**MONEY MATTERS**

**Presented By:**

# Saving tax dollars via cost segregation

Generally, early fall is a wise time to start planning year-end tax strategies. And one of the most effective tax-saving tactics for many dealerships is to perform a cost segregation study.

With cost segregation, the individual components in a facility are separated into different categories for depreciation purposes. Certain categories of assets have shorter depreciable lives and can thus be depreciated faster, lowering taxes.

### How does cost segregation work?

When calculating depreciation of commercial property, dealerships must use the correct method and cost recovery period for the type of property. Dealership property can be categorized as nonresidential income property, tangible personal property or land improvements.

*Nonresidential income property* must be depreciated on a straight-line basis over 39 years. But *tangible personal property* and *land improvements* can be depreciated over a shorter period: five or seven years (using double declining balance) for tangible personal property and 15 years (using 150% declining balance) for land improvements.

Unless a cost segregation study is performed, the different components in a facility are aggregated as nonresidential income property for depreciation purposes. In this scenario, the entire facility will have to be depreciated over 39 years.

A cost segregation study will provide a detailed analysis of the costs related to the construction, acquisition or remodeling of dealership facilities in order to reallocate some of them as tangible personal property or land improvements. These individual components can then be depreciated faster, resulting in larger tax deductions sooner — and this can improve cash flow and boost profitability.

There are a wide range of different components within a dealership that can usually be reallocated for depreciation purposes. Plumbing and electrical systems, carpeting, awnings and canopies, and parking lot paving are a few common examples of these types of components.

### Where else can cost segregation be applied?

In addition to dealerships building, remodeling or purchasing new facilities, dealerships that own existing facilities also may be able to benefit from a cost segregation study.

Final tangible property regulations issued in 2013 permit certain repair and maintenance costs to be expensed and deducted immediately, while other costs must be capitalized and depreciated. A cost segregation study can identify which repair and maintenance expenditures may be expensed and deducted now, instead of being depreciated over a number of years.

The permanent extension of the increased Section 179 expensing limit of $500,000 and temporary extension of first-year bonus depreciation by the Protecting Americans from Tax Hikes (PATH) Act present another tax opportunity to use cost segregation.

Up to $500,000 of qualifying fixed-asset purchases, including some of the building components listed above, can now be expensed each year. You can also immediately expense and deduct 50% of the cost of certain types of new property purchased and placed in service in 2017.

Performing a cost segregation study could enable you to maximize your bonus depreciation deduction this year. An example helps demonstrate how:

Suppose you are building a new facility at a total cost of $5 million and a cost segregation study reclassifies $1.5 million of this cost as tangible personal property that qualifies for accelerated depreciation. Claiming 50% bonus depreciation (or $750,000) on these expenses could save your dealership about $300,000.

### Who should conduct the study?

A cost segregation study should be performed by an outside, independent firm. According to the IRS *Cost Segregation Audit Techniques Guide*, there are no prescribed qualifications for cost segregation preparers. The guide, however, states that a study conducted by a construction engineer would, all else being equal, be considered more reliable than one by someone without a construction background.

The guide further states that other important criteria include "experience in cost estimating and allocation, as well as knowledge of the applicable law." It adds: "A quality study identifies the preparer and always references his/her credentials, experience and expertise in the cost segregation area."

### Is cost segregation right for you?

The details involved in cost segregation can be complex, so it's smart to obtain professional advice and assistance, including from a tax advisor. Your CPA firm can help you analyze the potential tax benefits of having a cost segregation study performed. The potential tax savings may be well worth the time and cost involved in the study.

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