



## Chattel Depreciation

Chattel depreciation (also known as ‘cost segregation’, ‘chattel valuation’, and ‘asset valuation’) is the process of placing a value on the personal property in a real estate investment property, then producing an IRS approved depreciation schedule. Depreciation can be deducted from federal income taxes over 5, 10, or 15 years.

Chattel is considered personal property that can be depreciated under IRS rules. Some examples of chattel include: kitchen appliances (stoves, range hoods, etc.) that are not permanently attached to real property, flooring, light fixtures, cabinets, draperies, window coverings, and many other items. Chattel can be any owned, movable, and tangible personal property, other than the actual building itself.

In addition to depreciating chattel, the IRS also allows you to depreciate land improvements. An example would be certain types of landscaping, sprinkler systems, driveways, walkways, fences, and a host of others.

### Examples of Chattel:

Stove	Counter Tops	Microwave	Dishwasher	Refrigerator
Range Hood	Removable Flooring	Garbage Disposal	Kitchen Cabinets	Wardrobe
Window Treatments	Lighting Fixtures	Ceiling Fans	Ornamental Millwork	Furniture
Concrete Work	Security Doors	Landscaping	Swimming Pool	Oven
Built in Desk	Driveway	Smoke Detectors	Carpet and Pad	Pantry
Water Heater	Handicap Accessibility	TV Outlet	Internet Port	Shelving
Security System	Window Air Conditioners	Covered Parking	Irrigation System	

### Benefits of a Chattel Appraisal

- Can significantly reduce taxes
- Can often create an after tax, cash flow positive real estate investment
- Accelerates an often under utilized and legal depreciation
- Cost of the appraisal is tax deductible
- Independent third party verification of assets allowing substantial tax savings
- Creates an inventory with written visual description of personal property. This can be helpful in dealing with insurance companies in the event of a loss
- Independent chattel appraisals are valuable aides in the event of an audit

## **Investor Return on Investment (ROI)**

- Our services are economical and allow clients to recapture their investment in the first year. Each person's tax situation is different but here is a simple way to look it:
- The average value of personal property found in a 1500 square foot house is approximately \$15,000 - \$20,000.
- This means that our clients save an average of \$3,000 - \$4,000 off their taxable income in their first year alone.
- For those in a 25% tax bracket that is approximately a \$800 - \$1,500 net savings on your tax bill each year for 5 years.
- For \$500 cost of a Chattel Appraisal you are looking at approx. 217-347% ROI (return on your investment) in the first two years alone.

## **What exactly do I get in the report?**

- 2 copies of the Cost Segregation Report (one for yourself and one for your CPA)
- Instructions for your CPA on proper use of the Cost Segregation Report
- Electronic copies (CD) of pictures of your personal property for your records and for insurance purposes
- An Inventory List that details quantities and descriptions of your personal property
- Serial numbers and models numbers of appliances if readable, to keep on file for insurance purposes

Receipt for Appraisal Service to file as business expense

- A single photo will be provided for multiple items of the same type, whether in the same dwelling or unit. Ex. carpet in the bedroom is the same as in living room, or, same fridge in every apartment.



## Case Study

Assume you purchased a personal property appraisal for your standard, single family residence that you acquired within the last year. This is an example of the tax savings<sup>1</sup> you're likely to see.<sup>2</sup>

So just how much chattel is there in a rental property? A conservative amount to use is 10% of the purchase price. Many times, this percentage is much higher. In our example below let's use a chattel amount of 10%.

### Single Family Home (Purchase Price \$200,000) - Example of Tax Savings

Year One	Without Appraisal	With Appraisal
Land	\$40,000	\$40,000
Building	\$160,000	\$140,000
Personal Property	-	\$20,000
27.5 Year Depreciation Allow	\$5,818.18	\$5,090.91
1st year deduction with appraisal	-	\$4,000.00
Total deduction 1st year	\$5,818.18	\$9,090.91
Tax Bracket - 25%	-	-
Potential Tax Savings	\$1,454.55	\$2,272.73

