Cost Segregation for Rental Properties

What is Cost Segregation?

Before we go into cost segregation, it's important to have an understanding of how depreciation works. As a rental property owner you are able to claim an annual depreciation expense of your property's building value. The general time period to claim this is over 27.5 years. For example:

-Your building value is $400K. $400K / 27.5 years = $16K of depreciation expense per year

This is great as taxpayer can use this $16K to offset yearly rental income…but what if there was a way to greatly increase depreciation in the earlier years to increase current cash flow and defer income taxes? This is where a cost segregation comes into play.

So again…What is Cost Segregation?

Cost Segregation is a commonly used strategic tax planning tool that:

- Generates immediate increase in cash flow through accelerated depreciation tax deductions.
- Identifies property's major components and leasehold improvements so they can be written off when replaced or renovated.

Rental property not only includes a building structure, it also includes all of its interior and exterior components (think appliances, blinds/curtains, landscaping, fencing, decks/patios, etc). **On average, 20% to 40% of those components fall into tax categories that can be written off much quicker than the standard 27.5 years used by most taxpayers.** A Cost Segregation dissects the construction cost or purchase price of the property that would otherwise be depreciated over 27 ½ or 39 years and separates out the components that can be depreciated much faster.

Is a Cost Segregation for everyone?

No. It's important to consult with a tax professional to analyze the potential benefits. In most cases we recommend that clients complete cost segregation studies when they plan to hold the property for at least 3 to 5 years. Why? When a rental property is sold all deprecation must be 'recaptured' (added back to your basis). A previous cost segregation will result in a larger 'recapture' upon sale and could catch an unknowing taxpayer by surprise.

Want to learn more?

Schedule a consultation with us where were will evaluate your current rental property and provide you with an analysis to help determine whether a cost segregation is best for you.

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3November2023