THE TAX CUTS & JOBS ACT

AND ITS GLORIOUS IMPACT ON

COST SEGREGATION

HOW THE NEW TAX LAWS HAVE AFFECTED REAL ESTATE DEPRECIATION

COST SEGREGATION AUTHORITY

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Regional Manager

OBJECTIVES

New Tax Law is Good.
New Tax Law WITH Cost Segregation is AMAZING!

1. Learn about this less-understood tax strategy and principle
2. Illustrate the low risk vs. high value of Cost Segregation
3. Identify aspects of the new Tax Law that affect depreciation.
4. Illustrate how to apply these strategies in your practice.
5. Identify HIDDEN deductions for your client.

DO YOU SEE THE HIDDEN TIGER?

DEPRECIATION & COST SEGREGATION

Depreciation

- Depreciation is an tax deduction that allows a taxpayer to recover the cost of certain property.
- An allowance for the wear and tear, or obsolescence of the property.

Cost Segregation

- A strategic tax tool that allows taxpayers to **accelerate** their DEPRECIATION expense.
- **Reclassification of assets from real property** (§1250) **to personal property** (§1245).
- *Requires an engineering-based Cost Segregation Study.*

SOUNDS LIKE A LOOPHOLE…

"It is desirable for taxpayers to maximize personal property costs in order to ***accelerate*** *depreciation deductions and, hence, reduce tax liability."*

IRS, Audit Guide

A VERY SHORT HISTORY

Hospital Corporation v. Tax Commission (IRS)

- Determined that a building could be separated into personal property and real property.
- Determined that certain tests for determining tangible personal property for MACRS remained applicable.
- Modern "Cost Segregation" was born.

OPINION ISSUED ON JULY 24, 1997

PERSONAL PROPERTY TESTS

IRC Section 38

1. *If the property can be removed without damage to building structure then it is personal property.* *Example: carpets, countertops, window coverings*
2. *If the relationship between the asset and equipment or machinery is so close that they would be retired contemporaneously.* *Example: specialty electrical/plumbing, concrete platforms*
3. *The relationship between the asset and the nature of the business are unique.* *Example: gas station canopies, clean room cooling*

PROPERTY CLASSIFICATIONS

COMMONLY SEGREGATED ITEMS

REAL PROPERTY (39/27.5 Yrs)

- Steel Structure
- Roof
- Walls/Doors
- Windows
- HVAC Systems
- Plumbing/Electrical Systems

Bonus Eligible

LAND IMPROVEMENTS (15 Yrs.)

- Parking Lots (asphalt)
- Curb, gutter, sidewalks
- Storm Drains
- Irrigation Systems
- Retaining Walls
- Trees, shrubs, landscaping

Bonus Eligible

PERSONAL PROPERTY (7/5 Yrs.)

- Carpet
- Countertops
- Cabinetry
- Blinds/window coverings
- Auxiliary Lighting
- Specialty Plumbing
- Window Treatments
- Wall Coverings
- Removable Flooring

AVERAGE RECLASSIFICATION

PROPERTY TYPE	AVERAGE BASIS REALLOCATION
APARTMENT BUILDINGS	20-50%
OFFICE BUILDINGS	10-40%
RESTAURANTS	20-50%
HOTELS	25-45%
MANUFACTURING	25-60%
GROCERY STORES	15-50%
RETAIL FACILITIES	20-50%
WAREHOUSING	10-30%
PROCESSING PLANTS	20-65%
R&D FACILITIES	20-50%

ENGAGEMENT QUESTION #1

Name 3 items that are commonly segregated as personal property from a Cost Segregation Study.

