Cost Segregation

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If you own rental real estate or are thinking of purchasing or building rental real estate then you should ask your CPA about cost segregation.

Cost segregation is the method used to divide or segregate the basis in your property into components. The tax saving advantage is that some components can be depreciated much faster than the standard 39 years that rental real estate must be depreciated under. The faster items can be depreciated the larger your depreciation deduction. The larger your depreciation deduction the lower your taxable income. The lower your taxable income the lower your taxes.

Every rental property owner knows to divide their property between the land and the improvements that are on the land.

The land is then divided between what is called the "raw land" and "land improvements". Raw land cannot be depreciated. Most land improvements which consist of driveways, sidewalks, curbs, landscaping, etc. can be depreciated over 15 years.

The improvements on the land can be divided between the building and the building components.

The building consists of the flooring, roof, walls, windows and electrical, which are depreciated over 27.5 years if it is a residential rental and 39 years if it isn't.

The building components include carpet, appliances, interior walls, etc. which depreciate over 5 or 7 years.

The most frequently asked question is whether or not it's worth the cost to do a cost segregation study. Obviously this will vary depending on many factors including the cost of the study, the type of entity that is holding the real estate, the basis of the real estate, the amount of components that can be separated, etc. In general if you have at least $1 million in property you'll probably get the cost of the analysis refunded with the first year's tax savings. If your property is valued at less than $1 million then you should ask your tax professional for an estimate of the cost and your potential savings.

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