EPISODE 1053

[INTRODUCTION]

[0:00:01.6] ANNOUNCER: Welcome to The Real Estate Syndication Show. Whether you are a seasoned investor or building a new real estate business, this is the show for you. Whitney Sewell talks to top experts in the business. Our goal is to help you master real estate syndication.

And now your host, Whitney Sewell.

[INTERVIEW]

[0:00:01.6] WS: This is your Daily Real Estate Syndication Show. I am your host, Whitney Sewell. It's that time a week and get where my business partner, Sam Rust, takes over the show and interviews our guest. I hope you enjoy the show.

[0:00:28.7] SR: This is Your Daily Real Estate Syndication Show. I'm your host, Sam Rust. With me today is Eric Oliver... Eric has been with the cost segregation authority for five years, helping real estate investors save millions of tax dollars. Eric speaks at a variety of local regional national events on cost segregation and other tax saving strategies, and brings a passion for identifying cost savings and educating commercial real estate owners on the benefits of cost segregation. Eric, thanks for joining us today.

[0:01:32.5] EO: Yeah, thanks for having me. Appreciate it.

[0:01:32.5] SR: So talking before we started here, Eric, but maybe we could give our audience just a little bit of a flavor for what cost segregation is, I think most folks know, so maybe we keep it a little bit on the reefer side, but what are we trying to accomplish by using cost segregation as commercial property owners, so congregation, really what we're doing is we're accelerating your depreciation deductions, so a lot of us get into real estate, not the only reason, but some of us get into real estate for the tax benefits.

[0:01:32.5] EO: So every time you buy a commercial property, you get to appreciate that property over 27, 15 for residential type properties or 39 years for commercial properties, and you get the tax deductions of non-cash deduction depreciation, and you basically on a, let's say an apartment building, you're gonna get 1 27th of that every year for the next 27-12 years, and so instead of waiting 27-15 years to realize the deductions, oftentimes, people will do a cost segregation study on that building to accelerate those deductions into current years. And the way we do that is we segregate out different components of your building, whether it's five, seven or 15-year assets, and you get to depreciate those over a much shorter time frame, for example, five-year assets are things like carpet, counter tops, cabinets, light fixture, a certain light fixtures, then you've got your 15-year assets, which is your land improvements, and so by segregating those components out of your purchase price, you're able to accelerate those deductions at a much faster rate and realize those gains that are much faster rate by doing a cost segregation study. So it's kind of a quick overview.

[0:02:37.8] EO: Let me know if you want me to go into more detail, but yeah. That's fantastic. And I think something that's important to point out, conceptually, it's investors, we talk a lot about IRR, internal rate of return, which takes into account the time value of money. It seems like I can't go an hour without seeing some inflationary article pop up across my screen, and so there's really true value in delaying taxes, even if you're planning on selling this property in just a couple of years, being able to capture those tax savings today. Invest those dollars or use those dollars for your business, it's gonna yield dividends down the road yet, and as inflation continues to be on the rise, and one of the questions that I get asked quite often by folks maybe in the smaller commercial space, Eric, is how small is too small for cost segregation, and I know there's different opinions on that, I know several fix and flippers that are exploring doing cost segregation even though they're not holding the assets for all that long, maybe it's a higher end flip where they're holding a project for nine to 12 months, but they are crossing that magical calendar, your barrier, what are some good rules of thumb for our audience who maybe you're doing smaller commercial projects, 20 doors and under fix and flips anything maybe under...

