Are you making the most of depreciation deductions?

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If you're looking for a way to lower your tax bill and your dealership owns real estate, a cost segregation study may be the answer. Read on to see if you qualify.

What is a cost segregation study?

You may be eligible to retroactively save taxes through accelerated depreciation if you purchased real estate, built a new showroom, renovated your facilities or expanded your property anytime since 1987.

Traditionally, dealers depreciate nonresidential buildings and improvements over 39 years using the straight-line depreciation method. A cost segregation study, however, works differently. It identifies, segregates and reclassifies qualifying property into asset groups with shorter depreciable lives of five, seven or 15 years. These shorter lived personal assets are eligible for MACRS accelerated depreciation schedules, rather than straight-line depreciation.

Cost segregation studies are used for tax purposes only. Your GAAP financial statements won't be affected by the study, unless your dealership uses tax depreciation methods for book purpose, too.

Which assets qualify?

Take a look at what's included in the value of your real estate. Chances are the gross amount will include such things as carpeting, window treatments, wiring, cabinetry, lighting, driveways, wall coverings and cubicles, landscaping and drainage. Soft costs such as architectural and engineering fees might also be lumped into the total. All of these items potentially can be carved out as personal property and depreciated more quickly than standard real estate.

For example, suppose a dealer purchased a new showroom for $5 million in 2002. In 2012, his CPA conducts a cost segregation study and determines that the following assets can be reclassified:

- Parking lot ($500,000),
- Carpeting, blinds and wallpaper ($20,000),
- Cabinetry ($25,000),
- Lighting ($5,000),
- Service equipment ($200,000), and
- Landscaping and drainage ($50,000).

This study enables the dealer to reclassify and accelerate depreciation on $800,000 of its fixed assets. In 2012, he can deduct all the depreciation he could have taken since the building was acquired 10 years ago. Note that, with tax rates scheduled to rise in 2013, you may want to wait until then to finalize your study.

Auto retailers tend to achieve some of the highest savings from cost segregation studies compared to other businesses. That's because dealerships own significant fixed assets — including display areas, lift and repair equipment, showrooms, and other specialized mechanical systems — that can be mistakenly classified as real property.

When will tax savings happen?

By reclassifying assets, dealers can maximize their depreciation deductions in the early years, improving cash flow sooner rather than later. Cost segregation studies adjust the timing of deductions, not the total deductions taken over an asset's life.

Since 1996, dealers have been able to capture immediate retroactive savings from cost segregation studies. Before then, taxpayers had to spread depreciation savings over four years. Today, you can deduct the full amount as soon as your study is complete, thereby dramatically lowering your current tax bill. Of course, if you're buying, building or renovating a dealership currently, this also is an ideal time to perform a study.

By lowering the value assigned to real property, a cost segregation study also can help you save on real estate, sales and use taxes.

Why do I need a formal study?

Formal cost segregation studies are required to support the deductions on your tax return in accordance with IRS guidelines. An experienced professional can analyze a dealership's blueprints, engineering drawings and electrical plans to determine exactly which assets qualify as personal property. Bottom line? A formal cost segregation study will prove its worth should the tax man come a-knocking.

Savings varies

Tax savings will vary depending on the value of your property, its age and your effective tax rates. But, it's not uncommon to convert 20% to 40% of total building costs from real to personal property. Contact us to discuss how much you can expect to save from a cost segregation study.

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