Tax Reduction Affected by Cost Segregation

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Tax reduction is just one of the benefits of cost segregation. Many real estate owners and tax preparers believe cost segregation simply defers payment of taxes. While they recognize it effectively generates an interest-free loan from the government, they do not understand it also provides tax reductions in most cases.

For most real estate owners (corporations are the exception) income is characterized as either ordinary income or capital gains income. It is not intuitive, but cost segregation changes the character of income from ordinary income to capital gains income providing tax reductions of up to 20%. This occurs because the additional depreciation is a tax deduction that reduces ordinary income. When the property is sold, it is recognized as capital gains income. Having more tax deductions increases tax reduction.

Since a portion of the cost basis is allocated to short-life improvements, some owners and tax preparers express concern that the depreciation will be recaptured when the property is sold (at a tax rate of 25-35%).

When a property is sold, the owner and the tax preparer typically collectively review the sales price and depreciation schedule to allocate the sales price between land, short life property, long life property, and profit. After reviewing the condition of short-life property, it is usually determined the value is similar to the depreciated basis (book basis). Hence the depreciation is not recaptured since there is no gain upon sale.

This is reasonable and appropriate since the short-life property depreciates more rapidly than the structure of the building. Short-life property includes items such as carpet, vinyl tile, paving, and parking lot striping. These items do physically depreciate from use and weather (if outdoors).

The capital gains rate (maximum of 15%) is less than half the ordinary income tax rate (maximum of 35%). By converting the character of income from ordinary income to capital gains income, cost segregation identifies tax reductions by reducing the reduces tax rate by over 50% (for income shielded by cost segregation). In addition, cost segregation defers payment of taxes from the year it is earned until the year the property is sold.

Cost segregation produces tax deductions and reduces federal income taxes across the country and in every size market. Below are just a few examples of where cost segregation generates meaningful tax deductions.

City:

Atlanta, GA ; New York, NY ; Memphis, TN ; Miami, FL ; Orlando, FL ; New Orleans, LA ; Hartford, CT ; Dallas/Ft. Worth, TX ; Washington, DC ; Denver, CO ; Akron, OH ; Buffalo, NY ; Jacksonville, TN ; Chicago, IL ; Toledo, OH ; Harrisburg, PA ; Birmingham, AL; Augusta, GA ; Lakeland, FL ; San Antonio, TX; Jackson, MS ; Little Rock, AR ; Pittsburg, PA ; Sarasota, FL ; Chattanooga, TN ; Manchester, NH ; Youngstown, OH ; Riverside, CA ; Syracuse, NY and Wichita, KS

Cost segregation produces tax deductions for virtually all property types.

Property Type:

Manufacturing/processing , Tennis club , Retirement home , Auto service garage , Mini-warehouse , Single-tenant retail , Medical facility , Hotel , Retail and Vacant land

Almost every industry, including the following, can generate cost-efficient tax deductions by using cost segregation.

Industry:

Mineral product manufacturing , Electronic and appliance stores , Frozen food manufacturing , Non-durable good wholesalers , Furniture manufacturing , Food manufacturing , Chemical manufacturing , Automotive repair facilities , Amusement parks and Leather product manufacturing.

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O'Connor & Associates is a national provider of commercial real estate services including federal tax reduction,a Commercial Real Estate Appraisal, cost segregation, feasibility studies, insurance valuations, a <c:alink:www.poconnor.com
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