

# Cost Segregation Study Could Save Big Bucks for Clients, Says FAE Speaker

## N.Y. Tax Department May Create Taxpayer Advocate Position

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**W**alls last longer than wallpaper. It may sound obvious, but in the tax world, distinctions like these require the skills of a CPA—and the savings for clients can be tremendous.

Through cost segregation studies, which separate personal or “real property” and real estate assets, some assets—wallpaper or carpet, for example—can be reclassified to have their depreciation time shortened for taxation purposes.

The topic was hotly anticipated at the FAE’s Tax Planning for Individuals Conference in August. It’s what brought Society member **David Shulman** back to the conference this year.

“After taking this class, I was able to get my client a tax credit for \$700,000,” Shulman said. “He’s a wealthy man as is, but he was happy with the results.”

Jerome H. Kootman, founder and managing director of New Jersey-based valuation consulting firm Cost Recovery Solutions, described cost segregation studies as a blend between engineering, taxes and accounting. They accelerate deprecia-

tion deductions to save tax dollars now, rather than later, he said. For property owners, it can free up cash for reinvestment in other projects.

“Because as we all know, cash is king,” Kootman said.

An engineer can determine what elements of a building are not actual structural elements, such as the electrical system, decorative millwork and certain flooring. Typically, 15 to 40 percent of the overall cost of a building can be reclassified, Kootman said.

Structural elements, such as walls, are expected, for tax purposes, to depreciate within a 27.5- or 39-year period. Other less permanent aspects of the real estate, such as wallpaper, have much shorter depreciation periods. Wallpaper, Kootman said, would get a 5-year depreciation period.

Substantial savings are often realized immediately. For example, Kootman said, if a property owner has a \$2 million apartment building, and after a cost segregation study, 29 percent of the assets are reclassified, it could save that individual \$20,000 in a single year.

Cost segregation studies can also be applied retroactively as far back as 1987, he said.

What items are typically reclassified?

Among other things, the list includes decorative millwork such as cabinetry and moldings, certain types of flooring, food storage and preparation equipment hookups, floor drains, telephone and data systems, dock levelers and bumpers, fences, retaining walls, landscaping and lighting.

The Economic Stimulus Act of 2008 included some changes in the arena of cost segregation, including an increase to \$128,000 in the Section 179 deduction. It also brought back a 50 percent bonus depreciation for assets constructed and placed in service in 2008, “to provide relief to taxpayers and provide financial incentive to encourage capital spending,” Kootman said in his presentation.

The conference also provided tax tips for preparers with clients who may have loftier pursuits.

### Taxes and Taking Flight

The nation watched in late November when executives from the Big Three automobile manufacturers in Detroit appeared on Capitol Hill to plead for a \$25 billion bailout to avoid bankruptcy. California Rep. Brad Sherman made headlines when he began questioning the executives about their private jet use:

“I’m going to ask the three executives here to raise their hand if they flew here commercial,” said Sherman, a Democrat. “Let the record show no hands went up.”

“Second, I’m going to ask you to raise your hand if you’re planning to sell your jet, in place now, and fly back commercial,” he continued.

“Let the record show no hands went up.” The CEOs’ travel accommodations were seen as ironic because they were asking Congress for billions in taxpayer money. But in reality, many CEOs travel by private jet. And with that use comes a special set of tax considerations.

Ari B. Good, an attorney with Good Attorneys at Law, P.A., who specializes in providing legal and tax advice to the general aviation community, compared the tax obligations of private jet ownership to a five-layer cake. The top layer is the federal income tax, followed by state sales tax, state property tax, Federal Aviation Administration (FAA) regulations and the federal excise tax.

Good was joined at the conference by Walter Kraujalis, president of the aircraft sales and consulting firm AeronomX, to detail the differences between business and personal use of company-owned aircraft and the possible tax implications.

Good and Kraujalis provided a comparative pricing chart, using a Learjet 60 for a five-year period. According to their presentation, sometimes owning a Lear jet is cheaper than chartering one. Although the prospect of leasing or owning a plane can be costly, Good encouraged the audience to

always keep potential deductions in mind.

Fractional ownership could be a possible avenue for a federal income tax deduction. Fractional ownership is defined as the ownership of a minimum of 1/16 of the value of the plane, and in those cases, expenses, management and operation can be deducted, according to Good and Kraujalis’ presentation.

In order for a plane trip to be tax deductible for business purposes, 50 percent of the seats must be occupied by business passengers and their spouses or children. Good said that if a gray area exists, such as a trip that is for both business and personal use, it should be handled for tax purposes as a personal flight.

Reconciling the differences in definitions between the FAA and the IRS for the term “taxable transportation” is another important consideration, Good said, because it could determine whether the federal excise tax applies. The location of the aircraft when it’s not in flight is also key in determining state property tax for plane ownership.

### New York State Taxpayer Advocate?

Speaking during the conference luncheon, New York State Department of Taxation and Finance Commissioner Robert L. Megna said that New York state may soon have its own taxpayer advocate.

That pending legislation would establish an Office of the Taxpayer Advocate within the state tax department, with an advocate appointed by the governor and confirmed by the state Senate. Although the advocate would report directly to the commissioner, Megna said his office would have no authority over the office itself, including its staffing and budget.

At the conference, Megna also outlined his office’s budget and discussed several pieces of recently enacted legislation, including several new tax credits, brownfields reform and a new requirement that tax preparers provide clients with a Consumer Bill of Rights.

Megna, even in August, was also ready to call the current economic climate a recession—both at the federal and state levels. He said that while the national economy was receding in March, it had become apparent months later that New York state would follow suit.

He said in his presentation that forecasts are “unable to predict [the] exact duration of the recession, but if history is any guide, there should be little cause for optimism.”

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