

COST SEGREGATION STUDIES

What is a cost segregation study?

A cost segregation study is a comprehensive analysis of the acquisition and construction costs of real estate in order to classify these costs for depreciation purposes as personal property, land improvements or real property. By reclassifying assets with their appropriate depreciable lives, significant net present value tax savings can be realized.

What opportunities exist for a cost segregation study?

- Any existing building purchased or constructed after 1990
- Existing buildings undergoing expansion, remodeling or renovation – leasehold improvements also qualify
- Inheritance of a building where there is a stepped up cost basis to fair market value
- New construction projects

What are the benefits to my business?

- Lower taxes
- Improved cash flow
- Property tax savings

Can I get the benefit of the new bonus depreciation allowance on property with lives of 20 years or less if I have a cost segregation study?

Yes – recent tax law changes permit you to claim an additional first-year depreciation allowance on property with recovery periods of 20 years or less. New property that is identified through the cost segregation study as 5, 7 or 15-year property benefits from faster depreciation write-offs and bonus depreciation the first year.

What happens when the building is sold?

- Gain attributable to depreciation taken on personal property will be “recaptured” as ordinary income (as opposed to capital gain).
- Gain attributable to depreciation taken on the building will be treated as unrecaptured Section 1250 gain, which will be taxed at a 25% tax rate.

How will future tax rate changes impact the results of the study?

- Since it is impossible to predict what future tax rates will be, current tax rates will be used in computing the initial estimate of the net present value of tax savings.
- A cost segregation study will impact the timing of depreciation deductions (now vs. later). Since the purpose of a cost segregation study is to accelerate depreciation deductions from the future into the present, future increases in your tax rate would decrease the net present value of the tax savings from a cost segregation study. Future decreases in your tax rate would increase the net present value of the tax savings.

When would a cost segregation study not be practical?

- If your real property was placed in service many years ago and is nearing the end of its depreciable life
- If it is likely that you will sell the building in the near future
- If the total cost of the real property is not substantial enough to justify the cost of the study
- If you have loss carryovers or tax credits that will soon expire if unused



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What information will I need to provide to the firm to complete the study?

- Depreciation schedule
- Building plans
- Property closing statement
- A site visit inspection
- Recent property tax bill
- Project construction budget
- Contractor's final payment application
- Recent property appraisal
- Other cost information, such as indirect costs and change orders

What if I can't get everything you need to do the actual study?

Even if some of this information may not be available, a cost segregation study can still be done in most cases. You simply must provide as much of the evidentiary material listed above as possible.

Will most buildings have the same allocation of costs into shorter lives?

Results obtained from cost segregation studies differ depending on numerous factors, including building cost, square footage and building use. You cannot assume that one building has the same allocations as another building.

How much time will the study take?

You will usually receive a free estimate of your expected savings within two weeks. Once an inspection of the building is completed the study can normally be completed in six to eight weeks.

When can I have a study done if I am currently purchasing or constructing a new building?

For a current purchase or construction, a study must be completed by the time your return is filed (with extensions) for you to recognize the tax savings benefit on that return.

What will I get once a study is completed?

You will receive a cost segregation study report documenting and detailing all costs and their classifications into the shorter recovery periods under MACRS (modified accelerated cost recovery system). The report contains a description of the property, the procedures, terms and definitions, and project cost summaries that reconcile to your cost documentation.

What do I attach to my tax return?

If the study results in a change in depreciation from prior years, you must complete and attach Form 3115 to your return. If only depreciation from current and future years is affected, no attachments are required other than Form 4562, Depreciation and Amortization.

Will the change in tax depreciation affect my fixed asset schedule and depreciation schedule used to prepare my company's financial statements?

You generally do not have to change the accounting records used for your traditional financial statements that are prepared for management and use by third parties. Tax depreciation methods are independent of those used for financial reporting.

How much does a cost segregation study cost?

Fees are based upon the number of hours actually required to complete the project and vary with the type of construction, size of the facility and interior finishing requirements.



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