Real Estate Investors Take Advantage of the IRS…

Residential real estate investors can financially benefit (dare we say profit?) from using this tax strategy.

Tax Talk

Real estate investments are often attractive because of their ability to create passive income and simultaneously provide tax benefits. But sometimes, the property is not cash-flow positive. Sometimes the tax benefits provide a small cushion when what you're looking for is a body-sized down pillow. Instances like these call for new methods. In the economic terrain of investment real estate, while many paths are already charted and developed, there is another older path, much less trodden and ready for exploration.

Old Code, New Investors

The IRS allows an accelerated depreciation on personal property in your income-producing residential real estate. The term "accelerated depreciation" basically means that you can receive tax credits on a 5 year schedule (that's the "accelerated" aspect) for those items in your investment property that wear out or get worn down (there's the "depreciation").

The IRS has always allowed these deductions[1], but they certainly have not advertised them. Most people know that commercial investors depreciate nearly everything under the sun, and this fact may cause some furrowed brows among residential real estate investors. If commercial property gets depreciation deductions based on their income-producing status, then why can't income-producing residential real estate qualify for similar breaks?

It can, and it does.

It has taken a new breed of investors to ferret out the fact that this IRS code has always existed, that the code is relevant, and that residential real estate investors can financially benefit (dare we say *profit*?) from using this tax strategy.

Appreciation for Depreciation

There is more to *accelerated depreciation* than writing the IRS a note as to how much you think your light fixture is worth, and deducting that amount from your taxes for 5 years. The process of receiving accelerated depreciation depends on three things: the condition of the personal property in your investment home, a personal property appraisal (also known as a *chattel appraisal*), and your CPA.

A personal property appraisal service will supply you with what is called a Cost Segregation Study. This study categorizes the depreciable property in your investment home, and ascertains a monetary value for it based on its original quality and the condition of the property at the time of its inspection. At the end of the report, you have a dollar amount that

[1] Under Code 167(a), the Internal Revenue Service allows a reasonable allowance for a deduction, over time, for the cost of capital or income earning assets. Code sections 38 and 168 and Revenue Procedure 87-56 later clarified by Revenue Procedure 88-22, provide guidance on the life of a given object that is depreciable.

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you can show to your CPA. The CPA then applies the tax code to your filing, and a percentage of the assessed dollar value becomes another tax deduction that year.

So, just how much is my back fence worth?
Landscaping is actually depreciated on a 15 year schedule, not a 5 year schedule—but to answer the question: a considerable amount. A fence in decent condition can be valued on the order of thousands of dollars. What's more: even in a 500 square foot condominium with no landscaping, there can be found more than $10,000 of personal property. This means that over five years, you would see an average of $2,000 in tax deductions per year.

Solve Cash Flow Problems
Taking advantage of these tax deductions helps remedy cash flow problems commonly seen in investment properties. Sometimes a piece of property will just barely break even in terms of profitability. Even more disappointing is when your investment is cash flow negative. You don't have to consider selling. You don't have to resort to whatever exit strategy you had planned for the 'worst case scenario.' You can solve the problem.

Your Tax Situation is Unique, Just Like Every One Else's
Let's be frank: new tax strategies tend to scare investors. But under the guidance of your CPA, and with a personal property appraisal, you can quite easily add an accelerated depreciation schedule to your list of tax strategies. It doesn't matter whether you have one rental property or a 90-unit apartment building—this tax strategy can be seamlessly integrated into a real estate investment portfolio of any size.

Having a discussion with your CPA will prove that even the cost of the service can be written off. The cost for single units is quite reasonable. Owners under the control of more than 21 rental units may balk at what they think the service is worth, until they learn about Section 179. Your CPA can explain in detail that this Section allows a write-off of up to $108,000 in the year those 21+ units are purchased.

Editor's Note:
For more information on how a personal property appraisal can benefit your investment properties, call the Depreciation Specialists at National Chattel Experts, a nationwide service that is committed to educating investors about personal property and accelerated depreciation.

National Chattel Experts provides Cost Segregation Studies for individual real estate investors, real estate networks, and offers studies as part of Developers' incentive packages.

Always consult your CPA when employing new tax strategies.

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