

Cost Segregation

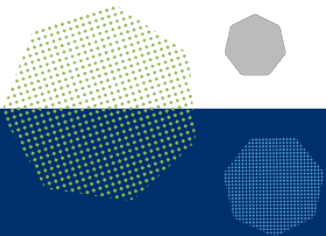
Heather Benson

August 17, 2022



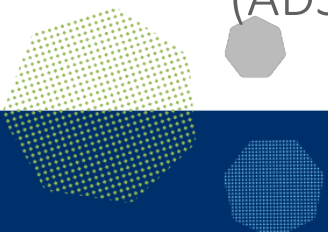
Overview

- What is Cost Segregation
- Who Can Benefit
- Difference in Recovery Lives
- Tax Savings Perspective
- Bonus Depreciation
- Quality Improvement Property (QIP)
- Case Study Example
- Comparing Results with and without Bonus Applied



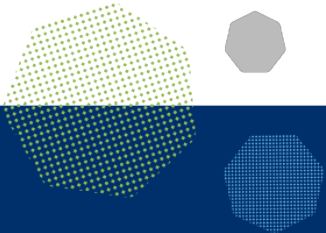
What is Cost Segregation?

- The purpose of a Cost Segregation Study is to identify assets within a building structure that can be segregated out into accelerated recovery lives
 - Reallocating total basis cost into appropriate classes and recovery periods
 - Provides accurate depreciation calculations
- Without a study a building and the land improvements are classified as §1250 real property (structural components)
 - 27.5 year (residential), 39 year (non-residential), 40 year (ADS)
- Identifies assets in the building and land improvements that qualify as §1245 personal property
 - 5-year (personal property), 7-year (FFE/manufacturing), 9-year (ADS), and 15-year (land improvements)



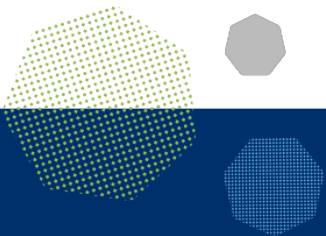
Who can benefit from a CSS?

- Commercial Real Estate Owners
- Acquisitions (previous or new), new construction, renovations, expansions, tenant improvements, 1031 exchange, Tenancy in Common (TIC), Step-Up in Basis, Real Estate Investment Trusts (REIT)
- Industry type examples: multi-family, assisted living, mixed use property, hotels, restaurants, business and medical office suites, hospitals, light industrial/warehouse, self-storage, manufacturing, auto dealerships, retail shopping centers, grocery stores, veterinary/animal care facilities



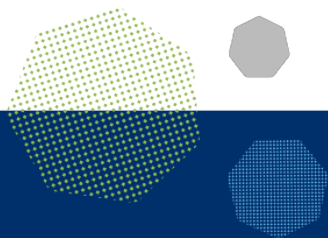
Polling Question 1

- What is the purpose of a cost segregation study?
 - A) To reallocate depreciable cost basis of property into appropriate class lives and recovery periods
 - B) To identify assets that can be accelerated for depreciation
 - C) To increase depreciation expense for tax savings purposes
 - D) All of the above



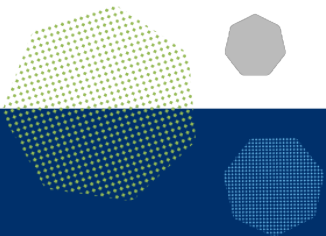
§1250 Real Property

- §1250 Real Property is the building structure
- IRS defines a “building” as any structure enclosing a space withing its walls, usually covered by a roof, to provide shelter, housing, work, office, parking, or sales space.
- Structural components of building include walls, partitions, permanent floorings, ceilings, windows, doors, stairs/elevators, and all systems required to run and maintain building (MEP, fire protection)
- Excluded from the definition includes
 - Any structure essential to machinery or equipment
 - Structure which houses property used as an integral part of an activity
 - If the use of structure is closely related to the use of the property
 - If use of structure clearly can be expected to be replaced



