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 are 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),
- 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.

APPROACH

Our approach to completing your cost-segregation study includes:

- A physical inspection of the property
- A through examination of the architectural / engineering drawings and specifications, the building services systems, and interior finishes and personal property.
- An analysis of all cost data, including the general contractors' application for payment, change orders, owner-incurred costs, and indirect costs.
- The identification and preparation of an itemized list of those property units that, in our opinion do and do not qualify for shorter life, based on our experience with the Internal Revenue Service and interpretations of revenue rulings, private letter rulings, and judicial decisions.
- A proper allocation of the indirect costs.
- A proper reconciliation of the total cost used in our analysis to the total project capitalized costs, as documented in your accounting and control records.

Our methodology is based on fully documented, professional engineering and cost-estimating procedures and complies with IRS Letter Ruling 7941002. Our study will provide an audit trail that can be traced from the derived unit costs taken from the contract documents to the completed building and its components.

At the conclusion of the engagement, we will produce a bound final report for your files, detailing the asset breakdown, relevant costs, assumptions and conclusions.