

Action Item:

If less than 20% of the cost of your building is allocated to 5, 7 or 15 year property, you are probably over paying your taxes.

Did you know that most commercial real estate owners overpay their taxes? When asked to perform a tax review by a non-client, we often find that the short-life property is not properly classified which results in less depreciation deductions (and a higher tax liability). Often these same properties are also over-valued for property tax purposes.

The good news is that you can retroactively capture those lost depreciation deductions by doing a “retro” cost classification study.

What is a retro cost classification study?

A retro cost classification study is a study that is performed for a facility that was purchased, built or renovated in a prior tax year. Filing for a change in accounting method, taxpayers can catch-up their previously understated depreciation deduction in the year of change.

Turnkey construction projects include elements of tangible personal property (e.g., phone system, computer system, etc.) that are §1245 property that can be depreciated over 3, 5, 7 or 15 years. The first step is to identify these items as §1245 property and allocate a portion of the total project costs to them. Digging deeper, however, a cost classification study may also report certain building occupancy items, such as carpeting, wall coverings, partitions, millwork, lighting fixtures, suspended ceilings, doors, etc. as §1245 property. Also potentially eligible for reclassification are land improvements such as sidewalks and parking lots. These items may or may not constitute qualifying §1245 property depending on particular facts and circumstances. A typical office building could see between 20%-40% of its costs reallocated to short life property. Another great tax planning strategy for facilities placed in service during 2009 or 2010 would be to perform a cost classification study and elect 50% bonus depreciation on any short life property identified. This would allow the taxpayer to deduct over half of the cost of short life property in the first year. Rest assured that our report conforms to IRS guidelines for proper documentation of the property, methodology, and firm experience in preparing these studies.

Case study

A professional services company purchased an office building six years ago at the cost of \$1.5 million. After performing our analysis, we found that over 25% of the total cost should be reclassified as §1245 property and depreciation had been underreported by over \$380,000. By filing a change in accounting method, the deduction translated to over \$130,000 in tax savings! The added bonus was that the same property was over-valued for property tax purposes, and when we shared the properties income with the assessor’s office, we were able to negotiate a \$4,000 per year property tax savings!

This article was written by Mike Bosma, CPA and Jack Buice, a staff accountant at Bosma Group. Mike Bosma founded Bosma Group, a CPA firm dedicated to serving closely held growing businesses. Bosma Group is the ONLY CPA firm in Northern Nevada that specializes in Cost Classification Studies. Contact Mike at 775-786-4900 or by email at mbosma@thebosmagroup.com



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