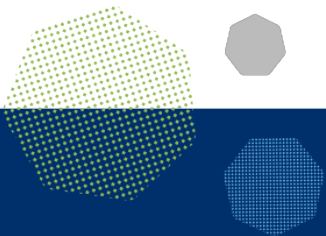
§1245 Personal Property

- The exclusion of items which are not considered structural components, can be considered §1245 personal property
 - Easily removable
 - Decorative in nature
 - Specialty to the industry the building is operating as
 - Components dedicated to machinery and other equipment
 - Secondary systems



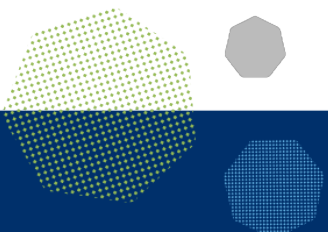
Land Improvements

- Land improvements are both §1250 real property and §1245 personal property
- Structural/Real Property land improvements are specific to building structural components (utility lines, building pad grading)
- Personal property include improvements made to land not related to building structure
 - Paving, landscaping, signage, dumpster enclosures, fencing, storm drainage



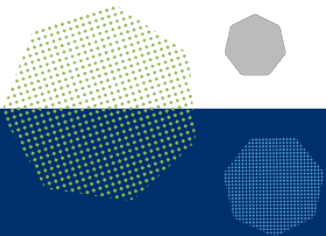
§1250 vs. §1245 Examples

	Building Shell	Doors & Windows	Finishes	Carpentry & Millwork	Electrical	Plumbing	HVAC
1250 Real Property	<ul style="list-style-type: none"> Exterior Finishes Doors & Windows Roof 	<ul style="list-style-type: none"> Standard Doors, Frames & Hardware 	<ul style="list-style-type: none"> Drywall Paint Permanent Flooring - Ceramic Tile 	<ul style="list-style-type: none"> Framing Bathroom Vanities 	<ul style="list-style-type: none"> Primary Lighting Non-Specialty Electrical Wiring 	<ul style="list-style-type: none"> Plumbing necessary for building function – bathroom & drinking fountains Kitchen sinks in residential units 	<ul style="list-style-type: none"> Heating and cooling systems for the general building
1245 Personal Property	<ul style="list-style-type: none"> Awnings Building Signage Building Lettering Overhead door seals and bumpers (Dock equipment) 	<ul style="list-style-type: none"> Double Swing/High Impact Doors Interior Overhead roll-up doors Interior Vision Panels 	<ul style="list-style-type: none"> Wallpaper/Vinyl Wallcoverings Removable Flooring – Carpeting, Vinyl, Strip Flooring Wall Mirrors 	<ul style="list-style-type: none"> Baseboard & Crown moldings Base Cabinets Countertops Wall Cabinets Wood Wall Paneling 	<ul style="list-style-type: none"> Secondary accent lighting Dedicated equipment/special purpose outlets Dedicated equipment/Special purpose wiring Security Cameras Site Lighting 	<ul style="list-style-type: none"> Kitchen sinks in non-residential (break-rooms, medical offices) Compressed Air piping Interior Hose Bibbs Floor Drains & Sink Grease Traps Plumbing dedicated to appliances & equipment 	<ul style="list-style-type: none"> Kitchen/Equipment Exhaust Fans Clothes Dryer Venting Equipment Ductwork/Venting PTAC units – IT Room Auto body exhaust systems Interior refrigeration panels



Polling Question 2

- What is an example of a 1245 personal property item?
 - A) A new roof
 - B) The main lighting system
 - C) Carpeting
 - D) Ceramic Tile



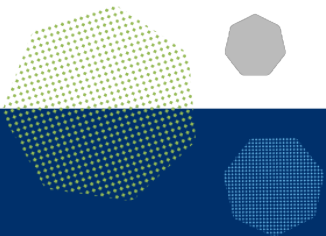
How does this help from a tax savings perspective?

