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September, 2005

Mr. A. Smith
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Dear Mr. Smith:

Cash Flow Tight? Consider a Cost Segregation Study

Got profits? Then most likely, you have a tax liability. In today's business world, in order for a company to succeed financially, it must not only pay strict attention to the changing winds of customer demands, but also to the ever changing tide of our tax laws. As business owners, you must be vigilant in seeking out different ways to increase revenue and decrease expenses to drive up profits. However, you must also look for ways of minimizing tax liabilities as a result of the increased profits. For auto dealerships, one strategy to consider is a cost segregation study.

Auto dealership owners must wear many hats in order to have a financially successful business and most likely, being up to par on the latest tax code and regulations is NOT one of those hats. That's why you have a proactive accountant who is up to date on the latest rules and regulations.

In 1997 a landmark tax court case, *Hospital Corporation of America*, the taxpayer successfully defended its cost segregation study, which was used to obtain enormous tax benefits. This landmark case ultimately laid the groundwork for future real property owners to be able to perform cost segregation studies and obtain similar tax benefits.

What is a cost segregation study? Simply put, it is a means of accelerating depreciation on real property that is used in a trade or business. By accelerating depreciation, a company's tax liability can be drastically reduced, thereby substantially increasing the business's cash flow.

A cost segregation study itself is a comprehensive analysis that identifies building components in new or existing buildings, which can be reclassified from real property to personal property. The study also specifically evaluates the different types of personal property identified and allocates them to specific class categories, thus allowing the business to maximize accelerated depreciation for qualifying building components.

Traditionally, owners of buildings claim depreciation on the buildings over lengthy periods (27.5 and 39 years for residential and nonresidential property, respectively) using the straight-line method of depreciation. However, using a cost segregation study, qualifying property is identified, segregated and reclassified into shorter depreciable tax lives of five, seven or 15 years for federal and state income tax purposes. Savings are achieved by reducing the business's tax liability in earlier years, thus enhancing cash flow. Items such as specialty lighting, wall coverings, carpeting, special purpose wiring, cabinetry, mechanical equipment, special types of floor coverings, landscaping, etc.—whatever items are not considered structural, can be segregated and reclassified into shorter depreciable lives.



The potential savings realized from a cost segregation study will vary based on a number of factors, including your effective tax rate -- but it is not unusual to obtain savings approaching \$100,000 on projects as small as \$1,000,000 in total development costs. Businesses also have quite a bit of flexibility when it comes to choosing which tax year they intend to claim the benefits of the cost segregation study.

The following table illustrates the potential benefits obtained from performing a cost segregation study.

Property Type	Total Costs (in millions)	Net Present Value of Tax Savings	Tax Savings Years 1-5
Apartment Complex	\$1.52	\$84,039	\$129,704
Auto Dealership	\$1.64	\$118,238	\$141,210
Manufacturing Facility	\$2.81	\$208,136	\$259,101
Strip Shopping Center	\$2.48	\$117,738	\$372,425
Office Building-- Class A	\$3.50	\$158,668	\$178,303

One reason why a cost segregation study benefits auto dealerships in particular is the specialized nature of the facilities. There are display areas, showrooms, specialized lift and repair equipment, as well as many other equipment systems, all of which would be classified as personal property subject to the shorter accelerated depreciation methods. If you feel that your property might be suitable for a cost segregation study, you will want to talk with cost segregation experts to determine what the cost benefits would be for your specific property. You should be able to find a qualified team of cost segregation experts who will do a no-cost feasibility study for you, which will give you an indication of the net present value you can expect as a result of your study.

Typically, in order to proceed with a study, your team will need:

- A complete set of construction and site plans
- Final AIA application and a document of certification for payment or other cost information
- Listing of all leasehold improvements
- Direct or indirect costs paid by the owner that are not included in other documents
- Other information deemed appropriate.
- The final purchase price less land value
- Estimated square footage

Your team of experts can help you seamlessly navigate the cost segregation process. If you put your property into service after 1986 and you plan to hold your property for an additional two to five more years, you may want to consider if a cost segregation study is right for your auto



dealership. We hope this information is helpful and if you would like more details please do not hesitate to call Ryan Losi directly at (804) 228-4179.

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