[0:03:50.1] EO: Call it 3 million and purchase price. So I like to look at anything over 100, 000, especially with the current tax laws the way they are, when conservation first came out, it was 10-15000 to do these studies and you had to have a million, two million asset for the pencil out. But nowadays, with the bonus depreciation, which we can talk about quickly, but bonus depreciation, basically, with the Trump tax cuts and jobs act, Trump raised the bonus depreciation to 100% bonus, so any assets purchased or built after September 27th of 2017 are eligible for 100% bonus. And so that really put cost segregation almost on steroids and said, Okay, now it even applies to more people, because now I wanna say a by 150000 single family rental home, I take out 20000 for land value, that gives me 130000 a depreciate basis. If we do a contact study on that and we can segregate out, let's say we typically secrete somewhere around 30%. So 30% of 130 is 39000 of deduction. Take that 39000 times your tax bracket, if you're in a 30% tax bracket, you're now looking at close to 10000 of tax savings, and so a study like that on a single family residential might cost you 2000 to get the study done, but you're gonna save 10000 in taxes, the first year.

[0:05:18.7] EO: And so for me, in the past, 150000 property may not have been a good candidate for cost segregation, but now we look at it, we say, Okay, well, did you purchase it after that magical September 27th, 2017 date, and if you did, maybe it's eligible for bonus and so it kinda depends on a number of factors, how long you've held it, when you bought it, what you paid for it, but we wanna look at anything over about 100000 and see if their significant tax savings there, so I know there's some different opinions in the industry some companies won't look at anything over 500000, or even some companies that won't look at anything under a million, but we don't make a ton of money on single family rentals, to be honest with you, but from an investor's standpoint, 10000 tax savings, if I have to pay 2000 to save 10000. I'll do that all day long. So that's a pretty good ROI, what has driven the cost of the segregation study itself down so much over the last 10, 15 years? That's a great question. What I think is education, just people being aware of people like yourself putting this information out there, a lot of investors, I can't tell you how many...

[0:06:23.3] EO: Especially when I first started, this was five years ago, when I first started, I would meet with cpas who had never heard of cost segregation, and so they weren't offering it to any of their clients, and so just the education, I think has been a huge impact on driving those costs down, and then also with the bonus depreciation, with the Tax Cuts and Jobs Act, I think there's a lot more players in our industry, and so we've seen the costs come down significantly since the Tax Cuts and Jobs Act. And then the third would just be technology, all the conservation companies have become more efficient, and so we're able to reduce the amount of time it takes us to do the studies and pass that savings on to the client. So I think those are the big factors. But yeah, anything under 100000 is worth looking at. It doesn't mean it's gonna make sense to move forward on, but you should at least have some numbers run, most cost segregation companies will run you a free benefit analysis before you ever engage them, but before you ever have to pay anything, and so have the numbers run so you lease to have the information and say, Okay, does this make an impact in my tax return and should I move forward on something like this? So as you alluded to, Eric, there's a lot of cost segregation providers out in the space, I think there's a big educational component, there's a lot of people that are waving the flag of cost segregation, so to speak, but that leaves the consumer, the investor or the person who's going out and finding these studies may be a little bit overwhelmed, what are some good questions to ask when someone's looking to select a cost segregation provider, what do you find is a good differentiator of quality and overall experience?

[0:07:54.1] EO: Firstly, I just find out how long they've been in business.
I think that is key. It's interesting, we see a lot of competitive situations, we're get in with clients where they're looking at multiple providers, and it is hard, I will say it is hard for the average investor to look at the benefit analysis from three different companies and make sense of it, you're very rarely comparing apples to apples, so I'll ask... The client will say, Hey, just show me what the competitor is giving you, and I'll let you know whether or not we're comparing apples to apples, for example, some companies don't include all the tax paperwork that is required to submit these... There's a 3115 tax form that is required on some studies when you submit these with your tax return, and so I see vendor A, it might be a little bit less expensive upfront, but they're not providing this nine-page tax form that your CPA is gonna charge at 1200 to compile. And so you're not always comparing apples, you might save 1000, but then you're gonna pay your CPA 1000 more for preparing the tax form. So piling the 3115 tax form is important. The other thing I would say is, look for audit support.

