Using Cost Segregation to Reduce Building Costs

Performing Financial Due Diligence

It's mind-boggling how many dentists today are thinking about constructing a building or expanding their existing facility. While there are many reasons to improve your current facility or purchase a new building for your dental practice, there is one you may not have considered.

Under current tax regulations, there is a methodology you can use that will dramatically cut your tax bill with Uncle Sam. Called "cost segregation," this approach will help you reduce building costs by way of accelerated depreciation, and ultimately increase your cash flow.

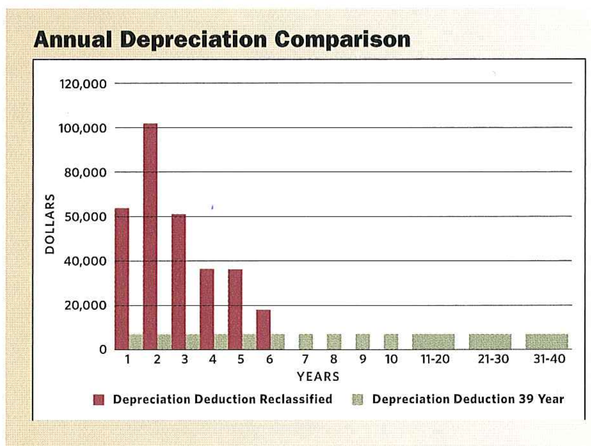
Cost Segregation is an IRS approved method of shifting a significant portion of the depreciable basis of your building from 39-year life property to five-, seven- and 15-year life property. By reducing the depreciable life of your property, you can greatly accelerate your annual depreciation and reduce your tax liability, generating immediate cash flow. In addition, cost segregation allows easier write-offs when an asset becomes obsolete, broken or destroyed.

The key to cost segregation is viewing a real estate acquisition as consisting not only of land and buildings, but also tangible personal property and land improvements. The process of cost segregation begins with a formal engineering report at the time of property purchase that segregates assets into four categories, identifying any assets that qualify for a shorter depreciable life:

Personal property. This category typically includes items such as furniture, carpeting, fixtures and window treatments, and can be depreciated using a five- or seven-year recovery period, producing significant tax savings.
Land improvements. Typically including items such as sidewalks, fences and significant landscaping, this category is subject to an accelerated depreciation method with a typical recovery period of 15 years, again producing useful tax savings.
The building. The engineering report will assign separate values to various components of the building so that if a component (such as the roof) subsequently becomes worthless, you can write it off more easily.
Land. Whatever amount of the purchase price is not accounted for in the first three categories is allocated to land, which generally has a low or insignificant value and therefore will not generate significant tax savings.

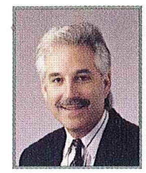
A taxpayer can use cost segregation when constructing a new building or buying an existing one. In addition, even if you have owned your building for several years, you may be able to "catch-up" all of the depreciation you could have taken in prior years, in the current year.

Cost segregation is not without controversy. One of the trickier aspects is the actual categorization of property and distinguishing between tangible personal property and a building's structural components. A CPA trained and experienced in cost segregation will play a central role in making these distinctions and guiding you through the cost segregation process.



The cost of the engineering study that forms the basis for cost segregation can appear daunting, but the advantages in tax savings far outweigh the initial investment. In the typical dental practice, for instance, assets that qualify for accelerated depreciation can range from 15 to 40 percent of the total building cost. The huge tax savings this represents could significantly offset the costs of owning or constructing your building, providing even greater leverage when designing your dream practice.

Author



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