- Longer recovery lives result in lower depreciation expense/lower tax deduction
- Accelerated class lives increase depreciation expense, resulting in larger tax deduction, allowing for an increase in cash flow
- On average a study will reclassify 20-40% of the depreciable cost basis into shorter recovery lives
- Bonus Depreciation and Quality Improvement Property (QIP) allow for additional tax savings



Bonus Depreciation

- Bonus Depreciation currently allows assets with a MACRS class life of 20-years or less to be fully accelerated/deducted in the first year
 - 100% - PIS date between Sept. 28, 2017- Dec 31, 2022
 - 80% - PIS 2023
 - 60% - PIS 2024
 - 40% - PIS 2025
 - 20% - PIS 2026
 - 0% - PIS 2027 and later

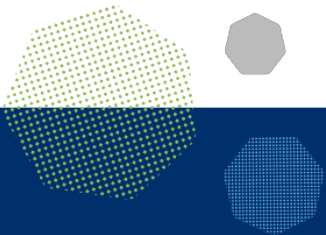


Quality Improvement Property (QIP)

- Property that has interior renovations made to an existing footprint
- PIS date after 12/31/2017
- Assets that are typically structural components with a recovery life of 39 years can be accelerated to 15-year QIP Eligible for Bonus Depreciation
- Examples: Flooring that is considered permanent (tile), interior walls, paint, new electrical/plumbing/fire suppression systems, components of HVAC systems (ductwork)
- Does not include elevators/escalators, or structural framing
- Allows for higher percentage to be reclassified (Up to 100%)

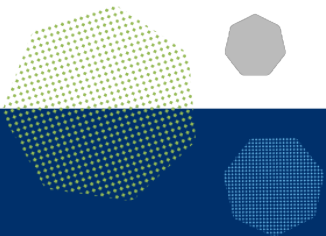
Polling Question 3

- Which would qualify for QIP
 - A) New exterior doors and windows
 - B) New ceramic tile in an existing space
 - C) A new roof on an existing property
 - D) An expansion of a property



Case Study example

- Purchase a retail shopping center: \$3,400,000
- Standard Deduction: \$83,674
- Reclassified:
 - 27% into 5-year \$918,000
 - 21% into 15-year \$714,000
 - Total Deducted Year 1: \$1,632,000
- Increase in Depreciation Expense \$1,591,836
- After-Tax Increase in Cash Flow: \$518,811
- NPV of Study: \$316,283



Benefits of a Study with Bonus:

Year		Current Dep. Before Study	Estimated Results of Study:				Estimated Benefits of Study:			
		39-Year	5-Year*	15-Year*	39-Year	Total Deductions	Increase in Depreciation Expense	After-Tax Increase in Cash Flow	NPV Savings	
		\$ 3,400,000 100%	\$ 918,000 27.00%	\$ 714,000 21.00%	\$ 1,768,000 52.00%		F=E-A	G=FxTax Rate	H=GxPV Factor	
		A	B	C	D	E=SUM(B:D)	F=E-A	G=FxTax Rate	H=GxPV Factor	
1	2020	\$ 83,674	\$ 918,000	\$ 714,000	\$ 43,510	\$ 1,675,510	\$ 1,591,836	\$ 518,811	\$ 518,811	
2	2021	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (12,866)	
3	2022	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (12,138)	
4	2023	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (11,451)	
5	2024	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (10,803)	
6	2025	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (10,191)	
7	2026	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (9,614)	
8	2027	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (9,070)	
9	2028	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (8,557)	
10	2029	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (8,072)	
11	2030	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (7,615)	
12	2031	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (7,184)	
13	2032	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (6,778)	
14	2033	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (6,394)	
15	2034	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (6,032)	
16	2035	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (5,691)	
17	2036	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (5,369)	
18	2037	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (5,065)	
19	2038	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (4,778)	
20	2039	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (4,508)	
21	2040	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (4,252)	
22	2041	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (4,012)	
23	2042	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (3,785)	
24	2043	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (3,570)	
25	2044	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (3,368)	
26	2045	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (3,178)	
27	2046	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (2,998)	
28	2047	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (2,828)	
29	2048	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (2,668)	
30	2049	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (2,517)	
31	2050	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (2,375)	
32	2051	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (2,240)	
33	2052	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (2,113)	
34	2053	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (1,994)	
35	2054	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (1,881)	
36	2055	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (1,774)	
37	2056	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (1,674)	
38	2057	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (1,579)	
39	2058	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (1,490)	
40	2059	\$ 3,638	\$ -	\$ -	\$ 1,892	\$ 1,892	\$ (1,746)	\$ (569)	\$ (59)	
Totals:		\$ 3,400,000	\$ 918,000	\$ 714,000	\$ 1,768,000	\$ 3,400,000	\$ -	\$ -	\$ 316,283	