CASE STUDY

CASE STUDY— FOURPLEX

- Acquisition Cost: $400,000
- Date: July 2017
- Current Tax Year: 2018

REVISED DEPRECIATION SCHEDULE

Year	Depreciation WITHOUT Cost Seg	Depreciation WITH Cost Segregation Study					Detail of Benefits		
		27.5 Year	15 Year	7 Year	5 Year	Total	Increased Depreciation	Tax Savings	Present Value of Tax Savings
2017	$ 7,273	$ 4,873	$ 3,000	$ 571	$ 13,600	$ 22,044	$ -	$ -	$ -
2018	14,545	9,745	5,700	980	21,760	38,185	38,411	14,596	14,596
2019	14,545	9,745	5,130	700	13,056	28,631	14,086	5,353	4,956
2020	14,545	9,745	4,620	500	7,834	22,699	8,153	3,098	2,656
2021	14,545	9,745	4,158	357	7,834	22,094	7,549	2,869	2,277
2022	14,545	9,745	3,738	357	3,917	17,757	3,212	1,221	897
2023	14,545	9,745	3,543	357	-	13,646	(900)	(342)	(233)
2024	14,545	9,745	3,543	178	-	13,467	(1,079)	(410)	(258)
2025	14,545	9,745	3,543	-	-	13,288	(1,257)	(478)	(279)
2026	14,545	9,745	3,543	-	-	13,288	(1,257)	(478)	(258)
2027	14,545	9,745	3,543	-	-	13,288	(1,257)	(478)	(239)
2028	14,545	9,745	3,543	-	-	13,288	(1,257)	(478)	(221)
2029	14,545	9,745	3,543	-	-	13,288	(1,257)	(478)	(205)
2030	14,545	9,745	3,543	-	-	13,288	(1,257)	(478)	(190)
2031	14,545	9,745	3,543	-	-	13,288	(1,257)	(478)	(176)
2032	14,545	9,745	1,767	-	-	11,512	(3,033)	(1,153)	(392)
2033	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(575)
2034	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(532)
2035	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(493)
2036	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(456)
2037	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(423)
2038	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(391)
2039	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(362)
2040	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(336)
2041	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(311)
2042	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(288)
2043	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(266)
2044	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(247)
Total	400,000	268,000	60,000	4,000	68,000	400,000	(0)	(0)	18,252
% of Total	100%	67%	15%	1%	17%	100%			

2018 Increased Depreciation = $38,411

2018 Tax Savings = $14,596

BONUS BENEFITS

ADDITIONAL BENEFITS WITH COST SEGREGATION

1. CATCH UP DEPRECIATION
2. REDUCED RECAPTURE
3. PARTIAL ASSET DISPOSITION
4. BONUS DEPRECIATION

CATCH-UP BENEFIT

COST SEGREGATION APPLIES TO PROPERTY YOU CURRENTLY OWN

- For *existing* properties, the IRS provides an automatic consent procedure to "catch-up" missed depreciation.
- ***Cumulative*** depreciation differences are allowed to be fully expensed in the year of the change.
- Uses Form 3115

COST SEGREGATION – CATCH UP

Year	Depreciation WITHOUT Cost Seg	Depreciation WITH Cost Segregation Study 27.5 Year	15 Year	7 Year	5 Year	Total	Detail of Benefits Increased Depreciation	Tax Savings	Present Value of Tax Savings
2014	$ 7,273	$ 4,873	$ 3,000	$ 571	$ 13,600	$ 22,044	$ -	$ -	$ -
2015	14,545	9,745	5,700	980	21,760	38,185	-	-	-
2016	14,545	9,745	5,130	700	13,056	28,631	-	-	-
2017	14,545	9,745	4,620	500	7,834	22,699	-	-	-
2018	14,545	9,745	4,158	357	7,834	22,094	68,199	25,915	25,915
2019	14,545	9,745	3,738	357	3,917	17,757	3,212	1,221	1,130
2020	14,545	9,745	3,543	357	-	13,646	(900)	(342)	(293)
2021	14,545	9,745	3,543	178	-	13,467	(1,079)	(410)	(325)
2022	14,545	9,745	3,543	-	-	13,288	(1,257)	(478)	(351)
2023	14,545	9,745	3,543	-	-	13,288	(1,257)	(478)	(325)
2024	14,545	9,745	3,543	-	-	13,288	(1,257)	(478)	(301)
2025	14,545	9,745	3,543	-	-	13,288	(1,257)	(478)	(279)
2026	14,545	9,745	3,543	-	-	13,288	(1,257)	(478)	(258)
2027	14,545	9,745	3,543	-	-	13,288	(1,257)	(478)	(239)
2028	14,545	9,745	3,543	-	-	13,288	(1,257)	(478)	(221)
2029	14,545	9,745	1,767	-	-	11,512	(3,033)	(1,153)	(494)
2030	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(724)
2031	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(671)
2032	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(621)
2033	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(575)
2034	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(532)
2035	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(493)
2036	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(456)
2037	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(423)
2038	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(391)
2039	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(362)
2040	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(336)
2041	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(311)
Total	400,000	268,000	60,000	4,000	68,000	400,000	(0)	(0)	18,063
% of Total	100%	67%	15%	1%	17%	100%			

Example: $400,000 Fourplex building, bought in 2014

2018 Increased Depreciation = $68,199

2018 Tax Savings = $25,915

SALE OF ASSET

AM I JUST GOING TO PAY IT ALL BACK WHEN I SELL?

