What great CPAs ask about cost segregation, and what you should too–Part 1 of 4 - by Christie Ellis

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This is part one of a four-part series. Part two will appear in the December 3rd issue of the Upstate Section.

Cost segregation provides income tax savings to owners of all types of commercial real estate and buildouts, by accelerating depreciation, decreasing taxable income, and providing you with income tax savings. If you own any commercial real estate – whether multi-family property, leasehold improvements, office renovation, distribution center, medical offices or facilities or even ski resorts and golf courses – you should be using cost seg.

Great CPAs are an incredible resource for their clients. They serve as quarterback for all financial matters effecting a company's health. As a tax strategy, cost segregation providers work closely with CPAs, though we do not compete with them when operating as stand-alone providers. Cost segregation requires both in depth engineering and niche tax knowledge that few CPAs possess. For that reason we partner with CPAs to augment their work for their clients.

Because cost seg is a growing field, with a lot of new adopters, the ability to determine the quality of a provider has become more challenging, and more important than ever before. Like any growing field, late adopters scramble to cash in on this growing strategy by offering low cost, low effort studies, which sadly, put uneducated buyers at risk.

By asking the four questions below, CPAs and their clients can begin to determine whether a cost segregation provider has the knowledge, expertise, and methodology to provide quality work, or whether their studies should be avoided entirely.

1. What approach do you use for cost segregation studies?

You only want to work with a provider using the Detailed Engineering Approach. These studies go through every inch of electrical conduit, every wall mounted door stop, every bolted down bollard to provide the maximum accelerated depreciation. Providers who do not spend the time to examine your property in this level of detail are missing significant value, and are also creating audit hazards for you.

Though there is no such thing as being IRS audit "bullet proof," by using the highest standards set forth by the IRS in its Audit Technique Guide (ATG), you can ensure that the methodology used is favored by the IRS, and that all items are allowed by tax court precedent. Though the IRS ATG does not require any specific methodology, when the ATG states concerns about the validity and accuracy of other methodologies, as a commercial real estate owner, you should avoid them.

2. Describe a typical property tour?

Quality studies should, on average, require 3-4 hours on site, by both an engineering and accounting professional. Some properties require as much as several days on site, an example, in the case of a large building with great complexity, like a hospital.

A quality study should photographically document all visible segregated items. “Drive by” studies where a tour lasts for only a few minutes, with limited documentation does not meet this highest standard.

If a provider is simply breaking down a building into percentage categories, for example, 30% electrical, this is a clear indication you have received a Rule of Thumb study. ATG states, “An examiner should view this approach with caution, since it lacks sufficient documentation.” Do you want to hire a firm using a methodology that is being viewed with caution?

3. Will the providers reports provide itemized breakouts of all segregated items, and how small are the items they examine?

You want to receive a cost detail of the project where each segregated item is broken out as a separate line item, with indicated value, short life, and the source of that value, be it a receipt, or an approved engineering estimating source. You also want to receive a study with items as small as wall mounted door stops indicated. When you’re looking for study value, it’s always the little items that are overlooked. When added together over the course of a building, these small items provide significant value to the owner. The presence of these sorts of items in an itemized cost detail shows the providers dedication to detail, and to providing you the best available value for your study.

4. Is your referred firm a part of a CPA’s required referral network, or are they referred specifically due to their expertise?

This is an important question for CPAs to ask, when they are a part of a medium sized regional firm which participates in an affiliate network, and it is also important for clients to ask of their CPAs. The mergers of large CPA firms continue, and to compete, regional firms are joining together to compete against these industry whales. Sometimes the service offerings increase can benefit these firms’ clients, however, with specialty services, like cost segregation, both CPAs and their clients are at risk of receiving poor studies from unqualified providers. In the past year alone, we have worked with the partners of two large regional firms in upstate New York, who discovered to their horror, that their cost segregation affiliate firm providers were using the highly suspect “Rule of Thumb” methodology which the IRS specifically states it views with caution.

By asking these questions of your intended cost segregation provider you can begin to understand the quality of their studies, and ensure that the work you receive will maximize your study value, and comply with IRS best practices.

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