

An aerial photograph of a busy city street intersection. A large, multi-story white building with many windows is the central focus. The street is filled with cars, buses, and taxis. Other buildings are visible in the background under a blue sky with some clouds.

**Take Another Look!**  
**Finding Hidden Value In Your Building**

**Cost-Segregation Studies**  
**Another Money-Saving Service From**  
**WebsterRogers LLP**

**WR** WebsterRogers<sup>LLP</sup>  
CERTIFIED PUBLIC ACCOUNTANTS ♦ CONSULTANTS

[www.websterrogers.com](http://www.websterrogers.com)

## **Cost Segregation Study F AQ's**

### **What does it accomplish?**

It saves you money by lowering taxes. And coupled with the most recent tax law changes, the results can impact the bottom line of almost any business.

### **What is a Cost Segregation Study?**

It is a process to identify asset costs buried in building costs and reclassify them to the shortest possible depreciation life, so the real estate owner can maximize their depreciation deduction, thereby lowering taxable income and taxes.

### **What types of building costs are eligible for a study?**

New construction  
Existing buildings  
Facilities purchased since 1987  
Renovations  
Additions  
Leasehold improvements  
And, costs attributable to the preceding

### **Who uses them?**

Manufacturers	Nursing homes	Office buildings
Healthcare	Surgery centers	Warehousing
Fast Food	Supermarkets	Laboratories
Hotels	Food processors	Apartments
Dealerships	Industrial	Technology
Telecom	Malls	And more . . .

### **What percentage of assets can be reclassified?**

Generally, 20-55% of assets can be assigned shorter lives, depending on the facility's use.

### **How does the IRS view them?**

The IRS recognizes them, and there are numerous rulings, procedures, and tax court cases supporting them.

### **Does it raise the chance of being audited?**

Not according to the IRS. You would be filing an automatic change in accounting method which the IRS has pre-approved, assuming the form is filed correctly. In addition, the IRS has issued a publication to follow in order to properly record the changes in depreciable lives. Keep in mind this is going from an incorrect method to a correct one, and the changes are generally black-and-white issues within the tax code.

### **Who performs them?**

Cost-segregation studies are sophisticated and require specialists in the engineering, construction, and tax disciplines who are also trained in asset classification. The IRS requires experienced engineers or estimators to determine asset costs and CPAs for

classification and advising.

### **Is it possible my accountant did one?**

Unless it was done subsequent to May 13, 1996, when the tax laws changed, you are probably depreciating your assets incorrectly. In the case of purchased buildings, if you do not have a specific appraiser's report breaking out the various building components, a study was not performed.

### **Are contractor invoices valid for asset classification?**

Generally, no. The category costs are misleading and insufficient for a study. Assigning un-examined costs from them would deprive the owner of substantial benefits, and more importantly, this methodology would not withstand IRS scrutiny. An experienced cost-segregation engineer will correct them and locate all qualified assets within their costs.

### **Will a study burden my staff?**

No. Usually the client's financial officer or accountant is the liaison for a study and need only provide the basic documents outlined in this client guide.

### **Will a study burden my contractor?**

No. As our specialists are experienced in engineering, construction, and estimating, they do not have to interview your contractor and his subcontractors. Even a modest project can have over 75 sub-contractors and extensive interviewing raises confidentiality issues.

### **We contracted the project ourselves. Can we benefit?**

Yes. Again, our experience enables us to allocate costs from your project invoices. Preferably, this is done from the start of a project to simplify record collection, but can be performed when the work is complete.

### **What is the effect on Alternative Minimum Tax?**

If this occurs, the savings will be at the 28% federal tax rate and not the 36% to 41 % rate. Of course, the amounts are large enough so it should not matter. In addition, the AMT taxes can be used against regular taxes in future years.

### **Will it complicate estate planning?**

Yes, it might, but the rewards of performing a study have great financial benefits if the owner of the building dies before the building is fully depreciated. Due to the "step-up-basis" rules, it is one of the rare times a taxpayer can "have his cake and eat it too." If done properly, a cost-segregation study is an estate-planning home run.

