Segregation Holding

Cost Segregation Specialists

: Frequently Asked Questions

What is a Cost Segregation Study?

A Cost Segregation Study is a strategic, tax-saving tool that can be used by companies and individuals who have constructed, purchased, expanded, or remodeled any kind of commercial real estate. The study allows the owner to take advantage of accelerated depreciation deductions and defer federal and state income taxes.

Normally, 100% of the cost of commercial real estate is depreciated over 39 years. During a Cost Segregation Study, components of a property or leasehold improvement that can be depreciated over a shorter time (5, 7, or 15 years) are identified and reclassified. For example, 30% to 90% of the total electrical costs in most buildings can qualify for 5 or 7-year depreciation.

Typical components that can be reclassified include a building's non-structural elements, such as carpet, decorative lighting and trim, dedicated electrical and plumbing, and security systems; exterior land improvements, such as landscaping, curbs, sidewalks, fencing, and signage; and indirect construction costs, such as architect and engineering fees and construction permits. The result of a Cost Segregation Study is that a property owner's tax obligation is reduced and cash flow is increased.

Is Cost Segregation something new?

Cost Segregation is not new; on the contrary, it has been in existence since 1954 when the IRS allowed for certain personal assets to be accelerated into a shorter life class. However, it wasn't until Hospital Corporation of America sued the IRS in 1997, and won, that the IRS revisited the issue of accelerated depreciation. The IRS ruled that property qualifying as tangible personal property under the former Investment Tax Credit (ITC) rules would also qualify for purposes of federal income tax depreciation under MACRS (Modified Accelerated Cost Recovery System).

The IRS Chief Attorney wrote a memo stating "...Cost Segregation, for it to be properly applied, had to involve those with competencies in architecture, engineering or construction and/or construction techniques, in order for personal property assets to be accurately identified and segregated." As a result of this memo, Cost Segregation became a viable tax-saving strategy allowed by the IRS.

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What type of real estate is eligible?

Commercial real estate property eligible for Cost Segregation includes buildings that have been purchased, constructed, expanded, or remodeled since 1987. A study is typically cost-effective for buildings purchased or remodeled at a cost greater than $100,000. A Cost Segregation Study is most efficient for new buildings under construction, but it can also uncover retroactive tax deductions for much older buildings. Other commercial property, such as rental houses and tenant improvements are also eligible.

What are the steps involved in the process?

The Cost Segregation process can be broken down into the following steps:

1. Engage a reputable Cost Segregation firm that utilizes engineers and architects trained in Cost Segregation and it's application to the proper allocation of assets.

2. The engineer determines what documents are available.

3. The engineer then sets a schedule for surveying the subject property and gathering the available documents for review prior to arrival at the subject property.

4. For those documents that are unavailable, time is then scheduled into the Cost Segregation process for document recreation using known costing data. *(After all necessary documents are acquired, it takes about 4 to 6 weeks to finish the process.)*

5. The site survey is executed and completed. (*Time varies for each survey, but typically it is completed within an hour.*) It is during the survey when measurements are taken and all areas are photographed for IRS verification and substantiation of asset values.

6. The engineer returns to the office and "crunches the numbers." This is when all documents are reviewed in detail, assets are verified and measured against known costing data, and asset reallocation is applied.

7. A review committee then examines the results of the analysis completed by the engineer of record to verify its veracity and confirm it meets and exceeds IRS guidelines per the *Cost Segregation Audit Techniques Guide*.

8. Once approved, the study results are compiled into a final report that includes: all IRS tax code to substantiate the reallocated assets, spreadsheets identifying all assets categorized according to their building codes, representative photographs of the reallocated assets, and the engineer's credentials for IRS review.

9. Final report is issued. Digital copies are emailed to the client for application to the client's tax return.

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Why bother? I'll eventually get the deduction.

The present or future value of the money you can save by having a Cost Segregation Study is usually quite substantial. Additionally, you have access to the cash now so you can reinvest it! A Cost Segregation Study in effect gives you an interest free loan from the government for the first 15 years, which you will then repay interest free over the remaining 25 years. Wouldn't you rather have your money? There are also advantages to doing a study if the building is going to be sold or if the owner of the building dies.

