FROEHLING ANDERSON

What Is A Cost Segregation Study?

Cost-segregation is the process of separating and classifying construction costs according to the classifications provided by Internal Revenue Service rules, regulations, and guidelines. The identification of these costs is important so that the construction costs can be segregated into separately identifiable components to maximize depreciation expense. Generally, the relevant classifications for depreciable property are as follows:

- 5-year property (computers, service providing assets),
- 7-year property (manufacturing assets),
- 15-year property (land improvements),
- 27.5-year property (residential),
- 39-year property (non-residential buildings)

By identifying and segregating costs related to 5-, 7-, and 15-year property from the 39-year non-residential property costs, such property can be depreciated over a much shorter time than otherwise would be the case. Additionally, accelerated methods are available for 5-, 7-, and 15-year property, producing faster tax deductions than the straight-line method required for non-residential real property.

How Does A Cost Segregation Study Benefit You?

A cost segregation study is a potential investment with substantial return. Properly segregated assets as explained above can generate current, additional cash flow of about 17 cents per dollar of project costs reclassified from 39-year to 7-year property, and 10 cents per dollar of project costs reclassified from 39-year to 15-year property (assuming an 8% discount rate and combined federal and state tax rate of 34%).This benefit is computed on a net present value analysis based on accelerated depreciation deductions in the early stages of the projects' life rather than spread evenly over a 39-year period. Based on our experience with cost segregation studies, a significant savings can be realized depending on the size and function of the building.

The benefit of accelerating depreciation deductions directly translates into increased cash flow by reducing your tax liability through increased deductions. The study also provides documentation necessary for capitalization of assets and to substantiate the write-off when future asset disposals occur.

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