

Forum Financial Group & CPC

Your Source for Tax Benefits
Thru Cost Segregation

The US Treasury Department States:

“Cost segregation is a lucrative tax strategy that should be used in almost every major purchase of commercial real estate.”

-Wall Street Journal – June 2003

CPC was created to provide smaller property owners the same real estate tax strategies afforded to Fortune 500 companies for over 40 years.

What is Cost Segregation

Definition

What Is The Purpose?

Why Does It Exist?

When Was It Started?

Why Haven't I Heard Of It?

When Should A Study Be Done?

Cost Segregation

Definition

- Cost Segregation is a planning tool that can help owners of commercial real estate save significantly on their federal income taxes. Applying Cost Segregation to commercial property will determine how quickly an owner should be depreciating the property on their income taxes – 5, 7, 15, 27.5, or 30 years.

Cost Segregation

Purpose

- The Internal Revenue Service allows owners of commercial properties to accelerate depreciation on their real estate, which will result in reducing the property owner's taxable income levels.
- A cost segregation study is an in-depth analysis of the cost incurred to build, acquire or renovate a real estate holding.
- The primary goal of a cost segregation study is to identify all construction-related costs that qualify for accelerated income tax depreciation.
- Small or large, your business can save money with a cost segregation study, typically many times the amount you invest.

Cost Segregation

When – Chronological History

- 1986 – ITC ends and ACRS changes to MACRS. The scrutiny under tax credit audits ends.
- 1993 – Long life assets go from 31.5 years to 39 years.
- 1996 – The IRS allows look-back via Form 3115.
- 1997 – The IRS changes the 1 year catch-up to 4 years and the HCA landmark case.
- 1999 – The IRS acquiesces the HCA case from 1997 and asks the accounting world for better studies.
- 2001 – 9/11 incident initiates 30% bonus and return to 1 year catch-up and QLI starts.
- 2003 – Additional economic incentives needed so 30% bonus moves up to 50%.

Cost Segregation

Recent Developments

- Several recent rulings have been issued by the government to spur economic growth, which can have a major impact for building owners with previous construction and acquisitions.
 - During 2002, the IRS automatically consents to changes in the method of depreciation via Form 3115, filed with the return in the year the change is elected. (Rev. Procedure 2002-09)
 - What this means to you is the IRS made it easy to change your method of depreciation to account for a cost segregation study, without the headache of an amended return.
 - Following the 9/11 tragedies, the government allowed taxpayers to catch up on all deductions from previous years for items reclassified into the shorter tax lives as a result of a cost segregation study. (Rev. Procedure 2002-19)
 - What this means to you is prior to the 9/11 ruling, the beneficial adjustment had to be spread out across four years, but can now be expensed entirely in the year of the change, reported as a reduction to the current year taxable income.
 - In 2004, the IRS reversed the two-year waiting period required to change the method of calculation for depreciation on their property. (Rev. Procedure 2004-11)
 - What this means to you is...you can change your method of depreciation in any year. Previously, if you purchased a property and elected to depreciate it over 30 years, you had to wait two years before changing depreciation methods and utilize a cost segregation study to take advantage of the shorter-lived personal property asset classes.

Cost Segregation

Before & After

39 years
Or
27.5 year
depreciation



Expense

5 year

7 year

15 year

39 year
or 27.5
year

Cost Segregation

Residual vs. Engineering

- Engineering-Based Method
 - Comprehensive & highly detailed study.
 - Termed "...the most methodical and accurate approach, " & "...the most time consuming method and generally provides the most accurate cost allocations." by the IRS.
 - Complete documentation provided.
 - Includes all asset classes in a format developed by a "Big Six" accounting firm.
 - Details component cost for personal and real property providing the ability to retire assets.
 - Compliant with the IRS Audit Techniques Guide.
 - Meets or exceeds all 13 of the "Elements of Quality" identified by the IRS.
 - Engineering-based study is the most accurate study available.
 - Work is performed by engineering and cost segregation experts.

Cost Segregation

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Feature	Benefit
Comprehensive/Highly Detailed Study and Complete Analysis	The IRS Audit Technique Guide terms this method "...the most methodical and accurate approach." It further states that this approach is "...the most time consuming method and generally provides the most accurate cost allocations."
Complete Documentation Provided Including Project Reconciliation	Comprehensive documentation of all asset classes in a format developed by a "Big Six" accounting firm designed for use by CPA's.
Details Component Costs for Personal and Real Property Providing the Ability to Retire Assets	Provides the information necessary for asset write-offs during re-modeling or demo.
Study Compliant with the IRS Audit Techniques Guide	Meets or exceeds all 13 of the "Elements of Quality" identified by the IRS in the Audit Techniques Guide.
Engineering Based Study is the Most Accurate Study Available	Maximize and support the tax benefit for your client using what the IRS defines as the "most methodical and accurate approach."
Work Performed by Engineers and Cost Segregation Specialists	IRS states the preparation of cost segregation studies "require the knowledge of both the construction process and the tax law..."

