

IMPROVE YOUR CASH FLOW

By Dave Collins, principal of COBE Development

Every business would like to free up money today to use and build for tomorrow. That is why I want to introduce what may be an unfamiliar tool, which could allow you to, legally of course, lower your taxable income: **Accelerated Depreciation using an Engineered Cost Segregation Process.** I recently learned about this service and quickly realized that it could benefit those of you who receive this newsletter.

Writing this article is like trying to describe what salt tastes like to someone who has never tasted it; I know what salt tastes like but explaining it, well...takes some time. So, first off, I'd like to define a few terms in the context of this article so it will make sense.

- 1) Depreciation is a tax deduction you are allowed for the wearing away and expensing over the lifetime of an asset; in this case, the asset is your office and its lifetime is 39 years according to the IRS. (**Note:** In order to take advantage of depreciation you must own your office, and/or own the leasehold improvements whether leasing or owning.)
- 2) Accelerating Depreciation using the rigorous process of an Engineered Cost Segregation Study allows you to reclassify building assets into "shorter lives" thereby affording larger depreciation deductions over the first several years of your assets' lifetime.

Cost segregation is an engineering-based approach that allows for significant portions of your building's cost to be depreciated in as few as 5 years, instead of the standard 39 years for commercial property.

"Our goal is to reverse engineer the commercial property into discrete components that would be necessary to rebuild from the start. This includes ceilings, communications, doors, hardware, electrical, flooring, HVAC, lighting, decorative millwork, paint, plumbing, walk-in signs to name a few. This will result in the identification of 5 year, 7 year, 15 year and 39 year property, often accelerating depreciation by more than 40 percent. This creates tens or possibly hundreds of thousands of dollars of additional depreciation that can be utilized in the year that the cost segregation study is completed," says Charles Sirro. Sirro and founding partner Trent Erickson's firm National Cost Segregation Specialists (NATCSS) specializes in engineered-based cost segregation and has successfully completed hundreds of these studies for commercial properties.

Basically, different components of your office have a shorter life expectancy than other parts. Those that wear out faster can be depreciated faster. An Engineered Cost Segregation study separates all the materials used to build your office into asset classes according to their qualified life expectancy.

Cost segregation does not eliminate the tax due but allows you to deduct the depreciation of your building more quickly. By segregating costs you lower your taxable income and up to 40 percent of a building's assets can be reclassified into

shorter life categories, thus improving cash flows, paying for renovations, or reinvesting. This means a considerable savings in the tax year the study is done.

NATCSS has provided the following table which illustrates the Cost Segregation Benefits for a new commercial office building for the first 6 Years:

Sample Cost Segregation Benefits

Building Size (sf) and Cost (\$/sf)	Cost (Building + TI's)	Cost Basis (less Land \$42/sf Est.)	Placed in Service	Depreciation 39 yr Method	Accelerated Depreciation w/Cost Seg	Additional Depreciation w/Cost Seg	*Additional Est Tax Savings at 40%
2500@\$310	\$775,000	\$670,000	2007	\$94,497	\$178,008	\$83,511	\$33,405
2500@\$350	\$875,000	\$770,000	2007	\$108,601	\$204,577	\$95,976	\$38,390
5000@\$310	\$1,550,000	\$1,445,000	2007	\$188,994	\$356,016	\$167,023	\$66,809
5000@\$350	\$1,750,000	\$1,540,000	2007	\$217,202	\$409,153	\$191,951	\$76,781

*The above table is a projection of the estimated savings associated with an Engineered Cost Segregation analysis and does not represent actual savings. Actual savings may be more or less depending on your company's individual situation.

Cost Segregation may not work for everyone but companies like NATCSS can run a complimentary analysis to find out if doing an engineered cost segregation study would be beneficial for you. Typically a cost segregation study is effective if the property is valued at a minimum value of \$600,000 (including tenant improvements), you plan on keeping the property for at least 2 years, and you have taxable net income. The after-tax savings over the span of the depreciation can be well in excess of 5-10 times the one time cost of the study which typically costs between \$9,000 and \$12,000 for a new 2,500 to 5,000 SF office.

While the IRS does allow you to "catch-up" any missed depreciation, the best time to perform a Cost Segregation Study is the year in which the building is purchased, constructed, or renovated. If you are interested in having a Cost Segregation Study done for your current office or an office you are looking to purchase we can set up a meeting to show you the potential savings. To read more about cost segregation please [Click Here](#).