

RENOVATIONS & REDEVELOPMENT

A cost segregation study (CSS) can generate significant tax benefits when used properly with renovation or redevelopment projects. Unfortunately, many are unfamiliar with the finer points of this valuable application and miss out on immediate deductions.

In addition to the initial accelerated depreciation benefit from a CSS, there is an ongoing asset management component to consider. Most businesses write-off adjusted basis when fixed assets are retired, so why do so many taxpayers overlook this strategy with what is often their largest fixed asset – real estate? Because they generally don't have the cost details needed to properly support this strategy.

ISSUES TO CONSIDER

- When an asset is retired, the taxpayer can generally write-off the adjusted basis of that asset in the year of retirement (adjusted basis is the remaining amount of depreciation).
- The cost of the asset must be known in order to determine adjusted basis.
- If the specific asset cost is unknown, the asset remains on the depreciation schedule.
- The costs of individual assets that make up a building are lumped together, and therefore unknown without additional analysis.
- A CSS can break-out the individual asset costs within a building and establish the details needed to calculate adjusted basis on an asset level to support these write-offs.

Example 1: Property A, acquired five years ago, was renovated this year. A CSS performed prior to the renovation provided details for \$1,000,000 of assets that were retired as part of the project and eligible for write-off.

- The adjusted basis of \$883,530 (34 years worth) will be deducted this year.
- Without the detail from the CSS, the retired assets would continue to be depreciated over the remaining depreciable life of 34 years at \$25,640 per year.

Example 2: Tenant X moved into Building B 11 years ago. The total cost for the leasehold improvements when they moved in was \$800,000; \$400,000 of which was paid for by the landlord (50%). Tenant X vacated the property last year and now the space is being renovated to prepare for Tenant Y. A CSS prior to the renovations showed that \$500,000 of original improvements was retired and eligible for write-off.

- The landlord's portion of the retired basis is \$250,000 (50% of the \$500,000 retired).
- The landlord will deduct the adjusted basis of \$188,833 (29 years worth) this year.
- Without the details from the CSS the landlord would continue depreciating the retired assets over the remaining depreciable life of 29 years at \$6,410 per year.

The IRS provides specific rules pertaining to this application which must be carefully considered. Bedford is available to discuss and explain these rules in detail. Contact us today to ensure you achieve the maximum benefit.