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➤ Residual Method

- Cherry picks the obvious personal property components.
- Is an abbreviated method which only short lived asset costs are determined and does not generally reconcile project costs.
- Does not meet all of the IRS "Elements of Quality."
- Has the potential to leave a significant amount of personal property in a long life property class.
- "Quick & Dirty" study – limited tax benefit, study documentation and support.
- IRS states a residual study can be less accurate than an engineering-based study.
- Does not give the property owner the opportunity to retire real property assets.
- Does not require the knowledge of engineers nor cost segregation experts, which can leave significant amounts of personal property in long life classification.
- May not be defensible under IRS audit producing potentially no benefits with a possible penalty.

Cost Segregation

Why Haven't I Heard Of It?

- The Cost Segregation Analysis (CSA) concept is relatively new to non-Fortune 500 companies.
- A CSA requires an engineering skill set and expertise most accounting firms do not have in-house.
- The IRS prefers an engineering-based approach be employed to identify and reclassify construction costs into applicable segregated categories.

Cost Segregation

When Should A Study Be Done?

- The optimal time to perform a study is the year the property is placed in service.
- However, current IRS procedures allow a taxpayer to recover any missed depreciation on properties placed in service as far back as 1987 without having to amend prior tax returns.

The Benefits

How a CSA Will Help You

Benefits Breakdown

Benefits Example

Benefits

How a CSA Will Help You

- The IRS allows taxpayers to correct the tax lives for assets placed in service back to 1987.
- A CSA can recapture all of the understated depreciation expenses for any asset that has been improperly classified in previous years.
- Since the tax law changes took effect, thousands of taxpayers have utilized CSA studies to defer millions of tax dollars.
- Typically, only 3% of a building's component costs are classified to reap the greatest tax benefits.
- Catch up by finding money under your roof!

Benefits

Breakdown

- Typically, only 3% of a building's component costs are classified to reap the greatest tax benefits.
- A CSA will:
 - Increase cash flow which allows you to control the investment of your money.
 - Reduce federal and state tax liabilities.
 - Repairs & remodeling will be less costly due to the accelerated depreciation related to the detailed breakdown of building components.
 - Allows you to build savings into your architecture for the properties you propose to construct; the BCA can actually reduce the cost per square foot.
 - Reduce real estate property taxes.
 - Reduce the transfer tax basis due to separating personal property from building cost prior to purchase.
 - Correct any misclassified assets and claim "catch up" benefits in the current year.
 - Benefit bank loan qualifications.
 - Demolition & rehabilitation: Allows property owners to write off rather than capitalize certain assets.

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- Reduces insurance costs.
- Bridges the gap between engineering, construction and accounting systems.
- Achieve faster building & acquisition cost write-offs.
- Qualify for possible refunds on prior taxes paid.

Benefits

Example

- Recently CPC worked with a chain of 8 grocery stores valued at \$18M. Through our CSA study they were able to accelerate depreciation on \$3.7M, creating a tax benefit of over \$1.5M.
- In another case, a client qualified for the 50% bonus depreciation and through a CSA study was able to shift \$1M from 39 year property classification to 5 year property classification. This created an increase in first-year depreciation deductions by an impressive \$575,000, which equates to a tax benefit of about \$230,000.

Benefits

“Time is Money”

- If you believe that a dollar today is worth more than a dollar tomorrow then naturally a tax deduction today is worth more than a tax deduction tomorrow.
- 30 years ago the price was...
 - Milk..... \$0.14 per gallon
 - Gas..... \$0.32 per gallon
 - Average Home..... \$40,000
 - Gold..... \$42 per ounce
- What will today's dollar buy in 30 years?

NOT MUCH!!!

Qualifications

Who Qualifies?

Types of Buildings Qualify?

Types of Components Qualify?

Ask Yourself...

Qualifications

Who Qualifies?

- You qualify if you....
 - Own a commercial property with a valuation of \$1,000,000 or higher.
 - Made leasehold improvements totaling \$500,000 or higher.
 - Pay federal income taxes or have paid federal income taxes in the last year.
 - Operate a for-profit entity.
 - Plan on keeping the property for at least 1 more year.
- A CSA can be performed before the acquisition of a building. Personal property can be separated from the building costs and the two costs can then be broken out in the sales agreement thus reducing the transfer tax.

Qualifications

What Types of Buildings Qualify?