How much will I save on taxes?

Your CPA can assist you in receiving a free analysis. From the information you supply, we can provide you a conservative estimate of the accelerated benefits you can expect as well as the fee proposed for the final study.

Typically, tax savings from 5% to 10% of the building's original tax-basis is realized, but there are instances where it can be substantially more.

How much accelerated depreciation can I get?

Certain types of commercial property can be grouped together to give us an idea of the percentage of those types of buildings that have been eligible for accelerated depreciation. Your results may be greater, or they may be less than those shown below, but in general, property that falls into one of the following categories is most likely to result in accelerated depreciation within the specified ranges.

Types of Commercial Property:

- Apartment Buildings 15 - 25%
- Dental/Medical 30 - 60%
- Health Care 25 - 65%
- Heavy Manufacturing 30 - 80%
- Industrial 25 - 70%
- Light Manufacturing 20 - 45%
- Office Buildings 15 - 25%
- Research & Development Facilities 30 - 75%
- Restaurant 15 – 30%
- Retail Centers 10 - 25%
- Senior Living Facilities 15 - 30%
- Warehouse 5 - 15%

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Does Cost Segregation have other benefits?

Yes! Cost Segregation can provide additional tax benefits. It can reveal opportunities to reduce real estate tax liabilities and identify certain sales and use tax savings opportunities. Under certain circumstances, segregated assets may qualify for a special bonus depreciation allowed by multiple tax reconciliation acts enacted by Congress. Additionally, a Cost Segregation Study can:

• Maximize tax savings by adjusting the timing of deductions. When an asset's life is shortened, depreciation expense is accelerated and tax payments are decreased during the early stages of a property's life. This in turn, releases cash for investment opportunities or current operating needs.

• Create an audit trail. Improper documentation of cost and asset classifications can lead to an unfavorable audit adjustment. A properly documented Cost Segregation Study helps resolve IRS inquiries at the earliest stages.

• Capture retroactive savings. Since 1996, taxpayers can capture immediate retroactive savings on property added since 1987. Previous rules, which provided a four-year catch-up period for retroactive savings, have been amended to allow taxpayers to take the entire amount of the adjustment in the year the Cost Segregation is completed – this alone is huge. This opportunity to recapture unrecognized depreciation in one year presents an opportunity to perform retroactive Cost Segregation analyses on older properties to increase cash flow in the current year.

How much does it cost to do a Cost Segregation Study?

Our experience shows that, on average, the total fee will generally fall between 5% and 20% of the estimated NPV tax savings. This can be impacted by how large or small the real estate project is. In addition, the location, accessibility, and quality of the records and documents impact the ultimate cost. We guarantee a minimum of 500% ROI (fee vs. tax recovery) on all projects over $500,000.

How long does a Cost Segregation Study take?

The time that a Cost Segregation Study takes depends on the size of the project and the completeness of the documentation that you supply. Generally, though, it takes about 4 to 6 weeks from the time we receive or recreate all of the appropriate documentation.

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What if I lack some of the needed documents?

Even if you lack some of the necessary documentation, we can still perform a study for you. Our construction, engineering, and other specialists can do an extensive site visit. They will measure and estimate using currently accepted costing techniques and pricing guides to determine the costs that qualify for shorter recovery life periods. *(To determine the costs that qualify, we use the IRS-recommended costing publications Marshall & Swift and RS Means.)*

Will a study increase the chance of an audit?

Our study strictly adheres to the IRS Cost Segregation Audit Techniques Guide. The type of study we perform actually **decreases** your chances of an audit because the study will place you in Internal Revenue Code Tax Compliance.

Will you assist me in the event of an audit?

Yes. Our Cost Segregation specialists will assist you in the event of an audit. Our focus in doing the Cost Segregation Study is to create documentation and support for our conclusions so that they are easily communicated and resolved with the IRS. In fact, our final report is "all inclusive." It quotes specific Internal Revenue Codes related to the reallocated assets. Additionally, we provide photographic evidence of these same assets for complete substantiation of our assessment.

We have never had any reallocated assets disallowed by audit.

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