings to existing clients at the same time that they increase the number of clients that they serve.

If your firm isn't ready to take on the overhead necessary to build a cost segregation practice in-house, we deliver cost segregation and other private-label tax strategies exclusively through CPA firms. We don't serve individual businesses, so there's no chance your clients are going to look to us for services in the future.

CLICK HERE To connect with us regarding cost seg partnership opportunities

Contact us at (901) 205-9043
www.fullercss.com