

A no-brainer

How a cost segregation study can lower tax burden **Interviewed by Jerry Roche**

By partaking in a cost segregation study, your company can recognize significant tax savings in real, permanent dollars. Although the overall concepts have existed for some time, certain court cases and some rules simplification have made cost segregation increasingly popular.

“A large percentage of the companies we meet with move forward with a cost segregation,” says Peter A. Bellini, CPA, a principal at Skoda, Minotti & Co., Cleveland-based CPAs, business and financial advisers.

Smart Business talked to Bellini about how cost segregation identifies, segregates and reclassifies the physical assets of your business that qualify for shorter depreciable tax lives.

What is cost segregation?

Cost segregation is an IRS-approved method of reclassifying components and improvements of a commercial building from real estate to personal property. The process allows the assets to be depreciated on a 5-, 7- or 15-year schedule instead of the traditional 27.5- or 39-year depreciation schedule of real property. The results will greatly reduce a company’s taxable income and increase its cash flow.

IRS rulings over the past several years and administrative changes have allowed taxpayers to take advantage of these previously understated depreciation expenses on property already in service by utilizing a change in accounting method that no longer requires the need to amend tax returns. New construction, buildings purchased in the current year, or any building placed in service after 1986 are eligible. Substantially large lease-hold improvements are also eligible.

What does a cost segregation study do, and how can it help a business?

Cost segregation uses an engineering-based study and analyzes construction documents, blueprints, invoices and other relevant information to determine which components of the facility can be depreci-



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ated over a shorter time period.

As instructed by the IRS Code, commercial real property must be depreciated over 39 years. Many of the components can be classified as personal property and depreciated over five, seven or — in the case of land improvements — 15 years. By depreciating personal property and land improvements over shorter lives, a company is able to recognize significant deductions and tax savings on its current and future tax returns.

What types of assets can be reclassified?

The types of items that can be reclassified to a shorter life include: site preparation, demolition, certain electrical systems, doors, windows, HVAC, ceilings, carpet, certain types of millwork, cabinetry, certain plumbing, special tooling for production lines, and even generators.

When do cost segregations make the most sense?

Cost segregation studies are applicable for any building placed in service after 1986. The starting threshold for a study to make sense economically begins around \$500,000 in building and improvement

costs. For buildouts and lease-hold improvements, that threshold can be materially lower. However, for practical purposes, buildings placed in service after 1995 will yield the greatest impact after taking into account several factors, primarily the time value of money. In addition, if a building was placed in service in 2002, 2003 or 2004, there are special bonus depreciation rules in effect that can compound your tax savings.

How can a cost segregation study increase cash flow?

Whether it is a current-year purchase or an existing building, the accelerated deductions reduce tax liabilities, thus increasing cash flow that can be used to help grow your business in other areas. Your tax adviser should review the study and deductions yielded in order to best use the benefits as part of overall tax planning.

Depending on the tax bracket of the business or individual, many companies have seen savings of 10 to 20 times the total cost of having the study done. In some extreme cases or with larger companies, that multiple has been over 60 times.

What is needed to perform a cost segregation?

It’s real easy to get started, because all you need for an initial analysis is a description of the building and a copy of the depreciation schedules. If it makes sense to move forward, a site visit, blueprints and copies of construction documentation are also required.

Is there any danger of the cost segregation rules being changed in the future?

There isn’t anything on the horizon that would change the cost-segregation process, because it’s not contained in one specific law. It’s a combination of various areas of the IRS Code melded together to arrive at an overall tax benefit for owners of real estate.

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