Abstract: A cost segregation study combines accounting and engineering techniques to identify building costs that are properly allocable to tangible personal property rather than real property. As a result, the business that owns the real property can claim valuable tax breaks. This article explores the concepts behind cost segregation studies.

Is it time for a cost segregation study?

Because of the economic impact of the COVID-19 crisis, many companies may want to conserve cash and not buy much equipment this year. As a result, you may not be able to claim as many depreciation tax deductions as in the past. However, if your company owns real property, there's another approach to depreciation to consider: a cost segregation study.

Depreciation basics

Business buildings generally have a 39-year depreciation period (27.5 years for residential rental properties). Typically, companies depreciate a building's structural components — including walls, windows, HVAC systems, plumbing and wiring — along with the building. Personal property (such as equipment, machinery, furniture and fixtures) is eligible for accelerated depreciation, usually over five or seven years. And land improvements, such as fences, outdoor lighting and parking lots, are depreciable over 15 years.

Often, businesses allocate all or most of their buildings' acquisition or construction costs to real property, overlooking opportunities to allocate costs to shorter-lived personal property or land improvements. Items that appear to be "part of a building" may in fact be personal property. Examples include removable wall and floor coverings, removable partitions, awnings and canopies, window treatments, signs and decorative lighting.

Pinpointing costs

A cost segregation study combines accounting and engineering techniques to identify building costs that are properly allocable to tangible personal property rather than real property. Although the relative costs and benefits of a cost segregation study will depend on your particular facts and circumstances, it can be a valuable investment.

It may allow you to accelerate depreciation deductions on certain items, thereby reducing taxes and boosting cash flow. And, thanks to the Tax Cuts and Jobs Act, the potential benefits of a cost segregation study are now even greater than they were a few years ago because of enhancements to certain depreciation-related tax breaks.

Worth a look

Cost segregation studies have costs all their own, but the potential long-term tax benefits may make it worth your while to undertake the process. Contact our firm for further details.