### Increased Tax Savings - \$818.18

Year Two	Without Appraisal	With Appraisal
Land	\$40,000	\$40,000
Building	\$160,000	\$140,000
Personal Property	-	\$20,000
27.5 Year Depreciation Allow	\$5,818.18	\$5,090.91
2nd year deduction with appraisal	-	\$6,400.00
Total deduction 2nd year	\$5,818.18	\$1,1490.91
Tax Bracket - 25%	-	-
Potential Tax Savings	\$1,454.55	\$2,872.73

### Increased Tax Savings - \$1,418.18

Over the first two years of ownership that is a tax savings of \$2,236, with a \$500 Chattel Appraisal fee; this translates into a return on investment (ROI) of 347%. That is an annual return on investment (ROI) of 173%. The IRS depreciates each year at a different rate, with year two being the largest percentage of deductions (as shown).

<sup>1</sup> Under Code 167(a), the IRS 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.

<sup>2</sup> This study does not account for homes purchased longer than one year ago that may need to file for a 'change of method' with your CPA. This study does not account for a home that has been substantially upgraded or particularly well-cared for, nor does it account for a home with a fair amount of landscaping. This financial product is not tax advice and should not be interpreted as such. Always consult your CPA about employing a financial tool.



## FAQ (Frequently Asked Questions)

1. What is Chattel (Cost Segregation Report)?
2. Can a chattel appraisal help me?
3. Why should I know about Chattel?
4. Why should I have chattel appraisals done on my investment properties?
5. What properties qualify for a Chattel Appraisal?
6. How much will I save on my taxes?
7. How many years can I depreciate the personal property off my taxes?
8. Can I just use retail values for my personal property and divide it by 5 years?
9. What if I already own an investment property and have filed taxes expensing the property?
10. What are some of the rules in determining what I can depreciate?
11. Could I just expense personal property I place into the rental rather than depreciate it?
12. How will a Chattel Appraisal affect me when I sell the property?
13. What is the Time Value of Money?
14. What if I am selling my property within 1 year?
15. Can't I just take the retail value of the personal property and divide that by 5 for each year I can write off my taxes?
16. If I buy new appliances, flooring, etc., what is the difference between depreciating the personal property and just expensing the personal property off my taxes?
17. Can I depreciate the chattel myself?
18. Is it legal?

### 1. What is Chattel (Cost Segregation Report)?

Chattel in the general sense means tangible, movable personal property. In real estate, there is a key distinction between real property and personal property, where real property is defined as land and immovable structure attached to the land - namely the building itself. Chattel, or personal property, is distinguished from real property by the fact that it is movable, without causing severe damage to the structure.

A chattel appraisal is the service of taking inventory of the personal property within your income-producing property, and determining its value, and classifying them into the proper depreciation schedule.

## 2. Can a chattel appraisal help me?

Real estate developers and Realtors can utilize chattel appraisals to improve cash flow estimates of investment properties for sale. Service providers within the real estate industry may add chattel the appraisal service to complement your core service offering, thereby creating competitive advantage in a competitive industry. Real estate investors with rental property, who stand to reap the direct benefit of the chattel appraisal, will save on taxes by utilizing accelerated depreciation to take larger deductions, thereby increasing after-tax cash flow.

More detail please...

Your rental property is first split up into three different types of property: land, building, and chattel (personal property). Land cannot be depreciated. The building and personal property can be depreciated, and generally, the standard depreciation schedule used is 27.5-year straight-line depreciation for 1-4 unit properties, and 39 year straight-line depreciation for 5+ unit apartments.

But wait a minute... there are things on your property that have a useful life of less than 27.5 or 39 years. It would seem ridiculous to depreciate things like carpet, stoves, dishwashers, light fixtures, fences, landscaping, etc. over such long periods when the useful life of these things is much shorter than that. You are absolutely correct, and the IRS agrees. These are examples of such things that you can take accelerated depreciation over shorter period.

The chattel appraisal report will break out costing of personal property and categorize them into the appropriate depreciation schedules. Your CPA or tax preparer will then utilize the depreciation schedules to take bigger tax deductions in the first several years of ownership.

This is a great benefit to buy-and-hold investors because the additional cash flow created via taking accelerated depreciation will allow you to build reserve funds, address deferred maintenance issues, or even buy properties that look "borderline" from a cash flow perspective with the speculation that market rents will increase in the next few years. In effect, the cash flow buffer created by the strategic use of chattel appraisal reduces the "out of pocket" risk that many investors are faced with in the early years of ownership.