[0:08:56.3] EO: There's a lot of low-cost providers out there who don't provide on IT support, or they will provide it, but it's for a fee, so meaning if you're ever audited or anyone ever questioned your cost segregation study, they're gonna require you to pay money to defend that study. So a lot of the larger companies provide free audits, and so that's something to look for, and then like I said, look for experience, we've re-done studies for other firms where the other company might only segregate 15% of the purchase price, so meaning if you buy a million dollar asset, they're gonna basically say, 150000 of that asset is short-term assets, so you get to take that 150000 reduction if you're in a 30% tax bracket, you're gonna save 45000 in taxes. We've got tires on that same building and found 30% segregation, which means you're 45000 tax savings just became a 90000 tax savings. So it's very same. You would think that it's a science and everything, the numbers would be the same no matter who did it, but it's just like if you were to take your tax return to five different cpas, you're gonna end up owing five different amounts depending on their interpretation of the law, their experience, there are a number of different factors that will make some tax return more than others, and so that's the same thing with cost segregation.

[0:10:08.8] EO: You get what you pay for. Let's just leave it at that. So I don't wanna go with the lowest cost provider, you wanna make sure that they're competitive, but I would say don't always go with the lowest cost provider because you're probably getting a lower in quality study. So look at their experience, look at how long they've been in business to make sure that they provide out-of support, and those are really the main factors when picking up co-segregation provider.

[0:10:08.8] SR: So here on the real estate syndication show, we talk primarily about multi-family, we have some self-storage, maybe some single-family investors here and there, but there's a lot of other classifications of real estate beyond just self-storage and multifamily, you've got office, you've got retail, you've got medical warehouse, industrial. I'm curious, just as a kind of a broad overview, I've heard cost segregation works in all the different areas, but I'm sure there's a range of outcomes where is maybe cost segregation the most efficient and the least efficient across the different asset types that you've seen...

[0:10:08.8] EO: Yeah, you know, I would say, which is good news for your audience, is that the multi-family tends to be the higher, there seems to be more a personal property in apartment building, you think about there's a lot of countertops, there's a lot of cabinets, a lot of appliances, ceiling fans, carpet flooring, those type of things, versus as a warehouse where you might just have an empty space, so multi-family is a good category, self-storage is a good category too, because of the land improvements, so oftentimes you've got a lot of curbs, gutters, asphalt concrete, depending on the type of storage unit supporting together, and then mobile home parks are also a good category, depending on the type of...

[0:11:43.3] EO: The mobile home park owns the homes or the people on the handles are some factors there, but mobile hard parts can be a great category as well, but usually we're finding somewhere between... You should get on the asset somewhere between 20 and 35% saturation, and so your multi-family is gonna be closer to that 30-35, and then your industrial warehouse is gonna be on that lower 20, but if you're getting less... If you've done a constant study and you've got less than 20% segregation, definitely have somebody else look at it because you shouldn't be getting at least 20% segregation on any type of asset unless there are some weird circumstances, but it's usually between 20% and 35%, depending on the asset class. Excellent, and then something that's not talked about a lot, Eric, and I'm curious for you to kinda step through this, but we often talk about completing the study, Realizing those benefits in year one, but then there's depreciation recapture on the back end, so a typical project for a syndication group might buy a multi-family property, realize the savings through cost segregation upfront, hold the project for five years.

[0:12:44.4] EO: What does that recapture process look like at the end of a five-year hold using simple numbers. Great question, I'm glad you brought that up 'cause that's a question we get quite often as well, if I have to Annette appreciation back. So why would I wanna front low a huge number. I don't know, I'm just gonna have to pay that all back, and the answer is no, you don't have to pay it all back, and you're paying it back in the lower rate. So let me just kind of walk through this. Do you buy a property today, you do a concert study, I'm gonna create a huge depreciation number that you get to take against your current income, you're gonna take that against your ordinary and can rate... So let's say I'm in the 37% tax bracket. I'm going to take that against 37% income, if and when I pay that back... So let's say I hold it for five years. I've done a contact study, I'm gonna pay a portion of that back in five years, and the reason I say a portion of that back is because remember in our contact study, we identify five-year assets, so how much is your flooring worth...

