The Effect of Recapture

When a cost segregation study is performed, we separate real property from personal property within a building, which allows for an accelerated depreciable life of the personal property. We recommend holding a building for at least 2-3 years after a cost segregation study is applied due to higher recapture tax rates on personal property at the time of sale. This allows time for the tax savings created by our study to generate cash flow that will outweigh any recapture effects when the building is sold. This can be done by putting the money to use by paying off debt, investing in new property, investing in new business equipment, etc.

Recapture occurs when the building is sold. There are recapture rates for both real property (27.5/39-year property) and personal property (5-, 7-, and possibly 15-year property). The gains on personal property sales are taxed at ordinary income tax rates, and gains on real property (39-yr) are taxed at a 25% recapture rate. Any gains made above the original cost basis of any asset are taxed at capital gains tax rates. Essentially the most you could pay back in recapture is the amount of tax savings we generate.

Typically, all of the savings generated will not be paid back as recapture can be minimized by assigning a smaller gain amount to the personal property we identify in the study. This can reasonably be done if the personal property has been in service for close to five years, at which point it is fully depreciated. At this point, it has diminished in value, and it is not worth as much as it was initially bought for. Therefore, a smaller gain can be assigned to these assets resulting in less recapture. More gains would be assigned to items that appreciate, such as the land and building structure. If this is done, cost segregation can still be beneficial even if a sale occurs soon after applying the study.

Another method to avoid recapture is through a 1031 Exchange where another property is purchased with the proceeds from the current property's sale. Also, real estate acquired through inheritance is not subject to recapture.

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