NO. Not only do you have the benefit of tax savings for the entire ownership of the property. But, with a cost segregation study you can improve (reduce) your recapture taxes when you sell the property.

- Time Value of Money. Cash Flow. Leverage.
- Taking deduction at higher ordinary income rate (~40%) and recapture the *Real Property Portion* at a lower rate (25%).
- Reduce or eliminate recapture on Personal Property.

SALE WITHOUT COST SEG STUDY

Apartment purchased in 2012 for $2.5M sold in 2017 for $3.3M (excluding land)

Input Data:	
Selling Price (Excluding Land Portion)	$ 3,300,000
15 Year Land Improvements Selling % of Cost	70%
7 Year Personal Property Selling % of Cost	40%
5 Year Personal Property Selling % of Cost	10%
Capital Gains Tax	20%

Benefit Calculator Input Data:	
Cost of Property	$ 2,500,000
Year Acquired	2012
Current Tax Year	2017
Federal Tax Rate	39%

	Section 1250 Property 27.5 Year	15 Year	Section 1245 Property 7 Year	5 Year	Total
WITHOUT Cost Segregation Study					
Selling Price (Excluding Land Portion)	$ 3,300,000				$ 3,300,000
Cost	2,500,000				2,500,000
Less Depreciation	(500,000)				(500,000)
Basis	$ 2,000,000				$ 2,000,000
Gain on Sale	$ 1,300,000				$ 1,300,000
Recapture of Depreciation	$ 500,000				$ 500,000
Tax Rate on Recapture of Depreciation	25%				25%
Tax on Recapture of Depreciation	$ 125,000				$ 125,000
Capital Gain	$ 800,000				$ 800,000
Tax Rate on Capital Gain	20%				20%
Tax On Capital Gain	$ 160,000				$ 160,000
Total Tax	$ 285,000				$ **285,000**

SALE **WITH** COST SEG STUDY

Apartment purchased in 2012 for $2.5M sold in 2017 for $3.3M (excluding land)

Input Data:	
Selling Price (Excluding Land Portion)	$ 3,300,000
15 Year Land Improvements Selling % of Cost	70%
7 Year Personal Property Selling % of Cost	40%
5 Year Personal Property Selling % of Cost	10%
Capital Gains Tax	20%

Benefit Calculator Input Data:	
Cost of Property	$ 2,500,000
Year Acquired	2012
Current Tax Year	2017
Federal Tax Rate	39%

	Section 1250 Property		Section 1245 Property		
	27.5 Year	15 Year	7 Year	5 Year	Total
WITH Cost Segregation Study					
Selling Price	$ 2,985,000	262,500	10,000	42,500	$ 3,300,000
Cost	1,675,000	375,000	25,000	425,000	2,500,000
Less Depreciation	(335,000)	(164,663)	(21,654)	(425,000)	(946,316)
Basis	$ 1,340,000	210,338	3,346	-	$ 1,553,684
Gain on Sale	$ 1,645,000	52,163	6,654	42,500	$ 1,746,316
Recapture of Depreciation	$ 335,000	52,163	6,654	42,500	$ 436,316
Tax Rate on Recapture of Depreciation	25%	25%	39%	39%	Various
Tax on Recapture of Depreciation	$ 83,750	13,041	2,595	16,575	$ 115,961
Capital Gain	$ 1,310,000	-	-	-	$ 1,310,000
Tax Rate on Capital Gain	20%	20%	20%	20%	20%
Tax On Capital Gain	$ 262,000	-	-	-	$ 262,000
Additional Depreciation in Year of Sale	$ (165,000)	164,663	21,654	425,000	$ 446,316
Tax Rate	-39%	-39%	-39%	-39%	-39%
Tax Reduction	$ 64,350	(64,218)	(8,445)	(165,750)	$ (174,063)
Total Tax	$ 410,100	(51,178)	(5,850)	(149,175)	$ **203,897**
Tax Savings with Study	$ (125,100)	51,178	5,850	149,175	$ **81,103**

PARTIAL DISPOSITIONS

AN ADDED BENEFIT TO COST SEGREGATION OF RENTAL PROPERTIES

IRS Regulations allow for the ability to EXPENSE the remaining basis of replaced components of a building, so a taxpayer will not have to continue to depreciate assets that are no longer in service.

