

# Real Estate Journal

COVERING ALL OF LONG ISLAND, NEW YORK CITY AND UPSTATE NEW YORK

## Practical applications for cost segregation studies: Using a CSS with an acquired property

**jh Jacob Hopper**



Bedford  
Capital  
Consulting

One of the most recognized uses for a CSS is following acquisition. In fact many property owners and investors have made cost seg a routine part of their overall acquisition strategy. Most tax advisors agree that this is a great time to consider a study. Those who have purchased commercial or residential rental properties, in the \$ million plus range, and have not looked into a CSS should certainly do so. The positive cash flow generated by accelerating depreciation deductions is usually significant and well worth the cost of the study. If you're thinking that you have missed out on this valuable opportunity, don't forget, a look-back study can be performed on properties that were acquired and placed in service many years ago (see June 13th article – *Using a CSS with Currently Owned Properties*).

The focus of a CSS is the

depreciable assets which generally include building and land improvements, but can also include furniture, fixtures, and equipment (FF&E). FF&E is often identified separately in the purchase and sale agreement and therefore does not always need to be included in the scope of the CSS. Non-depreciable land should be valued separately before the CSS is started.

### Lack of Documentation

One of the most important factors when performing a CSS on an acquired property is knowing what documents are available. More often than not, with purchased properties, there is little or no documentation available as to the original construction costs. In this case the cost segregation consultant must rely on estimating techniques. Estimating is a perfectly acceptable method in the eye of the IRS, if done correctly. Chapter three of the IRS's Cost Segregation Audit Techniques Guide (ATG) describes the Detailed Engineering Cost Estimate Approach (or Detailed Estimate Approach) and states, "if detailed cost estimates are prepared by qualified individuals, and the estimates are reconciled to actual

costs, then reasonably-accurate cost allocations are possible."

### Tenant Improvements

When dealing with the acquisition of multi-tenant properties it can be challenging to determine what tenant improvements the new owner has a depreciable basis in. This is important information and can be very valuable when a tenant vacates the property. If the new owner has a depreciable basis in any of the improvements in that former tenant's space then they can likely write-off the cost of those improvements when they are retired. When one tenant leaves and another moves in a space is often gutted and the old improvements are thrown away (retired). A qualified cost seg consultant can help determine the value of the depreciable assets attributable to the new owner and then separately identify them by tenant in the cost segregation report for future write-off. This is especially valuable for large multi-tenant properties such as office buildings and retail centers.

### 1031 Exchange

Although it is beyond the scope of this article, due to the popularity of the 1031 exchange it should be noted that a cost segregation study can still

be very beneficial when used with a property acquired through an exchange. However, it is extremely important to understand that the integration of these two tax deferral strategies must be carefully reviewed. While the benefits of combining cost seg and 1031 exchange can be great, this approach is not always the best option.

### Closing Thoughts

Engineering-based studies have become a focal point for the IRS in the past few years. In chapter four of the ATG the IRS specifically says, "In general, a study by a construction engineer is more reliable than one conducted by someone with no engineering or construction background." Buyer beware, there are many providers professing to offer engineering-based cost segregation services who do not have the necessary qualifications. Be a good consumer and do your homework. Ask for references and check qualification when selecting a cost segregation consultant.

**Jacob Hopper is a regional vice president at Bedford Capital Consulting, New York, N.Y.**