

# Cost Segregation 101

*Reducing Taxes Through Accelerated Depreciation*

**39 • 5 • 7 • 15**

## Property Classes Defined:

### 39 Year Property

refers to the building structure and its integral components. This includes the foundation, bearing walls, roofs, ceilings, general electrical, general HVAC and general plumbing. This category is real property.

### 5 Year Property

refers to equipment that serves the primary function of the business. Examples include specialized HVAC, electrical and plumbing systems that serve restaurant kitchens, and computer network wiring, etc. This category is personal property.

### 7 Year Property

includes those items that dress out the interior such as furniture, decorative lighting, drapes, flooring, cabinetry, non-bearing walls, telephone equipment, and office equipment. This category is personal property.

### 15 Year Property

refers to exterior land improvements separate from the building structure. It includes irrigation, site utilities, paving, grading, trash enclosures, storm drains, parking lots, retaining walls and landscape lighting.

*The purpose of Cost Segregation is to identify those assets within an investment property that can be reclassified as personal property or land improvements. The motivation is that, while commercial property is depreciable over 39 years, personal property is depreciable over 5 or 7 years and land improvements are depreciable over 15 years. By reclassifying such assets, property owners can greatly increase their depreciation deduction.*

The table below illustrates the relative annual depreciation for a \$1,000 asset in each of these categories.

<b>39</b>	<b>5</b>	<b>7</b>	<b>15</b>
\$25.64	\$200	\$142.86	\$66.67

To put it another way, every asset that is reclassified from 39 year property to 5 year property results in a 780% increase in annual depreciation.

A 7 year asset represents a 557% increase and a 15 year asset represents a 260% increase in annual depreciation.

To really bring the point home, let's assume that a \$100,000 asset has been reclassified. The table below illustrates the net tax benefit to the property owner, assuming a 35% tax rate.

<b>39</b>	<b>5</b>	<b>7</b>	<b>15</b>
\$897.44	\$7,000	\$5,000	\$2,333.33

Even these numbers don't do the strategy justice as 5 and 7 year property are subject to a 200% declining balance depreciation and 15 year property is subject to a 150% declining balance depreciation. Furthermore, a property owner can claim past years' depreciation on their current return.

If the owner has held the property for seven years before doing a cost segregation study, he could claim all 5 and 7 year depreciation in one return.

*For more information, please contact:*

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