- Partial Disposition Election on a Timely Filed Return
- Must be expensed in the year of the disposition
- Includes removal costs

Examples: Roof, HVAC systems, Carpet

TAX CUTS AND JOBS ACT

Bonus Depreciation

Pass Through Income Rules

Tax Brackets

Standard Deduction

Repatriation

Qualified Improvement Property

Corporate Tax Cut

M&E Expenses

ADS Depreciation

Individual Mandate

1031 Exchanges

Child Tax Credit

AMT Changes

Net Operating Losses

Mortgage Interest Deductions

Qualified Opportunity Zones

Section 179 Deductions

State-and-local Tax Deductions

BONUS DEPRECIATION (OLD LAW)

A valuable tax-saving tool for business and real estate investors allowing an immediate first-year deduction on the purchase of eligible property

REQUIREMENTS

- ✓ ~~Original use property (new)~~
- ✓ *Recovery period of 20 years or less. (A COST SEG STUDY IDENTIFIES THESE ASSETS.)*
- ✓ *The amount of bonus depends on the year placed in service.*

YEAR	BONUS
[illegible]	30%
[illegible]	[illegible]
[illegible]	50%
[illegible]	100%
[illegible]	50%
[illegible]	[illegible]
2018	40%
2019	30%

Cost Segregation Authority © 2018

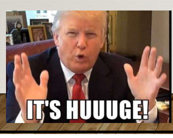
SUPER BONUS DEPRECIATION (NEW LAW)

A valuable tax-saving tool for business and real estate investors allowing an immediate first-year deduction on the purchase of eligible property

REQUIREMENTS

- ✓ *Recovery period of 20 years or less.*
- ✓ *The amount of bonus depends on the year placed in service.*

YEAR	BONUS
9/27/17—12/31/22	100%
2023	80%
2024	60%
2025	40%
2026	20%
2027	***0%***



Cost Segregation Authority © 2018

ENGAGEMENT QUESTION #3

If a building has a life of 27.5 years or 39 years, how does bonus depreciation impact real estate investors?

Cost Segregation Authority © 2018

SUPER BONUS DEPRECIATION

Year	Depreciation WITHOUT Cost Seg	Depreciation WITH Cost Segregation Study					Detail of Benefits		
		27.5 Year	15 Year	7 Year	5 Year	Total	Increased Depreciation	Tax Savings	Present Value of Tax Savings
2018	$ 7,273	$ 4,873	$ 60,000	$ 4,000	$ 68,000	$ 136,873	$ 129,600	$ 49,248	$ 49,248
2019	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(1,689)
2020	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(1,564)
2021	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(1,448)
2022	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(1,341)
2023	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(1,241)
2024	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(1,149)
2025	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(1,064)
2026	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(985)
2027	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(912)
2028	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(845)
2029	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(782)
2030	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(724)
2031	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(671)
2032	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(621)
2033	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(575)
2034	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(532)
2035	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(493)
2036	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(456)
2037	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(423)
2038	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(391)
2039	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(362)
2040	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(336)
2041	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(311)
2042	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(288)
2043	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(266)
2044	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(247)
2045	14,545	9,745	-	-	-	9,745	(4,800)	(1,824)	(228)
Total	400,000	268,000	60,000	4,000	68,000	400,000	-	0	29,302
% of Total	100%	67%	15%	1%	17%	100%			

Example: $400,000 Fourplex purchased after September 27, 2017

2018 Increased Depreciation = $129,600

2018 Tax Savings = $49,248

GROUPING

One specific type of planning opportunity that is seen quite often in practice is the grouping of rental activities with other trade or business activities. Typically, a rental activity cannot be grouped with a trade or business activity. However, taxpayers may group those activities as one activity if they constitute an appropriate economic unit and;

- The rental activity is insignificant in relation to the trade or business activity;
- The trade or business activity is insignificant in relation to the rental activity; or
- Each owner of the trade or business activity has the same proportionate ownership interest in the rental activity

GROUPING (EXAMPLE)

A physician group (P) is owned equally by five physicians (20% each) and is operated as a C corporation. P is operated out of a building owned by partnership R, which rents the building to P. R's partners are the same physicians in the physician group that make up P. The partners' ownership in the partnership equity is the same (20% each) as that of P. Under section 469, these two activities may be grouped as on activity, **but only for the purposes of whether the taxpayer materially participates in the rental entity.**

