COST SEGREGATION:

HOW COMPANIES CAN BENEFIT

If your company is planning to build, purchase or renovate a building, or has done so in the past several years, a cost segregation study is a powerful tool that may help boost your cash flow and save your company significant money.

Cost segregation studies separate real property into various depreciable categories, allowing taxpayers to depreciate property over much shorter periods of time as opposed to the standard 39-year (or 27.5-year residential) timeframe. By taking these deductions sooner, property owners lower their current-year tax liability and free up more capital.

Read on to see how three companies were all able to boost their profits through cost segregation.

CLARK SCHAEFER HACKETT
BUSINESS ADVISORS

HOW **ONE APARTMENT OWNER** BOOSTED PROFITS WITH **COST SEGREGATION**

ABC Company performed a cost segregation analysis for a multi-family property they acquired in 2018. The analysis identified and segregated the acquisition costs into appropriate Modified Accelerated Cost Recovery System ("MARCS") classifications for recovery purposes. The purchase price for the property (excluding land) was $2,217,190. Here are the property details:

BACKGROUND ON PROPERTY

ABC's property included a 60-unit, 53,000 square foot facility situated on 4.2 acres. The units were subdivided into five identical 10,584 square foot, 12-unit buildings. The buildings are three-stories in height and all of the units are two-bedroom/one-bath units, each with a living room, a large walk-in closet, carpet and laminate faux hardwood, a four-burner range, refrigerator, dishwasher, and sink. On the grounds of the facility there is a lawn area with trees, chain link fencing, wheel stops, a monument sign and a flagpole. Other exterior improvements include asphalt paving, concrete walkways, and a playground set.

COST SEGREGATION RESULTS

PURCHASE COST
$2,217,190

COST REMAINING AT 27.5 YR REAL PROPERTY
$1,571,760

COST REALLOCATED TO 15 YR PERSONAL PROPERTY
$200,904

COST REALLOCATED TO 5 YR PERSONAL PROPERTY
$444,527

REALLOCATION PERCENT **29%**

The asset allocation provided the following depreciation benefit and return on investment (assuming an aggregate federal and state tax rate of 34.6% and a discount rate of 8%):

Increased depreciation year 1:	$644,452
Increased cash flow year 1:	$222,980
Net present value benefit of tax deferral:	$133,748
Cost segregation study fee:	$8,750
After tax fee (since cost seg fee is tax deductible):	$5,723
Return on investment:	23 to 1

For an apartment property like ABC, the cost segregation study was extremely beneficial. Approximately 29% of the project's real property was reallocated to personal property, which has a shorter depreciable life. This reallocation allows for acceleration of depreciation expense resulting in increased cash flow in year 1 of $222,980. Additionally, the company will realize a $133,748 net present value benefit through the front-loading of depreciation expense (remember that time value of money tells us that money available at the present time is worth more than the same amount in the future due to its potential earning capacity). Given the NPV benefit and after-tax cost segregation study fee of $5,723 the company realized an ROI of 23 to 1 by conducting the study.

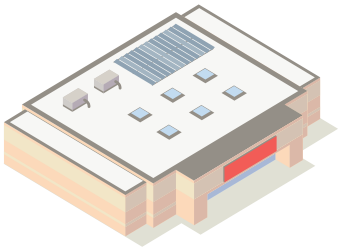
HOW **ONE RETAIL COMPANY** BOOSTED PROFITS WITH **COST SEGREGATION**

XYZ Retail Company performed a cost segregation depreciation analysis for a building they constructed in 2015. The total construction cost (not including the land purchase) for the property was $4,976,637. Here are the details of this case:

BACKGROUND ON PROPERTY

XYZ's building has two stories, is 40,093 square feet, and sits on 14.6 acres. It is primarily a single story, with the exception of a 7,340 square foot mezzanine. The retail portion of the building includes several display racks, display cabinets, and equipment/inventory for sale. Also included in this portion of the building are several counter tops for customer service/sales, multiple offices for sales personnel, management and administrative staff, a training room, a break room and kitchenette, locker rooms and storage areas. The mezzanine includes several offices, a conference room and storage area. The exterior of the building includes extensive landscaping, including lawn, shrubs and a pond with a fountain. Other exterior improvements include asphalt paving with striping, exterior lighting, concrete walkways, concrete curbs and a loading dock.

COST SEGREGATION RESULTS



PURCHASE/RENOVATION COST (LESS LAND VALUE)
$4,976,637

COST REMAINING AT 39 YR REAL PROPERTY
$3,429,668

COST REALLOCATED TO 15 YR PERSONAL PROPERTY
$1,093,004

COST REALLOCATED TO 5 YR PERSONAL PROPERTY
$453,965

REALLOCATION PERCENT **31%**

This asset allocation will provide the following depreciation benefit and return on investment (assuming an aggregate federal and state tax rate of 41% and a discount rate of 8%):

Increased depreciation (years 1–5):	$1,014,766
Increased cash flow (years 1–5):	$416,054
Present value benefit of tax deferral:	$338,037

Cost segregation study fee:	$10,500
After tax fee (since cost seg fee is tax deductible):	$6,195
Return on investment:	55 to 1

For a company like XYZ, the cost segregation study was extremely beneficial. Approximately 31% of the project's real property was reallocated to personal property, which has a shorter depreciable life. This reallocation allows for acceleration of depreciation expense resulting in increased cash flow in years 1-5 of $416,054. Additionally, the company will realize a $338,037 net present value benefit through the front-loading of depreciation expense (remember that the time value of money tells us that money available at the present time is worth more than the same amount in the future due to its potential earning capacity). Given the NPV benefit and after tax cost segregation study fee of $6,195 the company realized an ROI of 55 to 1 by conducting the study.