## 3. Why should I know about Chattel?

If you own real property as a rental and are not utilizing a Chattel Appraisal, you are paying taxes you don't need to pay. Real estate investors are legally entitled to depreciate chattels (personal property) from federal income taxes at an accelerated rate. To the IRS, your rental property is considered a business if you are collecting money for rent. In the course of renting out the structure, renters are also "renting" the personal property which supports the unit and, in the normal course of living, incurs wear and tear on this personal property. In order to allow the investor to retain some residual value on his/her chattel (personal property), the IRS provides a depreciation allowance over the course of five (5) to fifteen (15) years, depending on the item being depreciated.

## 4. Why should I have chattel appraisals done on my investment properties?

Utilizing the accelerated depreciation allowed by the IRS it can turn a negative cash flow property into a positive cash flow property, or improve the cash flow in one that is already cash flowing. A chattel appraisal can significantly reduce your taxable income now and your capital gains in the future.

Additionally, a chattel appraisal contains detailed information about the contents both inside and outside the house and acts as independent verification of property and its value. Also, having this information at hand in the unlikely event of an insurance loss can prove invaluable.

5. What properties qualify for a Chattel Appraisal?

The IRS sets a few requirements as to whether a property can qualify for a chattel appraisal. You must be the owner of the property and it must be used for business or an income producing activity.

6. How much will I save on my taxes?

Your tax savings will depend on several factors: the value of the chattel in the property, the condition of the property, and your tax bracket. Most single family homes have approximately \$15,000 to \$40,000 in depreciable chattel and land improvements. We estimate that the 5 year depreciation total will be at least \$5,000. Your small, tax deductible investment in our service will save you thousands of dollars in taxes.

7. How many years can I depreciate the personal property off my taxes?

The IRS typically assumes a five year life-span for most personal property, although some personal property has a life-span longer than five years.

Assuming you keep your investment property for five years, you will be able to depreciate the personal property on your taxes each year during those five years.

8. Can I just use retail values for my personal property and divide it by 5 years?

Unfortunately, it is not that easy. The IRS specifies different percentages allowed to be depreciated each year. Your accountant will know how to depreciate based on the info in our Cost Segregation Study.

9. What if I already own an investment property and have filed taxes expensing the property?

If you already own an investment property and have filed taxes expensing the property, then your accountant will need to file a "change of method" and you will need to determine if this is feasible due to additional accounting fees, if any.

10. What are some of the rules in determining what I can depreciate?

The chattel must have a determinable, useful life that is expected to last more than 1 year. It must be something that wears out, decays, gets used up, or loses its value from natural causes.

11. Could I just expense personal property I place into the rental rather than depreciate it?

Depreciating chattel allows you to lower your capital gains tax over a five-year period. However, if you expense your chattel, you only get a one time write-off for the year in which you purchased the item. So, during years two through five, you are potentially losing out on lowering your taxes. You will want to discuss this with your accountant.

12. How will a Chattel Appraisal affect me when I sell the property?

If you intend to sell the property within the next 12 months, a Chattel Appraisal does not make sense due to recapture. A property held for more than a year will benefit from depreciating Chattel based on the concept of Time Value of Money.

13. What is the Time Value of Money?

It boils down to this question: Would you rather have your money today, or at some time in the future? If you are like us, you would rather have your money today instead of waiting until some time later. Operating under this premise, you can better invest your tax savings using accelerated depreciation to create a bigger return, than to not accelerate and let the IRS hold onto it without earning a return.

14. What if I am selling my property within 1 year?

If you intend to sell the property in less than a year, a chattel appraisal does not make sense to conduct due to recapture tax and the IRS allows the largest percentage of deductions in year two.

Any property held for more than a year will, however, benefit from depreciating chattel based on the concept of money now. Taking advantage of depreciation helps you buy time and helps you grow your money faster.

15. Can't I just take the retail value of the personal property and divide that by 5 for each year I can write off my taxes?