WHEN TO DO A STUDY

- If You Currently Own an Income Property (catch up)
- Purchase an Existing Building or Build a New Building
- Renovate, Remodel or make Leasehold Improvements
- Before you Sell
- Property with 754 Step Up or Other Step Up

QUALIFIED IMPROVEMENT PROPERTY

Improvements made to an interior portion of a building, which is nonresidential real property

Old Law

- Included 3 separate classes (leasehold, retail, restaurant), with varying rules.
- Required a lease between unrelated parties
- Required the building be at least 3 years old
- Provided a 15-year depreciation period to all improvements

New Law

- Grouped all improvements into 1 class of Improvement Property: Qualified Improvement Property
- Eliminated unrelated parties and 3 –year rules
- Eliminated restaurants as a class
- Unintentionally? left out 15-year life clause, nullifying Bonus Depreciation (oops).
- Resulting in need for Cost Segregation Study.

1031 EXCHANGES

IRC Section 1031 allows the taxpayer to postpone paying tax on the gain of real property if the proceeds are reinvested in a similar property as part of a like-kind exchange.

TCJA CHANGES

- The portion of any exchange that includes personal property will no longer qualify and *may* generate "boot".
- Acquisition of new personal property may qualify for full expensing or accelerated depreciation, which would offset the gain noted above.

QUALIFIED OPPORTUNITY ZONES

The Opportunity Zones program offers three tax incentives for investing in low-income communities through a qualified Opportunity Fund

- Temporary Deferral
- Step-Up In Basis
- Permanent Exclusion

QUALIFIED OPPORTUNITY ZONES

- **Temporary Deferral** – A temporary deferral of inclusion in taxable income for capital gains reinvested into an Opportunity Fund. The deferred gain must be recognized on the earlier of the date on which the opportunity zone investment is disposed of or December 31, 2026

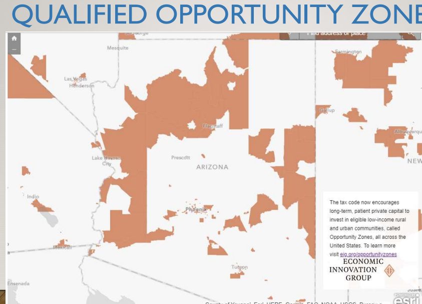
QUALIFIED OPPORTUNITY ZONES

- **Step-Up In Basis** – A step-up in basis for capital gains reinvested in an Opportunity Fund. The basis is increased by 10% if the investment in the Opportunity Fund is held by the taxpayer for at least 5 years and by an additional 5% if held for 7 years, thereby excluding up to 15% of the original gain from taxation.

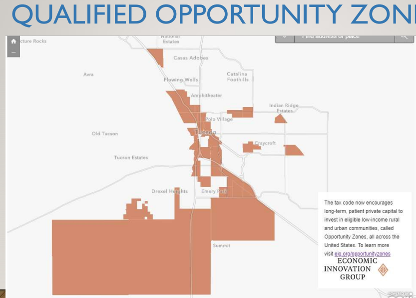
QUALIFIED OPPORTUNITY ZONES

- **Permanent Exclusion** – A permanent exclusion from taxable income of capital gains from the sale or exchange of an investment in an Opportunity Fund if the investment is held for at least 10 years. This exclusion only applies to gains accrued after an investment in an Opportunity Fund. (Note: this exclusion applies to the gains accrued from an investment in an Opportunity Fund, not the original gains).

QUALIFIED OPPORTUNITY ZONES



QUALIFIED OPPORTUNITY ZONES



WHEN TO DO A STUDY

- If You Currently Own an Income Property (catch up)
- Purchase an Existing Building or Build a New Building
- Renovate, Remodel or make Leasehold Improvements
- Before you Sell
- Property with 754 Step Up or Other Step Up

WHAT THIS ALL MEANS FOR YOU

- Cost Segregation is an incredibly valuable, tax-saving tool for your clients that must be familiar with.
- The new Tax Laws have supercharged this strategy
  - 100% Bonus Depreciation
  - 1031 Exchanges
- Applies to existing properties. Time to go review client's depreciation schedules and look for 39 and 27.5 year assets to reclassify.
- Clients will love you! (retention)

HOW TO PROCEED

Simply email or call with the following info for a benefit analysis at no cost

- Year Placed in Service
- Total Cost
- Type of Asset (e.g. retail, office, residential rental, etc…)
- Address (if readily available)

OR

- Depreciation Schedule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