Example of Cost Segregation Benefits

**INTRODUCTION**

Under existing tax laws, commercial real estate owners can increase current depreciation deductions on both new and existing facilities, thus minimizing their overall tax liability. By employing the services of an engineering-based cost segregation firm, you can achieve considerable increases in after-tax cash flow.

**PRESENT VALUE SAVINGS**

Each $100,000 in assets reclassified from a 39-year recovery period to a five-year recovery period results in approximately $16,000 in net-present-value savings, assuming an 8% discount rate and a 40% marginal tax rate.

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**EXAMPLE**

$10 million retail shopping center, placed into service 10 years ago:

Original depreciation method: 39-year straight line

Reclassified Amount with Cost Segregation Study:
- 5-year Property: $1 million
- 15-year Property: $1.5 million

Adjustment calculation and resulting tax benefit:

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Depreciation Reported Previously</td>
<td>$2,564,100</td>
</tr>
<tr>
<td>Cost Segregation Study Depreciation</td>
<td>$3,923,070</td>
</tr>
<tr>
<td>Section 481(a) Adjustment</td>
<td>($1,358,970)</td>
</tr>
<tr>
<td>Tax Rate</td>
<td>40%</td>
</tr>
<tr>
<td>Tax Benefit in Year of Study</td>
<td>$543,588</td>
</tr>
</tbody>
</table>

The bottom line – by performing an engineering-based cost segregation study, the building owner was able to increase the amount of depreciation expense, thus reducing the current year taxable income, resulting in an increase in cash flow of $544k.

**COST SEGREGATION DEFINED**

Engineering-based cost segregation studies allow commercial real estate owners to reallocate real property (Code Sec. 1250) to personal property (Code Sec. 1245), which results in a substantially shorter depreciable tax life and accelerated depreciation methods. Traditionally, property owners depreciated the cost of an entire building over 39 years. However, by engaging a cost segregation expert, non-structural building components can more accurately be classified into the 5, 7 and 15-year depreciable lives assigned to personal property. You not only benefit from reduced recovery periods, but can also apply the accelerated declining balance depreciation methods (150% and 200%) available under MACRS, thus generating tremendous cash flow benefits in both current and future years.

"The cost segregation studies Ernst & Morris performed for us deferred taxes, thus increasing cash flow. This extra cash flow is used to expand operations. We feel Ernst & Morris is proactive in looking for ways to help us achieve our goals."

Jan Saperstein, President
The Equinox Group