[0:13:42.8] EO: Your flooring is a five-year asset, what is the book value if you're flooring after five years at zero, you've owned it for five years, you fully depreciated it, you don't have to pay re-capture on that, the recaps a low state, you pay recapture on the amount of depreciation, you've taken or the gain on the cell, and this is where the light kinda goes off for cpas when we're talking with cpas, but what is the game... What is the value of my carpet after owning that carpet for five years, I'm not selling it for a gain, right. It's not worth more. It's dirty, it stained, it's five years old, it's not worth more than what it was when I bought it, and so you don't pay recap those five-year assets, so yes, you do have to pay recapture, but you're paying it back on a lesser amount and at a lower rate, so when you sell it, you're shifting it over to a capital gangrene of 20% or 15%, so you're taking your deduction at 37% and picking up a portion of it at 20% and saving the spread. And so, like I said, if you don't do cost segregation, what ends up happening is, let's say I buy a property for a million and I sell it five years later for 2 million.

[0:14:47.6] EO: You're telling the IRS that everything in that building, they'll land the walls, the dirty old car, but everything doubled in value, you're saying you're dirty old carpets were double today versus what you bought in four or five years ago, and that's just not the case. Your personal property depreciate, it goes down in value. It doesn't appreciate... And so, by doing a cost segregation study, it allows you to allocate the sales price to the right buckets, for lack of a better word, your five-year stuff isn't going up in your land and your walls went up in value, but your five-year dirty old carpet certainly didn't go up in value. And so you're being able to take that out of the recapture, and that's where the tax savings, so you're saving, you get the time value of money on the front end, and then you're reducing your recapture on the back end by being able to pull out some of that stuff that's fully depreciated, depending on how long do you own the asset, obviously... Sure. Using an example, if you bought a property for 10 million, you had 2 million in personal property. Let's say, which hits that 20% threshold, but then you hold it for the five years, you're knocking down a lot of what you're gonna end up paying and recapture because you can allocate your sales price, let's just say it was 13 million.

[0:15:56.2] EO: You grew by 3 million over that time span, you can allocate that gain outside of the personal property bucket... That's exactly right, yep. You're not putting that gain to your dirty old car, but your dirty carpet didn't go up in value, your land and your walls went up in the name, so you're shifting it from ordinary game to down to capital gains at 20%, so you're paying it back at 20%, but you're taking the deduction against income at 37%, possibly, depending on what tax bracket you're in and saving to spread. That makes a lot of sense. That's very interesting. So throughout this conversation, Eric, you've referenced the capital gains rate of 20%. Here we are, the year of our Lord, 2021, or in the summer time. Nothing has happened yet. There's a lot of rumor. There's a lot of smoke coming out of Washington, what they're gonna do to the capital gains rate, to the tax code in general. What, if anything has affected the cost segregation process since it has taken office, and what if anything do you see coming down the pike over the next six to 12 months that might affect this process? That's a question we're getting a lot now, is how has the new administration can affect my tax rates and my capital gains if I were to sell these properties? So the first thing to consider is there is discussion of eliminating light kind exchanges or 1031 exchanges on real estate games greater than 500000.

[0:17:13.7] EO: And so if you buy a property for a million and you sell it or it's valued at 2 million, you may no longer be able to exchange that and defer your tax bill, and so consecration could be more important because now you've got a has... If you've got other assets, you constants other assets, lower your taxable income, and now you're below that threshold so that you may be able to offset those gains. That's the first thing. The second thing is individual rates, they're talking about increasing those to 396% from the highest bracket right now is 37%, so again, what that does from a conservation standpoint is now instead of saving, if you're that highest tax bracket, you're now saving 3-96% in taxes versus 37. So you're getting an extra 26 in tax savings essentially by doing a cost take study. Now, if you're in a state where you've got high state rates like California, you're saving obviously significantly more, but the value of doing a contact study, if that were to go through just went out by 26%, your tax savings is going up, and the other thing that I would look at...

