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Tax strategy uses depreciation guidelines to increase cash flow

by Robyn Friedman, Special to the Sun-Sentinel

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Depreciation is not normally a topic that gets people excited. But some property owners are rejoicing because of a tax strategy that allows them to accelerate depreciation on their properties and thereby improve their cash flow.

Owners of commercial real estate (office, warehouse, retail and manufacturing buildings) can currently depreciate the buildings over 39 years. Apartment buildings can be depreciated over 27.5 years. But components of each of these properties can be written off over shorter periods -- for example, seven years for furniture and fixtures, and five for machinery and equipment.

Accountants use a "cost segregation study" to identify and "segregate" the different components of a building to use their shorter depreciation periods. That allows property owners to increase the depreciation deductions they take in the early years of ownership and lower their tax bill.

"You're increasing your tax deductions earlier in the project, so you're reducing your income tax liability and increasing your cash flow," said Larry Rosenblum, an accounting manager at Goldstein Lewin & Co. in Boca Raton.

Savvy property owners will no doubt recognize that the total depreciation taken on a property doesn't change as a result -- the total of all deductions will be the same whether the asset is depreciated over the normal 39- or 27.5-year schedule or on a shorter one. Still, by using a cost segregation study, property owners can "bunch up" deductions earlier in the life of the project, thereby freeing up cash.

"It's basically like getting an interest-free loan from the government," Rosenblum said.

Rosenblum said his firm does about three cost segregation studies a month. The minimum fee to conduct one, he said, is about $7,000. That involves the time of the accountant to walk the property and handle the tax aspects as well as the cost to hire professionals, such as construction experts or building engineers who can identify the components with shorter depreciation schedules. The process takes between four and six weeks.

Dale Chynoweth, chief financial officer for Keenan Development Group Inc., a developer of office, industrial and apartment buildings based in Fort Lauderdale, has had cost segregation studies done on three office buildings the firm owns.

"I was quite skeptical when I first heard of it because I wondered why wasn't it being done before by our accountants," said Chynoweth. "You just assume they're going to take the most aggressive stance."

Chynoweth was glad he overcame his skepticism. "It increased our depreciation in one year by $1 million," he said.

But Chynoweth stressed that while he's taking advantage of increased deductions early on, he'll pay the price down the road. "Over the first five years, I've got accelerated deductions that are a huge amount of money, but in years six, seven, eight, nine -- in those years, my depreciation is much lower than it otherwise would have been."

Rich Shavell, president of Shavell & Co. PA in Boca Raton, has formed a company dedicated to doing cost segregation studies called SCS Real Estate Advisors. He works with developers, contractors and owners of all types of commercial properties, as well as other CPAs to help them mitigate the tax liabilities of their clients.

He said the typical accounting firm does only about three cost segregation studies a year.

"They can't develop the expertise to walk the properties and determine what should be considered for segregation as well as work with the engineers, appraisers and contractors that are necessary," Shavell said. "It's truly a multi-disciplinary task, and we view ourselves as the quarterback."

Shavell has even created a course for accountants and attorneys that has been approved for continuing education credits. The course, "Cost Segregation Studies: What CPAs and Attorneys Need to Know," was recently presented in Boca Raton and was attended by 12 accountants from firms throughout Palm Beach and Broward counties. Plans are under way for additional courses.

But despite their advantages, cost segregation studies are not right for everyone. They are best for property owners who purchased or constructed property within the past five years for a price of at least $1 million and who intend to hold the property for at least two years.

Those interested in obtaining such a study should be sure to hire a qualified accountant. Not every accountant is qualified, experts say. Cost segregation studies should be done only by a firm knowledgeable about construction that has completed other similar studies.

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