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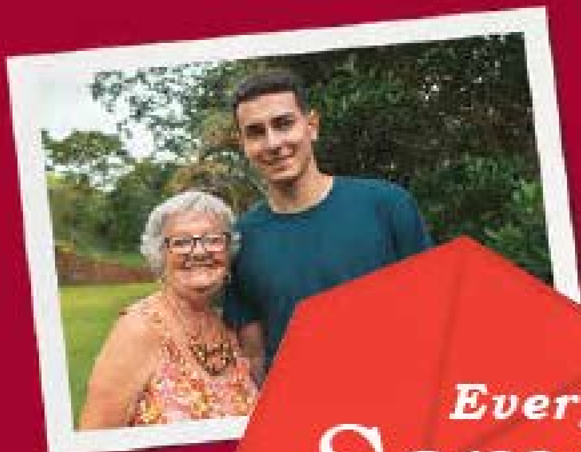
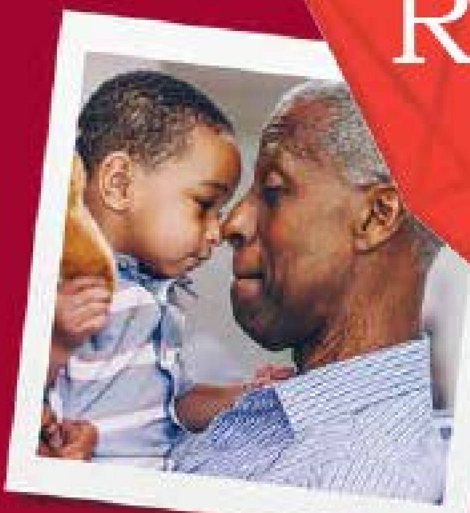
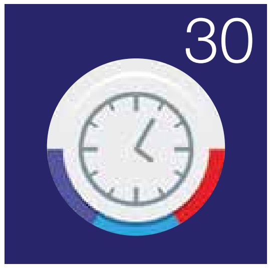


Everyone Has

Someone to Remember

While the means of memorialization may have shifted, our need as people has not.





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Capturing Tax Benefits

When is the best time to take advantage of a cost segregation study? The answer may be before you file your 2020 tax return.

BY GREG PERKINS

Never in income tax history have more benefits been available to owners of depreciable real property such as funeral homes. And never has cash flow been more important than in this unusual economic climate.

These benefits have come from changes in legislation. Cost segregation came about in the late 1990s, with the Tangible Property Regulations (TPR) in 2014, the Tax Cuts and Jobs Act in 2017 and the CARES Act in 2020. To receive these income tax benefits for tax year 2020, you have until you file your tax return, whether on time in March and April 2021 or with an extended return in September and October 2021.

Cost segregation has been a very worthwhile procedure in itself, but it got even better with the above legislations. It is the method of identifying, classifying and quantifying building components that allows an owner to accelerate depreciation and generate additional cash flow through income tax deferral. An engineering-based cost segregation study, with its delineation of component detail, is the basis for allowing the business owner to capture many of the tax savings opportunities, and it helps to maintain compliance with tax regulations moving forward.

THE TANGIBLE PROPERTY REGULATIONS, or Repair Regulations, was the largest single change to the U.S. Tax Code in 30 years. While many tax professionals are primarily concerned with compliance – adopting and electing various aspects of the regulations – there are various income tax benefits in these regulations that many tax professionals and their clients are still not taking advantage of – and some are time sensitive.

The 2014 regulations set the standard for whether a purchase or expenditure is to be expensed or capitalized. There were several safe harbors (de minimis, small-taxpayer, routine maintenance, etc.) put into place. For smaller expenditures, these safe harbors determine the course of handling. For medium to larger expenditures, determination is made by applying RABI standards (restorations, adaptations, betterments and improvements) and considering the significance of ratio analysis outlined through many examples in these regulations.

If an expenditure is not deemed a restoration, adaptation or betterment, then essentially, the expenditure has to be compared to the replacement cost of the appropriate building system within the applicable unit of property (building). If the ratio is 30% to 35% or less, the expenditure generally can be expensed as insignificant, regardless of dollar amount. Percentages greater than this are determined to be significant and must be capitalized on the depreciation schedule.

If a cost segregation study or a building systems valuation has not been conducted, the tax professional cannot calculate this ratio and may end up capitalizing an expenditure over 39 years that otherwise could have been expensed – this is a significant difference!