*100% Bonus Applied in year 1



Benefits of a Study without Bonus:

Year		Current Dep. Before Study	Estimated Results of Study:					Estimated Benefits of Study:		
		39-Year	5-Year*	15-Year*	39-Year	Total Deductions	Increase in Depreciation Expense	After-Tax Increase in Cash Flow	NPV Savings	
		\$ 3,400,000 100%	\$ 918,000 27.00%	\$ 714,000 21.00%	\$ 1,768,000 52.00%		F=E-A	G=FxTax Rate	H=GxPV Factor	
		A	B	C	D	E=SUM(B:D)				
1	2020	\$ 83,674	\$ 321,300	\$ 62,475	\$ 43,510	\$ 427,285	\$ 343,611	\$ 111,990	\$ 111,990	
2	2021	\$ 87,176	\$ 238,680	\$ 65,188	\$ 45,332	\$ 349,200	\$ 262,024	\$ 85,399	\$ 80,565	
3	2022	\$ 87,176	\$ 143,208	\$ 58,619	\$ 45,332	\$ 247,159	\$ 159,983	\$ 52,142	\$ 46,406	
4	2023	\$ 87,176	\$ 101,072	\$ 52,765	\$ 45,332	\$ 199,168	\$ 111,992	\$ 36,500	\$ 30,646	
5	2024	\$ 87,176	\$ 101,072	\$ 47,481	\$ 45,332	\$ 193,884	\$ 106,708	\$ 34,778	\$ 27,548	
6	2025	\$ 87,176	\$ 12,668	\$ 42,769	\$ 45,332	\$ 100,769	\$ 13,593	\$ 4,430	\$ 3,310	
7	2026	\$ 87,176	\$ -	\$ 42,126	\$ 45,332	\$ 87,458	\$ 282	\$ 92	\$ 65	
8	2027	\$ 87,176	\$ -	\$ 42,197	\$ 45,332	\$ 87,529	\$ 353	\$ 115	\$ 76	
9	2028	\$ 87,176	\$ -	\$ 42,126	\$ 45,332	\$ 87,458	\$ 282	\$ 92	\$ 58	
10	2029	\$ 87,176	\$ -	\$ 42,197	\$ 45,332	\$ 87,529	\$ 353	\$ 115	\$ 68	
11	2030	\$ 87,176	\$ -	\$ 42,126	\$ 45,332	\$ 87,458	\$ 282	\$ 92	\$ 51	
12	2031	\$ 87,176	\$ -	\$ 42,197	\$ 45,332	\$ 87,529	\$ 353	\$ 115	\$ 61	
13	2032	\$ 87,176	\$ -	\$ 42,126	\$ 45,332	\$ 87,458	\$ 282	\$ 92	\$ 46	
14	2033	\$ 87,176	\$ -	\$ 42,197	\$ 45,332	\$ 87,529	\$ 353	\$ 115	\$ 54	
15	2034	\$ 87,176	\$ -	\$ 42,126	\$ 45,332	\$ 87,458	\$ 282	\$ 92	\$ 41	
16	2035	\$ 87,176	\$ -	\$ 5,284	\$ 45,332	\$ 50,615	\$ (36,561)	\$ (11,916)	\$ (4,972)	
17	2036	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (5,369)	
18	2037	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (5,065)	
19	2038	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (4,778)	
20	2039	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (4,508)	
21	2040	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (4,252)	
22	2041	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (4,012)	
23	2042	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (3,785)	
24	2043	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (3,570)	
25	2044	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (3,368)	
26	2045	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (3,178)	
27	2046	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (2,998)	
28	2047	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (2,828)	
29	2048	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (2,668)	
30	2049	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (2,517)	
31	2050	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (2,375)	
32	2051	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (2,240)	
33	2052	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (2,113)	
34	2053	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (1,994)	
35	2054	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (1,881)	
36	2055	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (1,774)	
37	2056	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (1,674)	
38	2057	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (1,579)	
39	2058	\$ 87,176	\$ -	\$ -	\$ 45,332	\$ 45,332	\$ (41,844)	\$ (13,638)	\$ (1,490)	
40	2059	\$ 3,638	\$ -	\$ -	\$ 1,892	\$ 1,892	\$ (1,746)	\$ (569)	\$ (59)	
Totals:		\$ 3,400,000	\$ 918,000	\$ 714,000	\$ 1,768,000	\$ 3,400,000	\$ -	\$ -	\$ 225,939	

