actual cost records in addition to an itemized cost estimate approach...

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By Julio Gonzalez.

If you're an accountant like myself, you've heard the news: As a result of President Biden's Inflation Reduction Act, the IRS has been granted $78 billion to hire 87,000 new employees from now until 2031, which includes replacing retirees. While all these new employees won't be enforcement agents, some unquestionably will be, and some will be auditors, and since we do know that $45.6 billion is being directed toward enforcement, it means certainly that the IRS will be hunting for red flags in tax returns.

Because of this heightened scrutiny, if your real estate clients are interested in

But if the work is done in a sloppy manner and if the study's argument for tax savings based on depreciation is based on weak or faulty evidence, then the IRS will spot red flags right away.

If you or your client would like a preview of the IRS' demanding audit requirements when it comes to cost segregation, I recommend you consult the recently updated IRS Audit Technique Guidelines for Cost Segregation, which will show you precisely what the IRS is scrutinizing when reviewing cost segregation studies.

The Significance of Cost Segregation

If your clients who invest in real estate are unaware of cost segregation and bonus depreciation, please share this news with them. A cost segregation study is an ideal way to offset real estate taxes, and it's easy to explain.

Without a cost segregation study, you're forced to depreciate your real estate investment over a 27.5- or 39-year period, based on whether it's residential or commercial, respectively. But with a cost segregation study, you can expense the building by assessing components. A study identifies for the IRS how much of the building is non-structural in nature—those are the components that are eligible for cost segregation, such as heating and air conditioning systems and lighting fixtures, which deteriorate over time.

These components are allocated a five- or 15-year lifespan, which increases the depreciation deduction, particularly in the first few years. Thanks to a cost segregation analysis, in the first year, your client could write off up to 30-35% of their building's purchase price (except for land).

Authorize a Cost Segregation Study This Year to Get 100% Bonus Depreciation

If a client purchased a property this year, they can take advantage of the 100 percent

What To Expect from a Quality Cost Segregation Firm

First off, a qualified and reputable cost segregation firm will offer a free feasibility study to assess your client's tax situation and projected business plans to determine if a cost segregation study would be suitable for the property. They'll also offer an estimate for how much a study would cost.

Next, if your client gives the study the go-ahead, the firm will analyze the building's construction costs according to component or system and study construction documents. Either an onsite or remote visit will verify how the components and systems are used. As part of the study, your provider will perform a meticulous engineering review of the building's components, classify (or reclassify) them, and give them the correct tax life assigned by IRS rules. Your provider will then identify each asset's indirect costs. Finally, your cost seg partner will deliver to you a written report, which will furnish the asset details that substantiate the value of the classified and reclassified assets, and they will complete the required tax forms.

When Should Your Clients Have A Cost Segregation Study Done?

Your clients can only claim bonus depreciation for a property based on the year they acquired it, so they should try to have a study done during the year of purchase.Your clients should be aware that bonus depreciation can only be claimed retroactively within two tax years of when the building was placed in service.

Because cost segregation creates a baseline value for a property at the time of purchase, it's better to have a cost segregation study done *before* renovations. For the purposes of the IRS, the property's baseline value is more difficult to document after a rehab.

Don't Leave Money on the Table

Cost segregation could be a game-changing financial solution for your clients. With

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