Don't Shortcut the Cost Segregation Analysis - The Results can Be Expensive

A true Cost Segregation Analysis is a detailed engineering-based study performed by trained valuation professionals. When performed properly, the tax savings pay for the cost segregation fee many times over. Filing a tax return that is based upon past results and not on a unique analysis of the subject property(ies) can lead to a rejection of the analysis as well as fines and penalties, as you will see below:

1. **"Rule of Thumb" and other unsubstantiated allocations between personal property vs. real property are not permitted.**

   Ronald Pearce and Daryl Pearce v. Department of Revenue, State of Oregon (10/31/2011) - *the tax court disallowed the plaintiff's internally prepared Cost Segregation study. Citing the IRS's Cost Segregation Audit Technique Guide, the court described the "Rule of Thumb" methodology as insufficient, "lacking sufficient documentation to support its allocation of project costs".*

2. **In an acquisition, have the Cost Segregation done prior to finalizing the purchase and sale agreement -or- provide "wiggle room" in the contracted purchase price allocation (PPA) for a future Cost Segregation.**

   Peco Foods, Inc. & Subsidiaries v. Commissioner of Internal Revenue (1/17/2012) - *the court disallowed a Cost Segregation done subsequent to a PPA. The asset acquisition contract specified an agreed allocation between buyer and seller. This included categories such as "Processing Plant Building" and "Machinery and Equipment". The court disallowed a subsequent Cost Segregation study that tried to further allocate the "Processing Plant Building" category, arguing that (1) this would allow a tax whipsaw, (2) the PPA agreement would overrule any other allocation analysis, and (3) the PPA categories listed were clearly defined and thus do not need further analysis.*

3. **Costs related to replacement of building components should be capitalized, but taxpayers may take a retirement loss on the replaced components.**

   Temporary Regulations Deduction and Capitalization of Expenditures Related to Tangible Property (12/27/2011) - *the IRS provides new guidelines regarding the treatment of expenditures related to building components. For improvements related to HVAC, plumbing, electrical escalators, elevators, fire protection & alarm, security, and gas distribution systems, the improvement tests (betterment, restoration/ replacements, adaptation) should be applied separately to each component rather than the building as a whole. This will likely result in more frequent capitalization of these costs, rather than their expenditure. In addition, the remaining value of building components that have been replaced may be retired.*

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