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Cost segregation studies can provide building owners with healthy tax benefits

March 17, 2011 - Construction Design & Engineering

can be hard to see the forest for the trees. Since companies in the healthcare and biotech industries are always looking for ways to reduce costs and improve their bottom line, you may want to look around. You might literally be standing in one. If you have purchased a commercial building or paid more than $750,000 for tenant improvements over the past 10 years, you could be a candidate for a cost segregation study. And that could result in significant savings in the form of tax deductions.

How It Works

A building is depreciated over 39 years, using the straight-line depreciation method. However, when a cost segregation study is performed, that building becomes a collection of pipes, electrical wiring, wood trim, electrical outlets, countertops and hundreds or even thousands of other components that may be depreciated in five, seven or fifteen year increments. Essentially, a cost segregation study involves taking an inventory of every square inch to be used later for tax deduction purposes.

Typically, 10% to 30% of the purchase price of a building can be reallocated for depreciation over shorter periods. If you spend $10 million on a building, for example, it's likely that $1 million to $3 million can be reallocated. That works out to a tax savings of $50,000 to $70,000 per $1 million. And you can keep on saving every year for up to 15 years.

Cost segregation studies are especially valuable to owners of property with specialized construction (i.e. labs, research space, etc.) or that change tenants regularly. For example, the owner of a building that replaces a pediatric practice with a kidney dialysis lab will need to plan a whole new build-out. If a study documents every light switch and every piece of trim, all of the "abandonments" that are thrown into the dumpster can be written offâ€”but only if they are documented.

In addition, land improvements, which include landscaping, sewers, paving and curbing, can be depreciated over 15 years. Personal property, such as finish carpentry, emergency power generators, cabinets and even certain HVAC units, can be depreciated in five or seven years.

Some Words of Wisdom

Because cost segregation studies require combined expertise in the areas of construction, engineering and accounting, it is important to work with qualified professionals. When it comes to selecting an independent provider to perform a cost segregation study, Jeffrey Hiatt of MS Consultants, LLC has this to offer:

* The IRS has strict guidelines for what constitutes a qualified cost segregation study. Engineering firms typically perform them, but you want to make sure they are working with accountants who fully understand the tax implications of the study.

* Not all cost segregation studies are created equal. Be sure to retain an expert who will document the costs in great detail. The owner of a commercial building will need a breakdown by tenant, floor and unit. Any space should be broken down by function, such as manufacturing area, clean-room

area and office space.

* Do not hire a firm that offers to do the study on a contingency fee basis - unless you like the idea of being audited. The IRS frowns on arrangements that would give a third party an incentive to reduce your taxes.

* The cost of a study can vary, depending on the size of the project, but the firm conducting the study should be able to estimate your potential savings before you incur any cost. Typically, every dollar spent on the study nets a tax deferral of at least $10 and sometimes the savings are much higher. Building owners should consider undertaking a cost segregation study only if they can save at least $5 for every $1 spent.

To determine if your business is a good candidate for a cost segregation study, have someone with in-depth experience run the numbers so you can make an informed decision. You have nothing to lose and may have much to gain.

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