Unfortunately, it is not that easy. They do not make anything simple. The depreciation schedule has different percentages every year. Your accountant will know how to depreciate the items based on the information we provide you.

16. If I buy new appliances, flooring, etc., what is the difference between depreciating the personal property and just expensing the personal property off my taxes?

Depreciating the personal property allows you to lower your capital gains tax over the next 5 years. On the other hand, expensing the personal property allows you to write off or lower your taxes only the year it was installed. Having a one year write-off by expensing personal property could potentially cost you hundreds or thousands in the long run.

17. Can I depreciate the chattel myself?

You can if you understand the IRS laws, but you leave yourself open to a greater chance of being audited. Having a third party appraise your chattel delineates an objective view of the value of the personal property.

18. Is it legal?

Absolutely. This strategy is in line with the IRS code and its validity has been tested in the courts. In the past, this tax strategy had been used only in commercial real estate, but a court case called *Hospital Corporation of America vs. Comm* [109 TC 21 (1977)] blew the doors open for use in residential income properties. The IRS has since issued an Audit Techniques Guide on cost segregation, which can be found [here](#).



## **Myths about Chattel and Cost Segregation Studies**

### **1. My accountant probably did one.**

Many CPA's do not have the resources to conduct and produce a true Cost Segregation Study. Many CPA's have also have not had a resource to perform the Chattel Appraisal at an affordable price.

### **2. A Chattel Appraisal/Cost Segregation Study will not save me any money.**

A conservative estimate of the amount of Chattel in any property is 10% of the purchase price. Looking at a \$200,000 purchase price, there is conservatively, \$20,000 in Chattel. In a 25% tax bracket, this results in a \$5000 savings!!

### **3. I don't have any assets that qualify as Chattel.**

Every residential rental property has Chattel. Although we estimate 10% of the purchase price being Chattel, our experience has been seeing a much higher percentage.

### **4. My chances of being audited will increase.**

Not according to the IRS. The IRS has issued a publication to follow in order to properly record the depreciable lives. Keep in mind that you will be using a correct accounting method and the changes made are generally black and white issues in the Tax Code.

## Landlords, the Tax Deduction You Should Know About and Your CPA Might Not Be Telling You About

By [John Racine](#)

Investment real estate provides different things for different investors. Some buy real estate for the hopes of appreciation, some investors buy real estate for monthly cash flow, and still others purchase investment real estate for the tax benefits. There is a large portion of the investment community that buys for all of these reasons. So, what type of investor are you?

Congress, along with the Internal Revenue Service, provides a great many financial benefits for those who invest in real estate. From subsidized housing programs like Section 8 to the Gulf Opportunity Zone (GOZone), real estate is as attractive an investment as it has ever been, thanks in large part to the federal government. The tax benefits of investing in real estate can oftentimes increase the ROI immensely.

Take a piece of rental property, for example. The IRS allows a multitude of tax deductions, including: mortgage interest, travel, tenant background checks, repairs, utilities, advertising, landscaping, pest control, professional fees and the list goes on. These are all expenses as categorized by the IRS. Whenever you have one of these expenses, you'll most likely write a check or use your credit card to pay for it. So if you collect \$1500 in rent, and then pay all of these expenses, you may have \$250 left over in your account at the end of that month. That's not too bad when you invest in real estate for cash flow.

There is however, another "expense", the IRS allows you to take. It is called depreciation. Although depreciation is classified as an expense, you do not write a check to pay for it. Depreciation allows you to spread the cost of the building out over a period of time, and to take a portion of that purchase price over that time. Commercial buildings typically have a depreciation period of 39 years, while residential buildings have a depreciation period of 27.5 years. Depreciation is considered only on the building, the cost of the land has to be removed before calculating the annual depreciation. Let's look at example:

*Home Purchase Price: \$200,000*

*Land Value: \$40,000*

*Building Amount to Be Depreciated: \$160,000*

As you can see, we have a home purchase price of \$200,000 and the land was valued at \$40,000. What we subtract is the \$40,000 land value from the total purchase price of \$200,000, we are left with a building value of \$160,000. According to the current IRS rules, this \$160,000 can now be spread out over 27.5 years. So take the  $\$160,000/27.5 = \$5,818.18$  per year.

