

VALUATION ADVISORY

COST SEGREGATION SERVICES

Cost Segregation is the key to unlocking hidden savings in commercial property. The cost segregation study analyzes building assets & classifies them in order to identify those that qualify for accelerated depreciation, often resulting in massive reductions in tax liabilities.

A cost segregation analysis typically results in increased depreciation benefits by differentiating long-life property assets from short-lived assets for federal income tax purposes. Some of the key benefits include improving short term cash flow, identifying costs to be expensed, detailing fixed asset records, and creating a solid record for the IRS in terms of identifying assets. Cost segregation can also be used to lessen real estate tax liabilities, as well as identify sales and use tax savings.

WHY SHOULD A COST SEGREGATION STUDY BE PERFORMED?

Property owners who have recently acquired, constructed, renovated, or expanded new real estate assets can use a cost segregation study to help recover their capital investments quickly, as opposed to slowly over the standard tax-life of real property.

Results of a cost segregation can help a tax payer in the following ways:

Maximize tax savings by adjusting the timing of deductions. Depreciation expenses are accelerated and tax payments will be lessened in the earlier stages of owning the property, when the tax life is shortened. By shortening the tax life and allowing these larger depreciation expenses, the tax payer frees up cash flow for further investment opportunities or other business needs.

Cost segregation also helps document costs, and provide an audit trail for the IRS. By performing a cost segregation study, assets can be properly documented at the earliest possible time to help solve IRS inquiries, thus providing an audit trail.

WHAT PROPERTIES ARE ELIGIBLE?

Any property that has been recently acquired, constructed, renovated, or expanded since 1987. Typically assets worth over \$200,000 will show a benefit from a study. The best time to perform a study is as soon construction is complete, or quickly before or after a building has been purchased. Older buildings can also benefit from what's called "catchup" depreciation. In this case, a property owner that has constructed or acquired their property in the past catch up their savings and capture it in the first year, which can lead to a huge first year tax savings. This is typically beneficial on a building that is less than 7 years old.

RETROACTIVE COST SEGREGATION STUDIES TO INCREASE CASH FLOW

Since 1996, taxpayers can capture immediate retroactive savings on property added since 1987. Previous rules, which provided a four-year catch-up period for retroactive savings, have been amended to allow taxpayers to take the entire amount of the adjustment in the year the cost segregation is completed. This opportunity to recapture unrecognized depreciation in one year presents an opportunity to perform retroactive cost segregation analyses on older properties to increase cash flow in the current year. Additional tax benefits. Cost segregation can also reveal opportunities to reduce real estate tax liabilities and identify certain sales and use tax savings opportunities.

EXAMPLE OF POTENTIAL BENEFIT

OFFICE BUILDING

Purchased for \$2,000,000, land value of \$400,000. Assumed mid-year convention. Client tax rate of 33%, discount rate of 7%, 100% Bonus depreciation applied. Assumed 15% re-class to 5-year personal property, 15% re-classed to 15-year land improvements.

50-UNIT APARTMENT PROJECT

Purchased for \$3,000,000, land value of \$600,000. Assumed mid-year convention. Client tax rate of 33%, discount rate of 7%, 100% Bonus depreciation applied. Assumed 15% re-class to 5-year personal property, 20% re-classed to 15-year land improvements.

INDUSTRIAL/MANUFACTURING

Purchased/newly constructed for \$6,000,000, land value of \$900,000. Assumed mid-year convention. Client tax rate of 33%, discount rate of 7%, 100% Bonus depreciation applied. Assumed 25% re-class to 5-year personal property, 15% re-classed to 15-year land improvements.

Depreciation Deduction for Five Years

| | Before Study 39-Year Straight Line Depreciation | After Study MACRS Accelerated Depreciation |
|--------|---|--|
| YEAR 1 | \$5,136 | \$483,595 |
| YEAR 2 | \$41,024 | \$28,717 |
| YEAR 3 | \$41,024 | \$28,717 |
| YEAR 4 | \$41,024 | \$28,717 |
| YEAR 5 | \$41,024 | \$28,717 |