### **How do tax law changes benefit me?**

The Job Creation Act permits an additional 30% first-year depreciation allowance on qualified property acquired after September 10, 2001. Without a study, there will be no benefits.

## Client Guide To Cost-Segregation Studies

*Various typical studies normally require a minimum of information.*

### **Construction & renovations not yet in service**

*Additional benefits from the Job Creation Act of 2002 could apply.*

**Limited information** for tax classification, such as use, date of service, etc.

**Copies of invoices**, such as the contractor AIA G702. It is the most frequently provided source for project costs and they are usually classified incorrectly for cost-segregation purposes. They will be reviewed for anomalies and engineering and estimating specialists will break out their costs to the appropriate categories.

**Construction drawings** for identifying qualified assets. These can be half-size, and will be copied and returned, if requested.

**A site visit** to authenticate our findings. Usually less than two hours.

**Comments:** Although not necessary, the study should be engaged before construction starts. Contractors will usually be glad to forward a copy of the AIA G702 and change orders during their routine billing, thereby simplifying records collection.

**Advantages:** We impose no demands on your architect's, engineer's, or contractor's time. We are backed by technical expertise through our affiliation with the national CPA firm RSM McGladrey, which has performed hundreds of studies. Our services are confidential, stand-alone, and transparent to our clients' business activities.

### **Construction & renovations in previous service**

*Projects from 1987 and newer qualify.*

**Limited information** for tax classification, such as use, date of service, how booked for depreciation, etc.

**Copies of invoices**, such as the contractor AIA G702. It is the most frequently provided source for project costs, and they are usually classified incorrectly for cost-segregation purposes. They will be reviewed for anomalies, and engineering and estimating specialists will break out their costs to the appropriate categories.

**Construction drawings** for identifying qualified assets. These can be half-size, and will be copied and returned, if requested.

**A site visit** to authenticate our findings. Usually less than two hours.

**Comments:** Even if invoicing is incomplete or unavailable, construction and estimating specialists can determine the value of assets for cost segregation.

**Advantages:** We impose no demands on your architect's, engineer's, or contractor's time. We are backed by technical expertise through our affiliation with the national CPA firm RSM McGladrey, which has performed hundreds of studies. Our services are confidential, stand-alone, and transparent to our clients' business activities.

### **Advisors**

As in all tax services, the IRS requires qualifications and competency in advisors. Therefore, our CPAs will provide all advice prior to and during the study. They are current in tax issues, perform studies frequently, and are well-versed in cost segregation. They review and classify assets located by engineering and estimating specialists, and will advise you throughout the study.

## **Recent purchase not booked yet**

*Additional benefits from the Revenue Procedure 2002-19 could apply.*

**Limited information** for tax classification, such as use, date of service, etc.

**Copies of invoices**, if available.

**A set of construction drawings** for identifying qualified assets, if available. They can be half-size, and will be copied and returned, if requested. We can perform a study without them.

**A site visit** to authenticate our findings. Usually less than two hours. Longer, without drawings.

**Comments:** Even if invoicing is incomplete or unavailable, construction and estimating specialists can determine the value of assets for cost segregation.

**Advantages:** We are backed by technical expertise through our affiliation with the national CPA firm RSM McGladrey, which has performed hundreds of studies. Our services are confidential, stand-alone and transparent to our clients' business activities.

## **Purchase previously placed in service**

*Property purchased after 1986 qualifies.*

**Limited information** for tax classification, such as use, date of service, how booked for depreciation, etc.

**Copies of invoices**, if available.

**A set of construction drawings** for identifying qualified assets, if available. They can be half-size, and will be copied and returned, if requested. We can perform a study without them.

**A site visit** to authenticate our findings. Usually less than two hours. Longer, without drawings.

**Comments:** Even if invoicing is incomplete or unavailable, construction and estimating specialists can determine the value of assets for cost segregation.