The building is not the only part of your rental property that can be depreciated, however. The IRS Tax Code also allows you to depreciate the "personal property", called Chattel. In addition, the IRS allows you to accelerate this depreciation over a shorter period of 5 to 15 years. Let's look at a little bit of background on how this IRS tax deduction came about. A court case called Hospital Corporation of America vs. Comm [109TC 21 (1977)] makes all this possible. This case rules, that it is permissible to separate Section 1245 property from Section 1250 property. Your CPA should be familiar with section 1245 property and section 1250 property. After this case was settled, the IRS issued an Audit Techniques Guide on cost segregation which can be found [here](#). In this guide, the IRS describes several methods for determining the value of Section 1245 property. One of the methods is the "Residual Estimate Approach".

Basically, what this allows a rental property owner to do is segregate the value of the personal property, or chattel, and accelerate the depreciation on its' value over a period of 5 or 15 years.

So what is chattel? The IRS has identified over 65 items that qualify as chattel, including: flooring, cabinets, countertops, lighting, blinds, appliances, landscaping, walkways, driveways, swimming pools etc. So just how much chattel is there in a rental property? A conservative amount to use is 10% of the purchase price. Many times, this percentage is much higher. Let's go back to our original example above and use a chattel amount of 10%:

*Home Purchase Price: \$200,000*  
*Land Value: \$40,000*  
*Chattel Value: \$20,000*  
*Building Amount to Be Depreciated: \$140,000*

Let's now compute our new depreciation amount, including the value of the chattel:

*Building Depreciation: \$140,000/27.5 = \$5,090.91*  
*Chattel Depreciation: \$20,000/5 (years allowed) = \$4000*  
*Total Depreciation: \$5,090.91+ \$4000 = \$9,090.91*  
*Additional Depreciation: \$9,090.91 - \$5,818.18 = \$3272.73*

By segregating the value of the chattel from the value of the building we earn additional tax deduction of \$3272.73. Let's look at actual dollar savings:

*Depreciation Amount: \$5,818.18 x 25% Tax Bracket = \$1454.55*  
*Depreciation Amount with Chattel: \$9,090.91 x 25% Tax Bracket = \$2272.73*  
*Tax Savings: \$2272.73 - \$1454.55 = \$818.18*

Keep in mind, these are conservative numbers. So, now you may be thinking, what are the drawbacks? You should always check with your tax adviser before employing a new tax strategy. The most common question about chattel is the concept of a recapture and the recapture tax when you sell the property. You may already be aware; you pay recapture with the straight-line 27.5 year depreciation. Recapture does also apply to the accelerated depreciation taken through this tax strategy.

Let's talk briefly about recapture and the recapture tax. A recapture tax is applied when ever a depreciated asset is sold. The recaptured amount is subject to a maximum rate of 25%. The recapture tax percentage rate is based on the investors' income tax rate, and is capped at 25%. This allows you to keep the 75%, and utilize the Time Value of Money to create more investments. Let's use our example above, to illustrate recapture. We will assume the investment property was held for five years before being sold:

*Home Purchase Price: \$200,000*  
*Depreciation Taken: \$9,090.91 x 5 (years) = \$45,454.55*  
*Home Sale Price: \$250,000*

*Recapture Tax: \$45,454.55 x 25% (max rate) = \$11,363.64*

How many additional properties could your purchase with \$11,363.64 available before you had to pay it back? Is it one, three, or more? Remember, if your tax rate is higher than 25%, you will keep the difference since you are capped at 25%. This strategy also works with multi-family properties as well. The savings with multiple units multiplies greatly. If you own or are buying a large multi-family property, ask your tax professional about the Section 179 deduction. It provides over \$100,000 in deductions with specific criteria.

Now, the \$50,000, which is the difference between our selling price of \$250,000 and our original purchase price of \$200,000, is subject to capital gain. That is, unless you have utilized another strategy such as the 1031 Exchange or a Charitable Remainder Trust. The depreciation amount is not subject to capital gain. Again, always check with your tax adviser before making a tax strategy decision.

Congress and the IRS have made real estate such an attractive investment opportunity, it pays to utilize every strategy available to maximize your cash flow and lower your taxes. Ask your tax advisor about a chattel appraisal and a cost segregation study and start using the tax code to your advantage!



