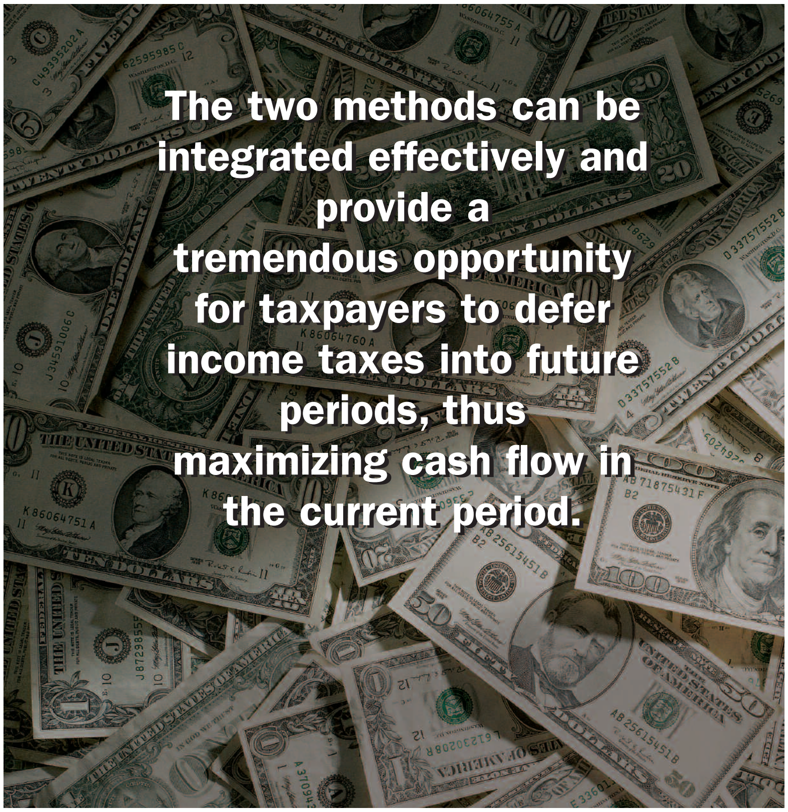
Cost Segregation and 1031 Exchanges



INTRODUCTION

Cost segregation and 1031 exchanges are two of the most valuable tax planning strategies available to commercial real estate owners today. Through proper tax planning, both tax deferral techniques can be used on the same properties in order to obtain the maximum tax benefits.

THE BENEFITS OF COST SEGREGATION

Engineering-based cost segregation studies allow commercial real estate owners to take what would otherwise be classified as real property (or §1250) for depreciation purposes and reclassify it as more rapidly depreciating personal (or §1245) property. This reclassification results in substantial cash flow benefits in both current and future years through substantially shorter depreciable tax life and accelerated depreciation methods.

THE BENEFITS OF 1031 EXCHANGES

A 1031 exchange allows a business or investment real property owner to sell a property, reinvest the proceeds in a new property and defer all capital gain taxes, as long as the owner acquires like kind replacement property. Any business or investment real property is generally considered like kind to any other type of business or investment real property.

THE SIMILARITIES

Both strategies are used to defer taxes and therefore improve cash flow. Cost segregation and 1031 exchanges can be performed on every type of commercial real property. Both techniques also encompass complex areas of tax law and necessitate the use of specialists. 1031 exchanges require a "Qualified Intermediary" to perform the transaction and ensure proper execution. Cost segregation studies require an engineering consulting firm to perform and validate the study. In turn, the specialists must work closely with the commercial property owner's accountant.

THE NEED FOR A SPECIALIST

When used in combination, the two techniques require tax professionals to understand both the tremendous upside and the potential recapture issues in a subsequent exchange. With proper planning, the two methods can be integrated effectively and provide a tremendous opportunity for taxpayers to defer income taxes into future periods, thus maximizing cash flow in the current period.

CONCLUSION

In order to use cost segregation and 1031 exchanges together successfully, the property owner's tax advisor must be well versed in the tax laws of both techniques and understand how they apply to the individual investment strategy of the client.

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Ernst & Morris · 2190 Dallas Highway · Marietta, Georgia · 30064
Fax: 770-427-4004 · info@costseg.com · 1(800)COST-SEG · **www.costseg.com**

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