

Cost Segregation

What is a cost segregation study?

- A cost segregation study is a viable means of increasing cash flow through accelerated depreciation of commercial real estate property.
- An engineering based study is utilized to identify portions of the basis in a building that can be reallocated from 27.5 or 39 year depreciable lives to 5, 7 and 15 years.
- This reallocation produces accelerated depreciation deductions and these deductions create significant income tax benefits for the owner.

How are assets reclassified?

- Most businesses will assign 100% of the cost of a building purchased or constructed to a 39 or 27.5 year (Section 1250) depreciable life. A cost segregation study identifies construction or acquisition costs of a building that qualify for the shorter life.
- A variety of sources are used to determine the cost basis of the shorter life property, including a thorough on-site investigation of the property by trained engineers, detailed analysis of construction plans, blueprints and budgetary documents used in its construction, as well as communication with relevant individuals such as the contractor, builder, developer or architect.
- Generally, a study results in a shift of 20% - 50% of the cost of the assets out of a 39 or 27.5 year classification and into a 5, 7 or 15 year asset classification.

What are typical tax savings?

- The actual reallocation of depreciable lives depends upon the nature, use and structure of a specific building. The overall tax savings will depend on this reallocation as well as the overall cost of the building, and date that the building was completed.
- Most cost segregation studies result in a present value tax benefit in the range of \$30,000 to \$50,000 for each \$1M of acquisition fees or construction costs (including tenant improvement construction costs) of a facility.
- If the property has been held for several years, the prior year changes to depreciation created by the study can be taken in the current year without amended returns. This can produce dramatic savings.

So who can potentially benefit from a cost segregation study?

- Potentially, any tax paying owner of a commercial property can benefit from a cost segregation study.
- Careful planning should be done to estimate the benefit and ensure that the study is timed in a way to produce the maximum benefit.