

# Cost Segregation

## Help your clients to further reduce their tax liability while building your bottom line

Bringing new tax and business ideas to clients is the goal of every CPA (after all, a happy client is a long term client!). One way to do this is to partner with other experts who have complimentary services that your firm doesn't offer. Cost Segregation studies are an example of a valued service that can make an immediate impact to your client's bottom line.

This whitepaper is designed to help you understand what a Cost Segregation study is, who qualifies for it and how to identify clients who are candidates for the service.

### What is Cost Segregation?

Cost Segregation is an engineering-based approach to identifying assets within a building that can be reclassified into a much shorter depreciation recovery period than the building itself.

Real estate properties are generally depreciated using a straight-line method of 39 years (27.5 years for residential properties). These properties are defined as real property.

A Cost Segregation expert can help with identifying, classifying and segregating the personal property components and land improvements of the building, resulting in depreciable lives of 5, 7 and 15 years using accelerated depreciation.

### What is Depreciation?

Depreciation is the allowance for the exhaustion, wear and tear, and obsolescence on certain types of property used in a trade or business for the production of income. Property is depreciable if it's used for business or held for the production of income; has a determinable life exceeding one year and it wears out, decays, becomes obsolete or loses value from natural causes.

### Is Cost Segregation Allowed by the IRS?

Yes! Rulings by the IRS including *Hospital Corporation of America v. Commissioner* have confirmed the applicability of Cost Segregation. The IRS also recognizes Cost Segregation studies with the use of an engineer or valuation expert on the project.

## Who Can Benefit from Cost Segregation?

All properties that have been constructed, purchased or renovated since 1987 qualify for this tax benefit. This includes manufacturing plants, assisted living facilities, hotels to restaurants and multi family buildings.

To determine if a cost segregation study is appropriate for your client, the following circumstances need to apply:

- Is the cost of your building at least \$750,000?
- Have you purchased, constructed or renovated any property since 1987?
- Do you plan on retaining your property for the next few years?
- Do you have net income that is being taxed?

## When to Apply a Cost Segregation Study

There are certainly 'triggers' that you should look for to help identify an opportunity for a Cost Segregation Study. Common events that indicate an opportunity include:

- Constructing a new facility
- Acquiring an existing facility
- Renovating or expanding

Clients that have built or purchased buildings or facilities in the past and haven't performed a Cost Segregation study might be able to benefit from a study which allows for correction of missed depreciation in past years.

## What are Examples of Potential Savings?

We have examples from a number of different buildings, facilities and manufacturing clients to share with you. To give you an idea, let's look at an office building Cost Segregation study example.

**OFFICE BUILDING:** This example is a typical, two-story office building with a total construction cost of \$1.5 million, assuming that 10% of the cost of the building was improperly classified as real property (39 year) instead of personal property (7 year). By moving the 10% improperly classified as 39 year property to a 7 year property, the first year tax savings realized would be approximately \$27,000. The estimated After-Tax Net Present Value Benefit (ATNPV) of the entire project is as follows:

Amount reclassified:

7 year property	\$150,000
15 year property	\$225,000
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Total Reclassified:	\$375,000

Net Present Value of Tax Savings:

7 year property	\$27,000
15 year property	\$23,000
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Total Reclassified:	\$50,000

### About Scarpello Consulting

Launched in 2001, Scarpello Consulting provides Cost Segregation consulting services to help clients maximize their depreciation allowances while minimizing audit risk. The firm has four locations including Los Angeles, CA, Omaha, NE, Overland Park, KS and New York City, NY. Additional information is available at [www.ScarpelloConsulting.com](http://www.ScarpelloConsulting.com).