HOW **ONE MANUFACTURER** BOOSTED PROFITS WITH **COST SEGREGATION**

ABC Manufacturing Company performed a cost segregation depreciation analysis for a building they purchased in 2014 and made major renovations to in 2015. The purchase and renovation costs for the property total $10,834,947. Here are the details of the property:

BACKGROUND ON PROPERTY

ABC's building has two stories, is 108,412 square feet and sits on 1.5 acres of land. The majority of the space is used for the company's manufacturing operation, which includes manufacturing, handling, packaging and storage equipment. The facility includes multiple administrative offices, storage space, and several loading docks for shipping and receiving. The exterior of the building includes a parking area and driveway, concrete sidewalks, fencing, and building lighting. Other exterior improvements include a parking canopy, concrete bollards, entry steps, and a fire hydrant.

COST SEGREGATION RESULTS

PURCHASE/RENOVATION COST (LESS LAND VALUE)
$10,834,947

COST REMAINING AT 39 YR REAL PROPERTY
$6,603,842

COST REALLOCATED TO 15 YR PERSONAL PROPERTY
$970,257

COST REALLOCATED TO 7 YR PERSONAL PROPERTY
$2,682,126

COST REALLOCATED TO 5 YR PERSONAL PROPERTY
$258,126

COST REALLOCATED TO **EXPENSE**
$320,557

REALLOCATION PERCENT 39%

This asset allocation will provide the following depreciation benefit and return on investment (assuming an aggregate federal and state tax rate of 41% and a discount rate of 8%):

Increased depreciation (years 1–5):	$1,436,756
Increased cash flow (years 1–5):	$589,070
Net present value benefit of tax deferral:	$498,764

Cost segregation study fee:	$15,000
After tax fee (since cost seg fee is tax deductible):	$8,850
Return on investment:	56 to 1

For a manufacturer like ABC, the cost segregation study was extremely beneficial. Approximately 39% of the project's real property was reallocated to personal property, which has a shorter depreciable life or could be expensed. This acceleration in depreciation expense will result in increased cash flow in years 1-5 of $589,070. Additionally, the company will realize a $498,764 net present value benefit through the front-loading of depreciation expense (remember that the time value of money tells us that money available at the present time is worth more than the same amount in the future due to its potential earning capacity). Given the NPV benefit of $498,764 and after tax cost segregation study fee of $8,850 the company realized an ROI of 56 to 1 by conducting the study.

NO-COST, NO-PRESSURE:
COST SEGREGATION FEASIBILITY ANALYSIS

Virtually every taxpayer who owns, constructs, renovates or acquires a commercial (or residential) real estate facility stands to benefit from a cost segregation study. Is it time to see if you can recover your capital investment sooner?

At CSH, we offer a no-fee, no-pressure cost segregation feasibility analysis, so that you can consider whether a study will benefit your company. The process is very easy. We just need to know the property acquisition cost (less land value), the placed-in-service date, building square footage, and use of property (manufacturing, office, retail, etc.) in order to prepare a cost segregation benefit estimate.

If you have any questions about cost segregation studies or whether a study might be appropriate given your company's unique situation, contact Brendan Walsh at bjwalsh@cshco.com.

BRENDAN J. WALSH
JD, MBA, CCSP
COST SEGREGATION PRACTICE LEADER

PRACTICE SUMMARY:
Brendan's experience is in tax consulting for businesses and their owners. His work focuses on strategic tax planning to minimize tax exposure, specializing in fixed asset strategies, depreciation, cost segregation, and tangible property regulations in the construction and real estate industries. With over 10 years of experience, Brendan has worked with companies ranging from start-ups to billion-dollar, publicly traded entities.

Brendan brings a skill set that combines both technical knowledge of tax concepts and legal acumen to decipher and interpret complex tax laws.

DESIGNATIONS & LICENSURE:
Certified Cost Segregation Professional; ASCSP Certified Member #C0026-13
Licensed Attorney – Ohio; Ohio Attorney Registration #0080223

PROFESSIONAL AFFILIATIONS:
American Society of Cost Segregation Professionals
Ohio State Bar Association
Cincinnati Bar Association
Urban Land Institute

EDUCATION:
JD, University of Dayton School of Law
MBA, Xavier University
BSBA, Accounting, Xavier University

COMMUNITY ACTIVITIES:
Down Syndrome Association of Greater Cincinnati
Xavier University Mentoring Program