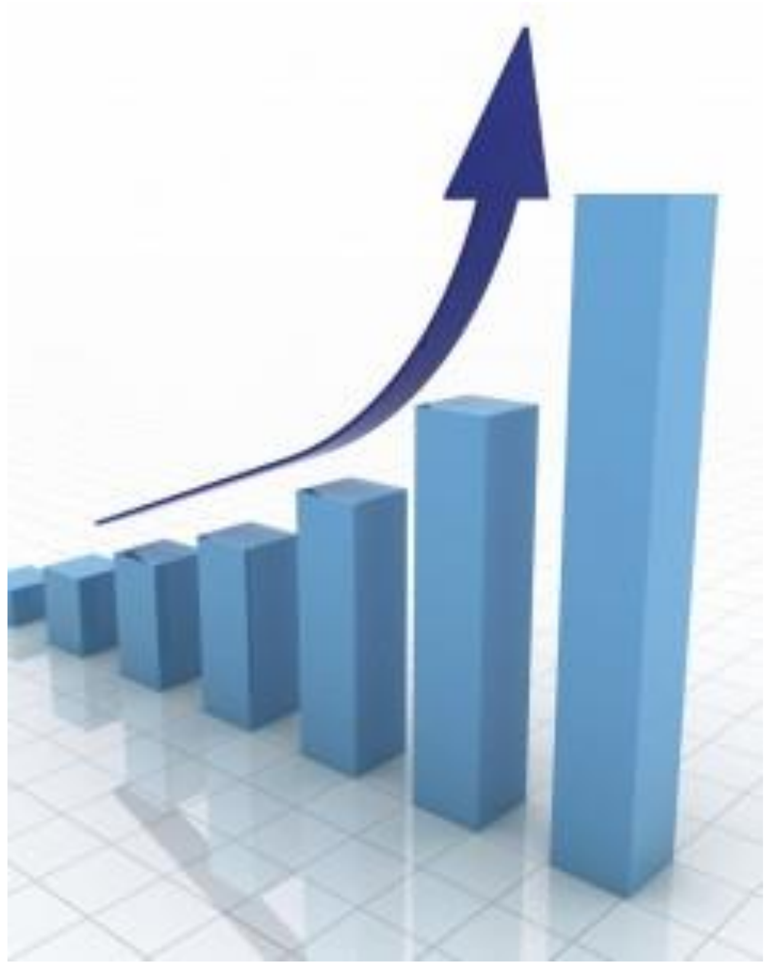
INCREASE Cash Flow and Tax Savings through Cost Segregation

