Federal Income Tax Planning For Commercial Real Estate Transactions Teleconference

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I. Cost Segregation After A Sale

A. Utilize "catch-up" depreciation

B. No amended returns (3115)

1) 3115 is change-of-accounting method

2) IRS approval not required

3) Massive level of additional depreciation for properties owned five-plus years

C. Rate arbitrage

1) 35% ordinary income minus 15% capital gains, equals 20%

D. Tax savings are 20% of amount of incremental depreciation

E. Individual/LP/LLC versus corporation

F. No deferral benefit

G. Depreciation first shields ordinary income, then is taxed as capital gain

H. Reduces recapture of long-life depreciation at 25%

II. Sales Price Allocation

A. Elements include:

1) Land

2) Five-year property (carpet, tile, etc.)

3) Seven-year property (signs)

4) 15-year property (landscaping, pavement, etc.)

5) Long-life property (27 ½ years for rental residential or 39 years for commercial)

6) Maximizing allocation to land and long-life property minimizes taxes

7) Market value of carpet and vinyl tile five to 10 years hence?

8) Market value of signs five to 10 years hence?

9) Market value of site improvements five to 10 years hence?

B. Myth is that cost segregation only reduces taxes; fact is that a reasonable sales price allocation effects a tax rate reduction

1) Example: An office building with a cost basis of $10 million, land value of $1 million, sold after 10 years for $12 million

a) Analysis without cost segregation

	1,000,000	Cumulative Depreciation	Sale Price Allocation	2,000,000
5				
7				
15				
39	9,000,000	2,307,700		10,000,000

b) Analysis including cost segregation

Land	1,000,000	Cumulative Depreciation	Sale Price Allocation	2,000,000
5	1,500,000	1,500,000		0
7	100,000	100,000		0
15	1,500,000	1,000,000		500,000
39	5,900,000	1,512,800		10,000,000
		4,112,800		

i. Additional depreciation: $1,805,100

ii. Tax savings (@ 35% - 15% = 20%): $361,000

iii. Tax savings from reduced recapture at 25%: $198,700

iv. Taxes at sale without cost segregation: $876,900

v. Tax at sale with cost segregation: $1,068,200

c) Taxes at sale without cost segregation

Sales price	$12,000,000
Less basis	$ 7,692,300
	$ 4,307,700

Recapture of long-life	$2,307,200 x 25% =	$576,900
Capital gains	$2,000,000 x 15% =	$300,000
		$876,900

d) Taxes at sale with cost segregation

Sales price	$12,000,000
	$5,887,200
Total gain	$6,112,800

Recapture of long-life depreciation	$1,512,800 x 25% =	$378,200
	$4,600,000 x 15% =	$ 690,000
		$1,068,200