

# Manufacturing



HOLBROOK & MANTER, CPAs  
PROFESSIONAL SERVICES FIRM

## ***Tools for thought:***

### **A Dollar Today is Worth More than a Dollar Tomorrow**

#### ***Cost Segregation Studies Can Free Cash Flow***

Weak economies slim-down profit margins, tighten credit markets, and restrict investment capital. Under these conditions, prudent business owners look for unconventional capital sources. One such unconventional source begins with a Cost Segregation Study (a “Cost Seg”). A Cost Seg can free cash for capital expenditures or normal operations.

Manufacturers can save on upgrading their production center; retailers can fund new/improved storefronts in existing and new markets; shopping malls or office building can remodel to lower energy costs and attract new tenants. The possibilities seem limitless. Interestingly, Cost Segs can enhance a business with no expansion/updating objectives too.

Cost Segs are technical tax componentizations applied to commercial buildings constructed, remodeled, expanded or purchased since 1987. Cost Segs can result in sizeable tax savings by accelerating depreciation allowances. Even the U.S. Treasury Department advised in the *Wall Street Journal* that Cost Segs “should be considered in almost every real estate purchase.”

Whether or not you’re considering a real estate purchase – or recently made one – multiple reasons exist for considering a Cost Seg.

A Cost Seg segregates the costs of various building parts/components. This permits classifying certain parts/components as “personal property” or “land improvements” rather than “real property.” This classification reduces your tax bill by accelerating available depreciation deductions.

Real property depreciation is figured over extended lives (as long as 39 years). Long lives mean small annual depreciation deductions. Personal property depreciation routinely entails substantially shorter depreciation lives such as 5, 7 and even 15 years. Shorter lives mean larger depreciation deductions. “A dollar in your pocket today is worth more than a dollar in your pocket in 2050.” Consequently, reclassifying \$100,000 worth of lighting, plumbing, HVAC and other such assets as five-year personal property (as opposed to real property) creates roughly \$16,000 in net-present-value tax savings (assuming a 5% discount rate and a 35% marginal tax rate).

Newly constructed improvements may qualify for either bonus depreciation or expensing under IRC §179. In any event profitable manufacturers moving to new (or at least new to them) facilities may find a Cost Seg results in partially funding the costs of buying and renovating the facility. A business with a net operating loss (aka NOL) may be able to carry back the Cost Seg-generated depreciation losses and secure cash refunds of prior year taxes.

A peripheral benefit of reclassifying building components as personal property may permit real property value reductions for “property tax” purposes. And Cost Seg componentization simplifies

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writing off the lighting, plumbing, HVAC or other such assets when they are replaced or become obsolete.

***Be Proactive!***

The IRS requires thorough and detailed records for Cost Segs to achieve their desired results. Hence, a Cost Seg specialist becomes indispensable. In new construction early specialist involvement assures more suitable documentation respecting personal property's use and cost. Specialists also assist your architects or engineers with creating necessary information and documentation. This is particularly valuable in constructing complex and highly detailed buildings.

Cost Segs are both possible and valuable after construction is complete. Success in this setting depends on recognizing, documenting and valuing all building components so the reclassification is approved by the IRS. In this setting IRS approval is necessary. Here is where the specialist really proves his/her worth.

Cost Segs can be applied to most types of commercial buildings, but conventionally Cost Segs are most valuable regarding specialized buildings such as manufacturing and processing plants, hotels, banks and apartment buildings.

A Cost Seg may be just the cash flow boost your business has been seeking.

*To learn more about Cost Segs and how they may favorably impact your business, contact Stephen C. Smith or your Holbrook & Manter representative before attempting any Cost Seg. We facilitate Cost Segs for growth-minded clients.*