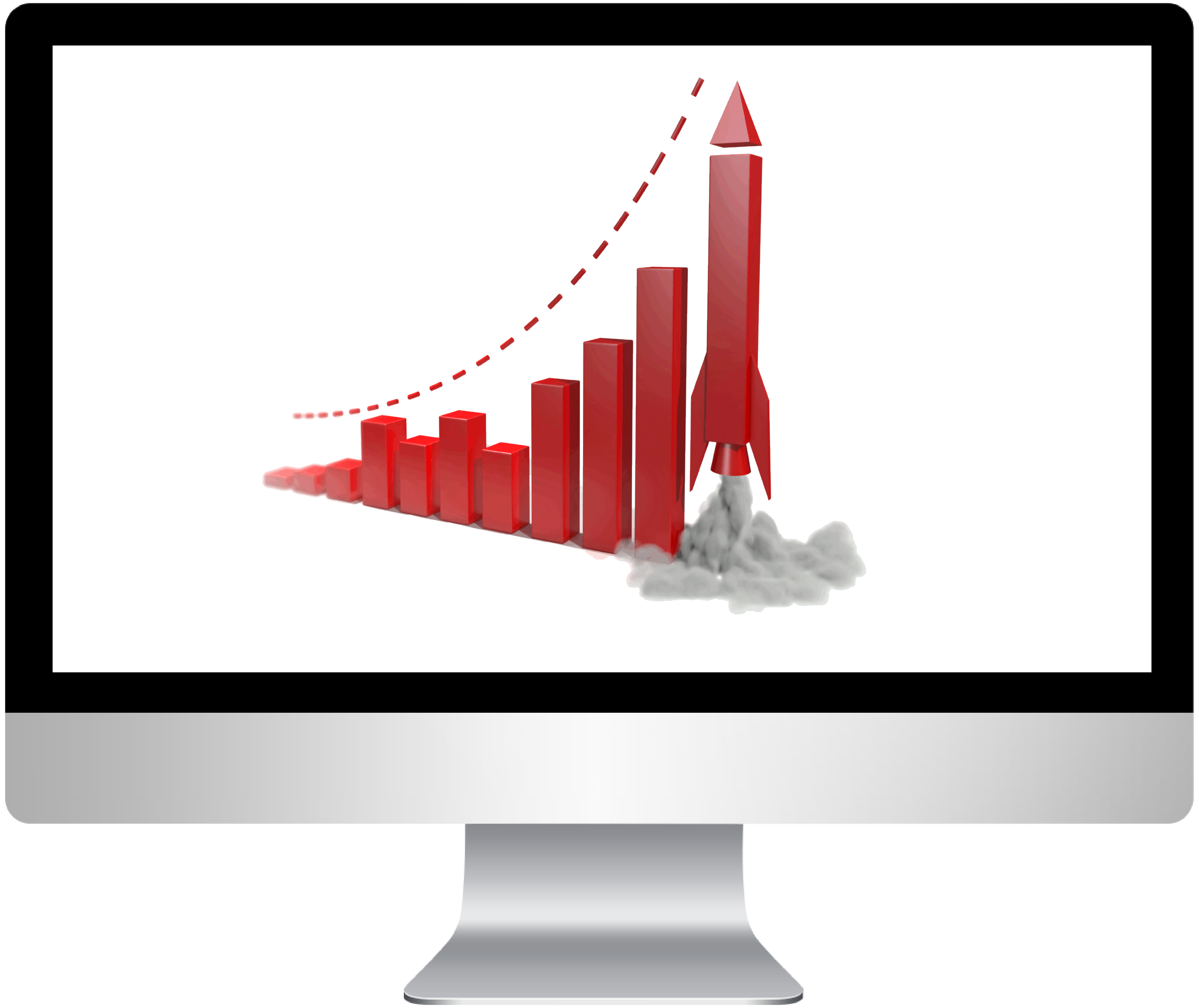
Cash Flow and Tax Savings



What is Cost Segregation Study?

- A detailed engineering-based analysis of all construction or purchasing costs associated with a property
- It classifies these costs based on allowable tax rules as personal property or real property
- Personal property are items such as cabinets, flooring, security systems, certain portions of the electrical and plumbing systems as well as all land improvements outside the building perimeter (such as asphalt, concrete, landscaping, etc.)

Cash Flow and Tax Savings



How does segregating personal property and real property increase cash flow and produce tax savings?

- It’s done through the magic of depreciation expense Depreciation expense is a non-cash tax deduction taken on all real and personal property.
- Depreciation expense REDUCES the net income from a property, thereby reducing taxable income and reducing tax payable for the real estate investor.
- This way, the real estate investor keeps more cash by paying less tax on rental net income.

Cash Flow and Tax Savings

Let’s see how the strategy works with a recent real-world example

Assume a Class A office building is purchased in Las Vegas on 1/1/2019 for $3,000,000

Depreciation Expense for 2019 **WITHOUT** Cost Segregation:

- 39 Year Assets only
- Depreciated using Straight-Line
- First Year Depreciation Expense is:
- **$58,974**

Depreciation Expense for 2019 **WITH** Cost Segregation:

- 5, 15 and 39 Year Assets identified
- Depreciated using DDB* and Straight-Line
- First Year Depreciation Expense is:
- **$1,213,371**

*Double Declining Balance

Cash Flow and Tax Savings

That’s a difference of $1,154,397!

Cash Flow and Tax Savings

Cost Segregation Example #2, building purchased before 9/27/17

Assume an office/warehouse purchased on 12/31/2015 for $2,000,000

Cumulative Depreciation Expense by 2019 **WITHOUT** Cost Segregation:

- 39 Year Assets only
- Depreciated using Straight-Line
- Cumulative Depreciation Expense is:
- **$239,402**

Cumulative Depreciation Expense by 2019 **WITH** Cost Segregation:

- 5, 15 and 39 Year Assets identified
- Depreciated using DDB and Straight-Line
- Cumulative Depreciation Expense is:
- **$589,345**

Cash Flow and Tax Savings

That’s a difference of $**349,944**
spread over the first five years!

Cash Flow and Tax Savings

Why such a substantial difference?

The answer is **100% BONUS DEPRECIATION**

- All ***personal*** property purchased or constructed after 27 September 2017, ***whether it was new or used***, became eligible for **100% Bonus Depreciation**.
- This means that, **ALL** personal property identified using Cost Segregation for buildings purchased or constructed after this date, are eligible for **100% WRITE-OFF** in the year purchased or completed!
- Before this date, bonus depreciation was still available, but only at 50% and only for **NEW** assets.
- **UNLESS YOU DO A COST SEGREGATION TO IDENTIFY THE PERSONAL PROPERTY, YOU CANNOT TAKE BONUS DEPRECIATION!** Therefore, a Cost Segregation study is essential in order to take advantage of 100% bonus depreciation.

Cash Flow and Tax Savings

Side-by-Side Comparison Las Vegas Office Building

Effects of Cost Segregation on Taxable Rental Income 2019

Rental Income	Without Cost Seg	With Cost Segregation
Rent	$ 200,000	$ 200,000
Rental Expenses		
Interest	$ 20,000	$ 20,000
Utilities	$ 10,000	$ 10,000
Maintenance	$ 5,000	$ 5,000
Insurance	$ 2,500	$ 2,500
Net Income	$ 162,500	$ 162,500
Depreciation Expense	$ 58,974	$ 1,213,371
Net Taxable Income	$ 103,526	$(1,050,871)
Tax	$ 46,587	$ -

Financial Effects of Cost Segregation

- Worst case scenario is that the loss created from the excess depreciation expense is carried forward to offset future net income from rental activity
  - Can be used to offset income from other rental properties in some cases
- For designated real estate professionals, this loss can be used to offset ***ordinary income***, which could wipe out taxable income for the entire year, depending on circumstances
- Either way, ***cost segregation will create increased depreciation expense*** to lower taxable income and increase cash flow

Cash Flow and Tax Savings

In summary…

01 Cost Segregation helps increase cash flow by keeping cash in the real estate investor’s pocket rather than sending it to Uncle Sam. This cash can be used to invest in more properties

02 Cost Segregation saves money on taxes by reducing current taxable income through increased depreciation expense.

03 Cost Segregation helps with tax compliance, given the new Treasury regulations on Tangible Property (a discussion for another day…)

THANK YOU!

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