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DID YOU KNOW?

Did you know you can take a current deduction for 'catch-up depreciation' on under-depreciated assets?

Sophisticated taxpayers will commonly commission a cost segregation study with respect to the acquisition of significant depreciable assets, such as real estate. This allows the taxpayer to take greater depreciation deductions sooner.

Commercial real estate is depreciable over 39 years and residential real estate is depreciable over 27.5 years. By contrast, land improvements (e.g., landscaping and sidewalks), are depreciable over 15 years; HVAC and certain other components are depreciable over seven years; and flooring (carpet, floor covering, etc.) is depreciable over five years. A cost segregation study allocates the cost of a building among these various components and greater depreciation deductions can be taken. For example, the cost attributable to the HVAC unit can be deducted over seven years rather than 39 years.

That sounds great, but what if a taxpayer has depreciated property for 10 years before it discovers the opportunity to use this depreciation methodology? They can still do a cost segregation study and deduct the difference between the depreciation that they actually deducted and the depreciation that they could have deducted. This can be done by filing Form 3115 Application for Change in Accounting Method. It is not necessary to file amended returns for the prior affected years. Moreover, the statute of limitations on amended returns does not limit the years for which depreciation can be deducted. A taxpayer can re-calculate the depreciation going back 10 or more years and take a current deduction for "catch-up" depreciation.

It is important to consider all the consequences of filing Form 3115 to change the method of accounting for depreciation. For instance, catch-up depreciation may need to be re-captured upon sale. The use of a cost segregation study methodology could convert real estate depreciation recapture (taxed at 25%), into depreciation recapture (taxed at higher ordinary income rates).

Bottom Line: If a person did not take advantage of a cost segregation study to enhance their depreciation deductions, it may not be too late – even if they have owned property for many years.

"Too much of a good thing can be wonderful." – Mae West

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