

KBKG Tax Insight: Does a Cost Segregation Study Increase the Likelihood of Audit?

One of the most common concerns that is raised regarding Cost Segregation Studies is whether it increases the likelihood of an IRS audit down the road. While it's well documented that these studies are accepted by the IRS if performed properly, there isn't much evidence suggesting the implementation of a cost segregation study on a tax return, by itself, will trigger an IRS audit.

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We've seen patterns suggesting that newly constructed buildings or improvements placed in service during bonus depreciation eligible years are reviewed closely. This make sense because cost segregation studies can have a sizable impact on the amount of bonus depreciation claimed on a tax return.

Caution: For building projects placed in service in phases over multiple years where bonus depreciation eligibility rules change, taxpayers should ensure their cost segregation report clearly and separately demonstrates when each cost is incurred for each component. According to [IRS Memorandum 20140202F](#), a hotel owner was denied bonus depreciation, in large part, because the cost segregation provider they hired did not identify the dates the costs were incurred for each asset.

We've also seen patterns suggesting that projects generating more than \$10 million of additional depreciation in a particular year are more likely to be scrutinized by IRS engineers, although smaller projects certainly do get looked at as well. Large fluctuations of depreciation in excess of \$10 million can be generated by a number of factors including the filing of the Form 3115, Change of Accounting Method, where a taxpayer claims missed deductions from prior tax years. While the Form 3115 can alert the IRS that a cost segregation study has been performed, we have not seen enough evidence suggesting that filing Form 3115 should raise concerns.

When reviewing a study, the IRS is primarily concerned with the methodologies and procedures used to prepare the cost segregation analysis. As long as the study is performed by a qualified professional following the approved guidelines, it is less likely to have issues during the audit. When selecting a cost segregation provider, you should always read the bio and resume of the people signing the final cost segregation report. We recommend that the individual performing the study is certified with the American Society of Cost Segregation Professionals (ASCSP). The designation for a Certified Cost Segregation Professional is "CCSP" and follows the engineer's name (John Smith, CCSP). Be wary of using any cost segregation company making claims that their work meets IRS standards when they don't employ engineers who have earned the CCSP designation.

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