The TPR also provide that many building owners, depending on their situation, may now reverse previously capitalized costs and expense them in the current year by applying the 2014 regulations to prior years. If you've made various renovation/repair expenditures in the past and at the time it the proper action was to capitalize those dollars, you are allowed to take the TPR rules backward. If, under the TPR rules, you could now have expensed the item, you are allowed to expense in the current year the undepreciated portion of the cost basis.

For current-year application, the TPR also allow you to write down the basis of what you disposed of and the costs for the removal and disposal of those items. This is called partial asset disposition (PAD). You can receive a tax deduction in the current year, but it's a use-it-or-lose-it opportunity. Fail to capture it in the current tax year, and you lose the ability to write it down. Both capital-to-expense reversals and PADs yield a permanent tax savings at the time of sale by reducing recapture costs. Determining what can be reversed and what can be written off as disposed is a valuable quantification service provided through cost segregation services.

THE TAX CUTS AND JOBS ACT held several key elements for property owners as well. Bonus depreciation was not phased out and was increased from 50% to 100% for properties acquired or built after September 27, 2017, and it applied to both used and new properties. Bonus eligible property must have a depreciable life of 20 years or less – items a cost segregation study identify. Previous categories of qualified leasehold improvements, qualified retail improvements and qualified restaurant property were all replaced with qualified improvement property (QIP). QIP refers to interior improvements to a nonresidential building for a "trade or business," with some minor exclusions. With the CARES Act, QIP now qualifies for 100% bonus depreciation, as well as Section 179.

Section 179 expense limitations doubled from $500,000 to $1 million, while the phase-out limitation was increased from $2 million to $2.5 million and adjusted annually for inflation. The law expanded the definition of qualifying property eligible for Section 179 to include roofs, HVAC, fire protection and alarm systems, security systems and QIP if these improvements are made to nonresidential real property and begun after the building was placed in service for its intended use. Section 179 still includes tangible personal property such as furniture, fixtures and equipment (FF&E).

THE 2020 CARES ACT alone may be the single biggest reason to take advantage of cost segregation for 2020. Amid the pandemic, a little-known CARES Act provision offers a considerable cash flow windfall for non-passive building owners. The CARES Act provision allows some building owners to get a federal refund on their individual tax return from the past five years. The net operating loss carryback provision has been overlooked during the grab for PPP loans and could be a valuable "lifeline" for some funeral homes, depending on how their real estate is owned.

The CARES Act allows for a five-year carryback of net operating losses (NOL) in 2018, 2019 and 2020. An NOL is created by having more expenses than income. If you find yourself in this situation, you may have gotten there different ways. You may have a "true" NOL due to a legitimate operating loss or it could be a "paper" NOL from acceleration of noncash depreciation deductions. Either way, getting refunds from past profitable years may be life sustaining.

If you've more deductions than you have income, the CARES Act allows you to go back five years and apply those losses to income from a previous year. The result is a refund in the current open tax year. Speak with your tax professional about NOL carrybacks and whether you qualify for this benefit.

A cost segregation study speeds up your building's depreciation, which is a noncash deduction. Its purpose is to help you defer income taxes through faster deductions. Prior to the CARES Act, if these significant deductions created a loss, that had to be rolled forward into a future year. A cost segregation study now allows certain non-passive owners to create an NOL and obtain a refund based on the new CARES Act rules. Instead of rolling the extra cost segregation deductions forward, you may now have the option of rolling them back to obtain a more timely and substantial refund. A no-cost analysis could quantify and shape your 2020 tax planning.

Again, never has cash flow been more important than in this unique year of 2020. A cost segregation company is a valuable strategic partner supporting you and your tax professional in maximizing your income tax benefits and assisting in helping you better make an expense decision, which is your first priority. If an expenditure can't be expensed and must be capitalized, a cost segregation company's role is to identify and quantify what can be written off in the fastest manner.

Why would anyone want to depreciate their entire funeral home over 39 years when a beneficial portion can be written off in five, seven and 15 years? Also, all of these currently qualify for 100% bonus depreciation and can be written off immediately! Don't miss the benefit in 2020 if you have owned your funeral home for 15 years or less or you have significantly improved your facility within that timeframe. A free analysis is available to quantify your missing benefits. ≣

Greg Perkins was a banker for more than 30 years and is an 11-year consultant with Cost Segregation Services Inc. He and partner John Scoble specialize in supporting the funeral home industry as a primary focus, while also assisting many other types of depreciable properties in 34 states to date.