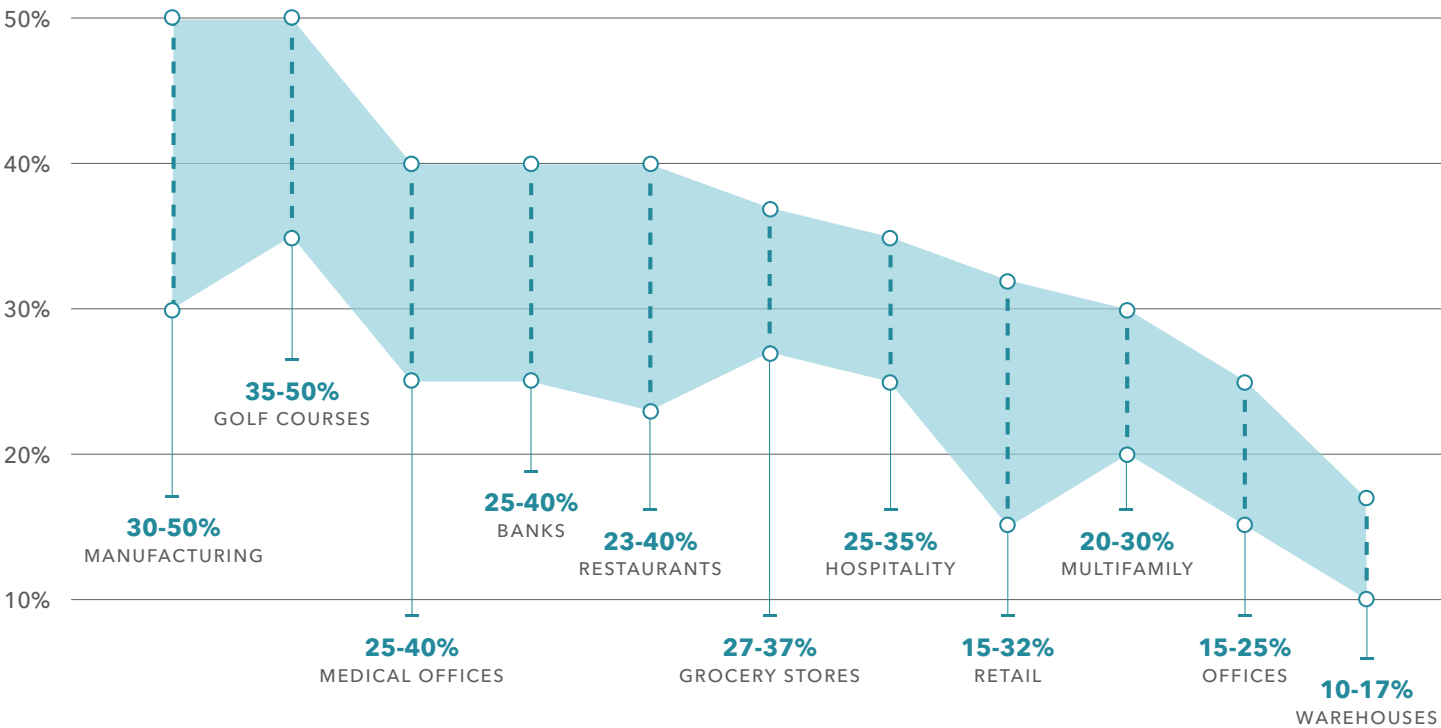
Depreciation Deduction for Five Years

| | Before Study 27.5-Year Straight Line Depreciation | After Study MACRS Accelerated Depreciation |
|--------|---|--|
| YEAR 1 | \$7,704 | \$845,008 |
| YEAR 2 | \$61,536 | \$39,998 |
| YEAR 3 | \$61,536 | \$39,998 |
| YEAR 4 | \$61,536 | \$39,998 |
| YEAR 5 | \$61,536 | \$39,998 |

Depreciation Deduction for Five Years

| | Before Study 39-Year Straight Line Depreciation | After Study MACRS Accelerated Depreciation |
|--------|---|--|
| YEAR 1 | \$49,113 | \$2,069,468 |
| YEAR 2 | \$130,764 | \$78,458 |
| YEAR 3 | \$130,764 | \$78,458 |
| YEAR 4 | \$130,764 | \$78,458 |
| YEAR 5 | \$130,764 | \$78,458 |

TYPICAL RELOCATION BY PROPERTY TYPE



BONUS DEPRECIATION

Bonus depreciation allows taxpayers to deduct a specified percentage (30, 50, 80, or 100 percent) of depreciation in the year the qualifying property is placed in service. The adjusted basis of the qualifying property is reduced by the allowable amount of bonus depreciation before the remaining depreciation deductions are computed for the placed-in-service year and subsequent years.

ELIGIBLE PROPERTY

In order to qualify for 30, 50, 80, or 100 percent bonus depreciation, the original use of the property must begin with the taxpayer and the property must be:

MACRS property with a recovery period of 20 years or less

Depreciable computer software

Water utility property

Qualified leasehold improvement property

Certain acquisition requirements and placed in service dates must also be met in order to qualify for 30, 50, 80, or 100 percent bonus depreciation, and are discussed in more detail below.

The Tax Cuts and Jobs Act increased the bonus depreciation percentage from 50% to 100% for qualified property acquired and placed in service after 9/27/2017, and before 1/1/2023. Bonus depreciation percentage is 80%, when placed in service between 1/1/2023 and 12/31/2023.

Taxpayers may elect out of the additional first-year depreciation.

PROPERTY TYPES FOR ANALYSIS

Multifamily

Retail/Restaurant/
Nightlife

Industrial/Manufacturing

Hospitality/Gaming

Golf Courses

Data Centers

Offices/Business Centers

Shopping Centers

Other "Specialty Use"
Properties

WHY KIDDER MATHEWS?

\$200K-\$3B

PROPERTY & PROJECT SCOPE

Our Cost Segregation reports are completed by experienced professionals who perform true engineering based studies. Our engineers have backgrounds in construction, and can truly "reverse-engineer" a building on paper. Our reports follow the guidelines set forth by the IRS in their "Cost Segregation Audita Technique Guide", and all providers meet and exceed the qualification requirements required. Our engineers have performed hundreds of engineering based cost segregation studies using MACRS analysis on properties ranging from restaurants, multi-family, distribution centers, manufacturing facilities, biotech

facilities, wineries, food processing plants, cold storage, gaming, resorts and hotels, to offices. Property and project scope from \$200,000 to an excess of \$3 billion. They have responded to IRS Information Document Requests (IDR) to document, support, and defend positions on various cost segregation studies.

Unlike some boutique firms, our engineers do the entire study from start to finish, including the on-site inspection. We feel there is no way to do a quality study if the engineer performing the study does not have this intimate knowledge of a property and its components.

Contact

RYAN BEGLEY

Executive Vice President, Cost Segregation Manager
Valuation Advisory Services
602.513.5157 | ryan.begley@kidder.com

KIDDER.COM