Types of Buildings	Average Cost Re-Allocation
○ Manufacturing Facilities	30-60%
○ Golf Courses	35-50%
○ Medical Facilities	25-43%
○ Banks	25-43%
○ Restaurants	23-40%
○ Veterinary Facilities	23-40%
○ Grocery Stores	27-37%
○ Hotels	25-35%
○ Auto Dealerships	20-35%
○ Retail Stores	15-32%
○ Apartments	20-30%
○ Offices	12-25%
○ Warehouses	10-17%
○ And more...	

Qualifications

What Types of Components Qualify?

- Communication Systems
- Transformers
- Hospitality Fixtures
- TV Outlets & Wiring
- Distribution Panels
- Distribution Wiring
- High Voltage Switchgear
- Data Jacks
- Miscellaneous Outlets
- Emergency Power
- Computer Data/Power
- Supply / Exhaust – Kitchens
- Removable HVAC Systems
- Environmental Control – Computer
- Environmental Control – Communications
- Specialized Fire Protection Systems
- Specialized Air Filtration / Sensing
- Sinks
- Drains
- Emergency Fixtures
- Waste Interceptors
- Security Access & Monitoring Systems
- Conduit / Wiring to Special Systems
- Flex Space
- Demountable Power Systems
- Shower / Deluge Fixtures, Supply & Waste
- Specialty Gas / Compressed Air Systems
- Millwork
- Floor Coverings
- Window Treatments
- Wall Coverings
- Demountable Walls
- Decorative Lighting
- Signage
- Sidewalk & Curbing
- Parking Lots & Curbing
- Site Utilities
- Landscaping
- Fencing
- Specific-Use Structures Foundations
- Mezzanines
- Stairs
- Platforms
- Structural Steel
- Task Lighting
- Vents
- Beams
- Columns
- Gas, Vacuum, Compressed
- Exhaust Systems
- Audio / Visual Systems
- Buss Ducts
- Neutralization Basins
- Humidity / Temperature Control
- Sewer & Drainage Systems
- Outdoor Lighting
- Swimming Pools
- Break / Coffee Stations

Qualifications

Questions to Ask Yourself

- Is there more than 1 electrical plug in each room?
- Do all of the walls penetrate the ceiling tiles and are they all load bearing?
- Is the decorative millwork throughout the property glued, nailed or hung on a wall?
- Is there a kitchen in the building?

A "YES" answer to any of these questions indicates that you will most likely benefit from a Cost Segregation Analysis!

Qualifications

Accurate Classification

- On average, CPC identifies that 20%-40% of a building qualifies as personal property.
- A much larger percentage of a building's assets are identified, classified and segregated for accelerated depreciation for federal income tax purposes.
- A comprehensive, appropriately documented Cost Segregation Study accelerates the tax benefits related to your building.

Why Forum Financial Group & CPC?

The Letter of the Law

CPC Experts

What We Can Do For You

Why CPC

The Letter of the Law

- The IRS developed a complicated and extensive document called the Audit Techniques Guide that provides a detailed outline of what a Cost Segregation Study and Report must contain.
- A CPC study will meet or exceed the 13 key components that make up a quality Cost Segregation Study and the 9 essentials required to ensure a quality report.

Why CPC

Our Experts

- Our engineering alliance leads the industry in conducting engineering-based cost segregation studies on commercial real estate.
- We have more than 150 years of combined Cost Segregation experience.
- We have the nation's top tax, engineering and construction experts on staff.
- The IRS supports our methodology and often asks our experts to review competitor's reports for accuracy.
- We have generated hundreds of millions of dollars in improved cash flow benefits for thousands of clients nationwide.
- Taxes are one of the largest expenses for commercial property owners.

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- Almost every for-profit commercial property owner can use this service.
- Most accounting firms do not have the necessary engineering staff to complete an IRS acceptable Cost Segregation Study.
- Recent tax law has made the Cost Segregation process seamless.
- One form is filed with the IRS to change the accounting procedure which reflects the tax benefits.
- Our goal is to serve commercial property owners by providing an ethical tax service which offers the property owner measurable tax benefits.
- At the core of our business are the values of ethics, leadership and excellence.

Why CPC

The Facts

- For more than 20 years, millions of dollars in tax benefits have been realized by commercial property owners who trusted our engineering alliance to perform their CSA.
- Over 150 years of combined experience conducting CSA studies is employed.
- Over 10,000 CSA studies have been submitted to and accepted by the IRS.
- CPC's Cost Segregation Analysis (CSA) ROI averages 25:1. (For every dollar spent on the service a property owner will receive 25 dollars in immediate tax benefits.)
- CPC's Cost Segregation Analysis is also completely endorsed by the IRS.