[0:18:19.6] EO: Or that there's discussion on is no longer being an advantage of the step-up in basis upon death. So right now, if I own a million dollar property, I bought a property for a million, I die, the property is now worth 5 million, and I handed that property over to my son in the current world, they get a step up to the 5 million and pay no taxes under some of the stuff that's being talked about in Washington, that step-up goes away, and now all of a sudden my hairs have to pay taxes on that 4 million gain in that scenario. And so my son, who doesn't have that kind of money, all of a sudden he... And here it's a property, it has to come up with a huge tax bill, Chancellor's gonna have to sell the property or find another way to pay for that tax bill, so that's some things that are being talked about, so there's some interesting scenarios where you can use cost segregation to get you out of those, to manage your tax brackets, to get you out of those higher tax practice gets you into some lower tax brackets and save significant tax dollars.

[0:19:17.7] EO: So we'll see what happens. Like I said, this is the stuff that's being proposed right now, they still have to agree on it and vote on it, which will be a little bit harder, I think, but we know for sure we're gonna be paying more taxes, how that's gonna come... We don't know, but chances are next year at this time will probably be paying more taxes than we are this year, and so just a... Segregation is extremely flexible, meaning I buy a property in 2021, I don't necessarily have to do the cost take study in 2021, if I don't have a big tax bill or I think the tax rates are gonna be higher in 2022, you hold off and do the constant study in 2022 and off-set your 2022 income. And so cost segregation is one of the few tax planning tools that is extremely flexible and kind of leave it your back pocket and say, Okay, where do I wanna play this card? I wanna play it when the tax reach are the highest of my income is the highest... And you have the flexibility to do that. So in saying that, I'll just give a shout out to the cpas out there because having a good CPA who understands these rules, who has a good CoStar that they work with, makes a huge difference.

[0:20:21.7] EO: I see the gamut, I've seen... It's amazing how much money people pay in taxes where they don't have to because they have a CPA who maybe is not necessarily well-versed on real estate or doesn't understand the real estate law and how you could play these different pieces together to save tax dollars. So get yourself a good real estate CPA, good cost segregation provider who works hand-in-hand with your CPA so that you can reduce your tax liability, 'cause we are gonna be paying more taxes here in the coming future up one of the few certainties in life death and taxes, right? Excellent, well, thanks for joining us today, Eric, where can people find out more about what you're doing over at cost segregation authority? Yeah, so you can go to a website, www.costsegauthority.com. You can reach me, my email is just Erik@costsegauthority.com. I'll give you my cell phone number is 60-2-5-6, 8-0-0-32. Feel free to call me if you have any questions pertaining to depreciation or real estate taxes, we see a lot...

[0:21:29.3] EO: We work with cpas all over the country. We see kind of what's happening. What's on the cutting edge? Don't call me and ask me about child tax credits, I can't help you with that. But please use us as a resource for anything depreciation related. We're happy to help, we're happy to jump on a call with your CPA to walk through this process, see if they have all your information. And so we wanna partner with cpas early in the process and say, Okay, does a congregation for fit for this client? How much can they save? CPA, have you thought about looking at it from this standpoint? Or from this standpoint, so we wanna partner with your CPA to do figure out if you can't save tax dollars, so again, feel free to call me, email me, visit our website. But those are the best ways to get a hold of me. Fantastic, well, thanks again, Eric, thank you listeners for joining us today on another episode of the real estate syndication show. Have a great rest of your afternoon.

[0:22:20.6] ANNOUNCER: Thank you for listening to The Real Estate Syndication Show, brought to you by Life Bridge Capital. Life Bridge Capital works with investors nationwide to invest in real estate while also donating 50% of its profits to assist parents who are committing to adoption, Life Bridge Capital, making a difference one investor and one child at a time. Connect online at www.lifebridgecapital.com for free material and videos to further your success.

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