**Advantages:** We are backed by technical expertise through our affiliation with the national CPA firm RSM McGladrey, which has performed hundreds of studies. Our services are confidential, stand-alone, and transparent to our clients' business activities.

## **Savings estimates**

*Estimates for each facility are free and easy with the following:*

1. Building use
2. New or purchased
3. Cost
4. Date of service
5. How to contact

**To obtain more information, contact Stephen Holladay:  
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# 10 Myths

*Cost-Seg*

*1. My accountant probably did one.*

Unless it was done subsequent to May 13, 1996, when the tax laws changed, you are probably depreciating your assets incorrectly. In the case of purchased buildings, if you do not have a specific appraiser's report or a professional who has construction-cost-estimating expertise using national industry costing manuals, such as RS Means or Marshall and Swift breaking out the various building components, then you definitely did not have a cost segregation study performed on the building.

*2. A cost-segregation study won't save any money.*

This is true only if the entity or pass-through entity is losing money and has no ability to either carryback or carryforward the losses generated. Otherwise, the savings generally range from 35% to 48% of the additional depreciation generated from the study. For example, if a cost-segregation study results in additional depreciation of \$1,000,000, a taxpayer in the 48% tax bracket would save \$480,000 in federal and state taxes over four years.

*3. We don't have any assets to reclassify.*

Generally, 20-55% of building costs can be reclassified to shorter depreciable lives.

*4. Our chances of being audited will increase.*

Not according to the IRS. You are filing an automatic change-in-accounting method, which the IRS has preapproved assuming the form is filed correctly. In addition, the IRS has issued a publication to follow in order to properly record the changes in depreciable lives. Keep in mind that you are going from an incorrect method to a correct method and the changes made are generally black-and-white issues within the tax code.

*5. There is no support if the IRS does perform an audit.*

There are over 75 IRS rulings, procedures, and court cases which allow for cost-segregation studies. The report we provide details out every change with applicable support and documentation. Our firm is affiliated with the national CPA firm RSM McGladrey, which has spent over 1,000 hours researching cost-segregation studies and has performed hundreds of such studies.

*6. We will get the deduction in the future anyway.*

Yes, this is true, but a cost-segregation study in effect gives you an interest-free loan from the government for the first 15 years which you will then repay interest-free over the remaining 25 years. Who do you want holding your money? There are also advantages to doing a study if the building is going to be sold or upon the death of a building owner.

*7. We are in an Alternative Minimum Tax (AMT) situation and/or the cost-segregation study will put us in one.* Congratulations! You are probably flush with cash. If this does occur, the savings will be at the 28% federal tax rate and not the 36% to 41% tax rate.

Of course, the amounts are large enough so it shouldn't matter. In addition, the AMT taxes can be used against regular taxes in future years.

8. *My CPA has segregated percentages of construction costs based on invoices or contractors' application for payment, so our company is already benefiting.*  
Without the contractor/engineer expertise coupled with the tax-law guidance, there will likely be valuable tax benefits left on the table. More importantly, this methodology will not withstand IRS scrutiny.

9. *A cost-segregation study will complicate estate planning.*  
Yes it might, but the rewards of performing a study have great financial benefits if the owner of the building dies before the building is fully depreciated. Due to the "step-up in basis" rules, it is one of the rare times a taxpayer can "have his cake and eat it too."  
If done properly, a cost-segregation study is an estate-planning home run.

10. *There is no negative impact to not performing a cost-segregation study.*  
This is an incorrect assumption. IRS regulations require that a taxpayer compute depreciation on what is allowed or allowable. Therefore, if you improperly depreciate a seven-year asset over 39 years, the IRS could disallow the depreciation on the asset beginning in year eight. In addition, if the building is sold the IRS could increase the gain by reducing the basis in the building by the depreciation that should have been taken in prior years, but was not.

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