



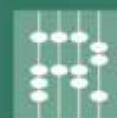
Behind the Costs: Looking for Tax Savings? Study Building Costs to Up Cash Flow

WHITE PAPER

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Cost segregation, though known by many real estate owners, is sometimes overlooked.

It is a methodology used to reallocate certain building costs into separate identifiable components that can be depreciated over shorter lives. The primary purpose of a cost segregation study is to reallocate as much building costs between land improvements and tangible property. The more costs allocated to tangible property, the greater the desired tax benefit. Tangible property creates tax benefits because it is depreciated over five or seven years while normal building costs are depreciated over 27.5 or 39 years.

A cost-segregation study may be performed for real estate already in service, for new construction and acquisitions. Generally, it is easier to analyze a building's cost structure during initial construction or expansion since building plans are readily available and can be utilized to identify various components that may qualify as tangible property.

Costs that may be reallocated to land improvements consist of, but are not limited to, certain landscaping, sidewalks and fencing which are depreciated over a 15 year recovery period. Costs that may be reallocated to tangible property include movable partitions, furniture, removable carpeting and wallpaper, certain fixtures and window treatments. Support systems that are needed to run certain equipment or machinery could be considered tangible property under certain circumstances.

There are several internal levels of cost-segregation studies ranging from a detailed engineering approach through a less formal rule-of-thumb appraisal. The Internal Revenue Service prefers the engineering approach since it will produce the most accurate results.

All businesses that acquire, construct or renovate real property would benefit from a cost segregation study. The real benefit of a properly documented cost-segregation study is the enhanced depreciation deductions it yields. A major advantage of the study is not necessarily that it produces more depreciation deductions, but that expenses accelerate more rapidly, producing a greater benefit due to the time value of money.

The ability to write off specific components identified as they are replaced is yet another advantage. For example, when a study is performed, the cost of the roof would be specifically identified. As the roof will eventually be replaced, the remaining cost could be written off.

One disadvantage of a cost-segregation study is the potential triggering of depreciation recapture and possible understatement penalties a taxpayer could incur for studies that are too aggressive in classifying costs. To avoid penalties and pass IRS scrutiny, the study must be objective and supported by contemporaneous records. Studies supported by an engineering study add credibility and produce the most accurate cost allocations.

Overall, cost-segregation studies can produce tremendous tax savings for those who build, acquire any business that builds, acquires or renovates property. The increased tax savings increase cash flow, which in turn, businesses can reinvest.

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