*100% Bonus Applied in year 1



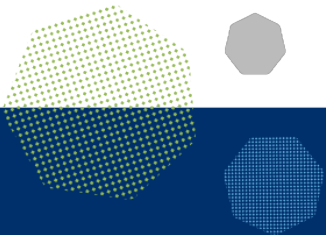
Comparison with and without Bonus Applied

	Total Accelerated	Year 1 Deduction	Increase in Depreciation Expense Year 1	Increase in Depreciation Expense Over 5 Year Period	Increase in Depreciation Expense Over 15-Year Period	Year 1 Increase in Cash Flow	Increase in Cash Flow over 5-Year Period	Increase in Cash Flow Over 15-Year Period	NPV of Study
With Bonus:	\$1,632,000	\$1,632,000	\$1,591,836	\$1,424,459	\$1,006,014	\$523,070	\$468,070	\$330,571	\$316,283
Without:	\$1,632,000	\$427,285	\$343,611	\$997,911	\$1,000,730	\$111,990	\$325,239	\$326,158	\$225,939



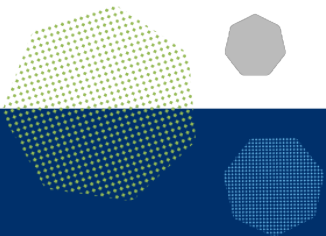
Example of QIP

- Client performed renovations within the existing office space \$4,940,000
- Standard Deduction: \$121,573
- Reclassified:
 - 18% 5-year \$889,200
 - 9% 7-year FFE \$345,800
 - 19% 15-year Land Improvements \$938,000
 - 30% 15-Year QIP \$938,600
 - Total Accelerated: 74% \$3,754,000
- Increase in Depreciation Expense: \$3,636,474
- NPV: \$600,114

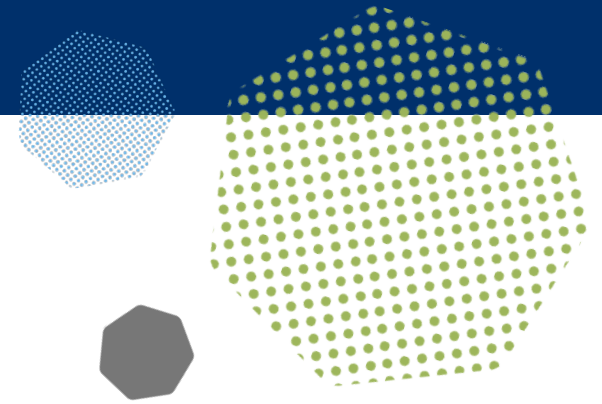


Polling Question 4

- Which is true of bonus depreciation?
 - A) Qualifying assets can be fully deducted in the first year
 - B) Begin decreasing at 20% each year starting Jan. 1, 2023
 - C) Adds additional impact on tax deductions in year 1
 - D) All the above



Questions?

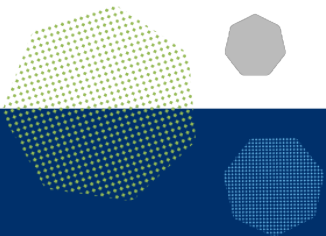


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