COST SEGREGATION ADVISOR, LLC
…we make Commercial Property Owners **SAY WOW!!**SM

The History of Cost Segregation

Background Information

The legislation and procedures used in an engineering-based cost segregation study have been in existence since the enactment of the Investment Tax Credit (ITC) in 1962. When the act was repealed in 1986, most people assumed that cost segregation studies provided no further benefit under the new tax law.

1997: However, **in a landmark 1997 tax court case, Hospital Corporation of America successfully defended** the application of engineering-based cost segregation as a viable method to differentiate real and personal property under existing law.

1999: IRS releases Legal Memorandum 1992-1045 in which the IRS agreed not to contest the HCA reclassification of building cost into different asset categories that result in shorter depreciable lives. Action on Decision (AOD CC-1999-008), the Service acquiesced to the validity of the method approved by the court (i.e., pre-1981 ITC tests remained applicable for determining tangible personal property under both ACRS and MACRS).

The Benefits of Cost Segregation

Engineering based cost segregation studies allow commercial real estate owners to take what would otherwise be classified as real property (*1250*) for depreciation purposes and reclassify it as more rapidly depreciating personal property (*1245*). This reclassification results in substantial cash flow benefits in both current and future years through substantially shorter depreciable tax life and accelerated depreciation methods.

Recent History

Several recent rulings have been issued by the government to spur economic growth, which can have a major impact for building owners with previous construction and acquisitions.

2002: the IRS automatically consents to changes in the method of depreciation via Form 3115, filed with the return in the year the change is elected. (Rev. Procedure 2002-09)

- The IRS made it easy to change your method of depreciation to account for a cost segregation study, without the headache of an amended return.

2002: following the 911 tragedies, the government allowed taxpayers to catch up on all deductions from previous years for items reclassified into the shorter tax lives as a result of a cost segregation study. (Rev. Proc. 2002-19)

- Prior to 9/11 ruling, the beneficial adjustment had to be spread out across four years, but can now be expensed entirely in the year of the change, reported as a reduction to the current year taxable income.

2004: the IRS reversed the two-year waiting period required to change the method of calculation for depreciation on their property. (Rev. Proc. 2004-11)

- You can change your method of deprecation in any year. Previously, if you purchased a property and elected to depreciate it over 30 years, you had to wait two years before changing depreciation methods and utilize a cost segregation study to take advantage of the shorter-lived personal property asset classes.