

LEVIN, SILVEY, ZELKO & MACKEY, P.A.

Certified Public Accountants

MITCHELL H. SILVEY, CPA
ROBERT A. ZELKO, CPA
BONNIE L. MACKEY, CPA, CSEP

2699 STIRLING ROAD, SUITE B-205
HOLLYWOOD, FLORIDA 33312-6543
(954) 985-8808
(954) 985-8839 (FAX)
WWW.LSZCPA.COM

Cost Segregation

Cost segregation is a tax technique used to accelerate depreciation on any new real estate. This is done by having an engineering study prepared on the purchase of Real Estate to segregate “real” property assets that will qualify for reclassification as “personal” property. Depreciation for residential rental property, such as apartment buildings, is calculated over twenty-seven and a half years compared to thirty-nine years for office buildings, warehouses, and other commercial buildings; whereas personal property can be depreciated over five to fifteen years as compared to real property. Therefore, if a portion of the long-term depreciation can be shortened to a range of five to fifteen years, income taxes can be saved, thus increasing cash flows as well.

Cost segregation increases tax savings and improves cash flow by utilizing faster depreciation expense, consequently lowering taxable income. For example, changing from twenty-seven and a half years or thirty-nine years to a period of five to fifteen years enables businesses to virtually write off the “personal property” in half the time which equals larger deductions! The increase in cash flow could then be used to make extra mortgage payments, which in turn saves on interest expense over the life of the mortgage.

Typically the cost segregation works best on real estate purchased up to ten years ago; therefore, it would make economic sense to do the study within the first ten years of owning the property. The effect of this engineering study can be applied retroactively by filing amended returns or can be applied currently by making adjustments going forward. Per the IRS, the cost segregation must be calculated through the use of an engineering study in order to take advantage of this technique. If you think your business might qualify for these tax savings and/or energy efficient deductions, please call our office for further details. In addition, we can discuss with you how to receive these credits for a non-profit or government agency.

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