What To Do

First Step

CPC Deal Flow

What We Will Do For You

Critical Step

The Report

Tax Preparation

What To Do

First Step

- Send in your Tax Depreciation Schedule to CPC
- Within 10 business days of receiving a copy of your Tax Depreciation Schedule and basic property information CPC will:
 - Present a proposal outlining your tax benefits and our fee. The CSA fee is a flat bid based on the expected time, costs and travel expenses.
 - Your CPA's involvement is welcomed throughout the proposal presentation.
 - CPC is so confident of our final product that should an audit occur, no additional charges are incurred.

What To Do

What CPC Will Do For You

- Review architectural/engineering drawings and specifications, blueprints, contracts and invoices.
- Reconcile all project costs.
- Itemize assets that qualify for shorter life classification.
- Inspect the facility.
- Allocate indirect costs.
- Recalculate depreciation schedules.
- Prepare Form 3115.
- Issue a report to your CPA that will outline future depreciation schedules for your tax filings.
- CPC will perform a non-intrusive, yet detailed engineering study of a building's walls, floors, ceilings, and its plumbing, electrical, lighting, telecommunications, heating and cooling systems.

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- To achieve maximum client benefits, our experts prefer to work from building plans and cost documents in addition to an on-site inspection.

What To Do

Critical Step

- Throughout the CSA process, the CPC experts will identify, according to federal tax law, which components of each system can be assigned a shorter tax life of 5, 7, or 15 years eligible for accelerated depreciation, rather than straight-line over 39 years.
- These benefits drop right down to your bottom line!!!

What To Do

The Report

- The following will be included in the CPC report:
 - Scope
 - Tax Considerations – Specific legal authority to support classifications (Court cases, revenue rulings, etc.)
 - Detailed description of the property
 - Photographs
 - Schedules
 - Cost reconciliation – Indirect and Direct Costs
 - Summary by appropriate IRS class lives

What To Do

Tax Preparation

- A cost segregation study does not replace the accountant's role in determining taxes or preparing tax document and forms.
- It provides information to the accountant so the proper IRS forms may be prepared and the correct, allowable depreciation calculated.
- The document processing with the IRS is not complicated. No amended tax return re-filing is required – just a straightforward form prepared for your accountant.

Summary

Cost Segregation Summary

Experts Agree

Expert Advice

Recent Success Stories

Claim Your Tax Advantage Now

Summary

Summary

➤ Brief History

- The legislation and procedures used in an engineering-based cost segregation study have been in existence since the enactment of the Investment Tax Credit (ITC) in 1962. When the act was repealed in 1986, most people assumed that cost segregation studies provided no further benefit under the new tax law. However, in a landmark 1997 tax court case, Hospital Corporation of America successfully defended the application of engineering-based cost segregation as a viable method to differentiate real and personal property under the existing law.

➤ Benefits

- Engineering-based cost segregation studies allow commercial real estate owners to take what would otherwise be classified as real property (1250) for depreciation purposes and reclassify it as more rapidly depreciating personal property (1245). This reclassification results in substantial shorter depreciable tax life and accelerated depreciation methods.

➤ Why Haven't I Heard of Cost Segregation?

- So if cost segregation has been around so long, it begs the questions, Why haven't you heard of it? In order to realize the maximum benefits available under current tax law, the IRS prefers a specialized engineering firm to provide your CPA with an engineering-based cost segregation study. The majority of CPA firms are not qualified to provide these services.

Summary

Experts Agree

- “The impact of a cost segregation study, following the passage of the 2002 act, to properly allocate assets and depreciate them over a shorter depreciable life is astounding and creates an opportunity not to be missed for real estate investors.”

- Jane M. Brewer, CPA, MST and M. Kent Thomas, CPA
Shareholders with the Certified Public Accounting
and Consulting Firm of KAWG&F, P.A.
The First Set: Sending Your Tax Depreciation Schedule

Summary

Expert Advice

- “A cost segregation study, for either new construction or recently completed projects, can significantly improve the financial viability of a project by accelerating depreciation deductions, as well as improving return on investment.”

-Robert Rahner, Accounting Today

- “Faster write-offs of commercial property building costs are usually available when a cost segregation study is performed.”

-Don Ray, Ward's Dealer Business

- “Whether a real estate investor is constructing, purchasing or expanding a building, a cost segregation study can significantly increase cash flow by accelerating tax deductions.”

-Jane M. Brewer, CPA, Baltimore
Daily Report, Time Is Money

Summary

Claim Your Tax Advantage Now

- Initiating building component analysis studies as soon as possible results in maximum savings.
- Building component analysis studies can begin before a building is constructed, acquired or after a project is completed, even years later.
- Every dollar of depreciation claimed today is worth one dollar of tax deduction, but every dollar of depreciation claimed 39 years from now is only worth a small fraction of that.

TIME IS MONEY – GET STARTED NOW!!!

THANK YOU!

For more information, or to arrange for a free initial cost segregation analysis, call or email us. We'll be glad to help you evaluate your options.

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