

Reduce Taxes and Increase Cash Flow On Investment Properties With a Cost Segregation Study **by Scott Janko, CEA**

The Problem

Many times, the depreciable assets in a commercial property are categorized with a depreciable life of 27.5 years.

Often these assets are partially or fully personal property or land improvements. Such assets are depreciable over 5, 7, or 15 years.

By having such asset miscoded, you will be missing depreciation expenses, therefore over paying taxes and decreasing your cash flow.

What is a Cost Segregation Study?

A Cost Segregation Study (CSS) (a.k.a. Cost Segregation Analysis) is a financial and engineering-based analysis of all expenditures associated with a property. The objective of the cost segregation study is to properly separate and classify capital expenditures using the shortest life possible based upon IRS specifications and current case law. The cost segregation study uses IRS prescribed engineering based methods to quantify and value assets and place them into their proper asset category. The end result of the cost segregation study is a reclassification of assets that allows for accelerated depreciation and improved cash flow on your property.

The Solution - A Cost Segregation Study (a.k.a. Cost Segregation Analysis)

A well designed cost segregation study conducted by trained and experienced tax and engineering professionals will provide for the proper identification and re-classification of your properties' capital assets.

The cost segregation study yields a comprehensive analysis and report that shows which assets are miscoded and the correct depreciable lives of those capital assets.

The net result is that you can start taking the new, accelerated depreciation rates in the current tax year. The Cost Segregation Study provides you with an immediate reduction in taxes and improved cash flow.

How a Cost Segregation Study Works

Phase I - Opportunity Assessment (OA)

- Complete an initial questionnaire regarding the property.
- The Pre-assessment team will use this information to determine feasibility and benefits of a cost segregation study.
- If you agree with the Opportunity Assessment report, then the cost segregation team will be formed.

Phase II - The Cost Segregation Study (CSS)

- Construction engineers and CPAs are assigned to the CSS project.

- The Engineers will study drawings and physically inspect the property. The CPAs will take input from the engineers and prepare an itemized list of assets that qualify for accelerated depreciation.

- Establish depreciable life for each asset.
- Research any current case law that may influence classification.
- Prepare a final report.

Phase III - File a Change in Accounting Method

- Final report goes to your tax advisor.
- Submit a change in accounting method.
(no amending of returns)

Other Benefits

- A Cost Segregation Study can save up to 7% or more of the costs of a building.
- You can benefit from a Cost Segregation Study even if you have sold the property.

Example

Apartment complex is purchased for \$4,000,000. Owners allocate \$400,000 of purchase price to non-depreciable land, and depreciate the remaining \$3,600,000 over 27.5 years as commercial real property.

Cost Segregation Study

The study reveals that 5% (\$180,000) of building costs are allocated to 7 year property and 15% (\$540,000) to 15 year property.

The study yields an additional \$758,000 in depreciation over the first seven (7) years. This additional deferral yields a net decrease in taxes of \$294,000 over the first seven years. The net present value of the tax savings is \$164,000 (8%) reduction in building cost, for the 27.5 year period.

The tax strategies that NAFEP provides are Self Directed Installment Sales (SDISsm), Self Directed IRAs via a LLC (ICOsm), Self Directed 401(k)s (one.Ksm), Cost Segregation Studies, 1031 Rescue and 1031 exchanges.

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