## Reference Links:

<http://www.cpaleadership.com/public/329.cfm>

<http://www.aicpa.org/pubs/jofa/aug2004/soled.htm>

<http://denver.bizjournals.com/denver/stories/2004/04/26/focus8.html>

<http://www.aicpa.org/pubs/jofa/aug2005/allen.htm>



## Request for Chattel Report

Please fill out this form and **fax to Michelle Kohl at 1-630-566-0990**. If you have questions, please call at **1-630-294-5844**.

### Part I: Required Information

1. Owners name(s):
2. Owner's contact information (please include phone and email contacts):
3. Complete address of property(s) to be appraised:
4. Are you the owner of the property being appraised?  Yes  No
5. Number of units (single family = 1 unit, duplex = 2 units, and so on):
6. Property type (check one):  
 Single family     Condo\*     Attached (townhouse)     Duplex     Triplex  
 Fourplex     Multi-unit  (# of units) and  (# unique unit types)
- \*If condo, are landscaping and deck owned by the investor or the HOA?  Investor  HOA
7. Date property purchased (must be greater than 2002):
8. Property cost:
9. Property value (at time of purchase):
10. Land value (if condo, then land value is \$0):

**(Note: We cannot accept your estimate of the land value. This information is on the property appraisal. If you do not know this information, ask your CPA or the realtor or loan broker involved in the sale. Most land values are public record and may be available online.)**

11. Was this property acquired through a 1031 tax exchange?  Yes  No

### Part II: Property Information

12. How many years have you filed taxes with this property?
13. When do you usually file your taxes?
14. Do you want us to contact your tenant or property management company to negotiate the chattel appraisal date?  Yes  No
  - 14a. Who currently manages the property (company, contact name, and telephone number):
  - 14b. Is a tenant currently occupying the property?  Yes  No
  - 14c. Tenant's name:
  - 14d. Advise how we should contact your tenant:
15. Number of stories:
16. Number of bedrooms/bathrooms (per unique unit type):
17. Square footage:
18. Is there anything special about the property we need to know (alarms, animals, special circumstances, neighbors, where to park, etc.)?

29. How can we enter the property?

20. Is this an executive rental that is fully furnished?  Yes  No

21a. If yes, do you have receipts for the items that are in addition to a standard rental (e.g., linens, furnishings, paintings, utensils, tools, etc.)?  Yes  No

21. Which of the appliances and/or furnishings in the property are owned by the tenant (if any)?

Refrigerator     Dishwasher     Microwave     Washer     Dryer  
 Air conditioner     Window treatments (list):

22. Property owner agrees to pay the sum of \$\_\_\_\_\_ for this service. **knowledge.**

Mail checks to Chase Real Estate, 1315 Macom Drive, Ste. 105, Naperville, IL 60564

23. Parties and addresses to which the final report should be sent:

Name:  Email:

Mailing address:

You acknowledge, by executing this form, your agreement and understanding that Chase Real Estate, LLC, as part of its general real estate services, provides clientele the opportunity to order a chattel appraisal from an independent chattel appraiser not an employee or agent of Chase Real Estate, LLC. Chase Real Estate, LLC does not perform or conduct the appraisal, does not direct or control in any way the independent appraiser, nor does it warrant the accuracy of said appraisal. As such, you agree that you will neither hold nor attempt to hold Chase Real Estate, LLC or its employees or agents liable for, and you will indemnify and hold harmless Chase Real Estate, LLC, its employees, and agents from and against, any and all demands, claims, causes of action, fines, penalties, damages (including consequential damages), liabilities, judgments, and expenses (including without limitation attorneys' fees) incurred in connection with or arising from the preparation of the chattel appraisal by the independent appraiser, including but not limited to any acts, omissions or negligence attributed to the independent appraiser. In addition, Chase Real Estate, LLC is not a tax advisor and makes no representation relative to either the validity of the chattel appraisal or its uses. Chase Real Estate, LLC advises you to seek the advice of a tax professional of your choice.

**X**

**Your signature above signifies that you have read, understand, and agree to these statements.**

Notes: