

# Partners in Business

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## **Cost Segregation—A Tax Deduction to Write Home About!**



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Advanced Auto Service & Tire Centers provides you with complete automotive care to include repair, scheduled maintenance, tires, wheels and accessories. We opened our first Auto Service store in Ahwatukee 28 years ago and since then we've expanded to 14 locations throughout Arizona. Today the competition is all around us and we are still number one with our customers. Many of our original customers still come to us today!

Since 1989 we've built our business on trust, honesty, great pricing, and quality products serviced and installed by highly trained professionals. We will let you know when something needs fixing, when it might need repair in the future... and when it doesn't.

# Presented By: Chuck Thornton

## *CPA/PFS, CFP, MBA, CLU, CLTC, CCPS*

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Roy “Chuck” Thornton is one of those tax experts that seems to pull miracles out of the air. We’ve seen him in action with clients and on the tax presentation stage. He’s hosted a variety of professional designations like CPA, PFS, CLU, MBA (tax) CCPS. Maybe your tax situation needs a miracle!

Stay Tuned!

# Tax Savings with Commercial Property

**“Cost Segregation is a Lucrative Tax Strategy that should be used in almost Every Major Purchase of Commercial Real Estate”**

**– THE WALL STREET JOURNAL.  
2003**

# Some Real Results

Industry	First Year Savings
Wholesale Distributor	\$125,000
Contractor	\$325,000
Internet and Local Retailer	\$225,000
Dentist, Sole Practitioner	\$ 82,000
Retail Distributor	\$126,000
Major Medical Group	\$229,00
Manufacturer	\$182,000

*How did they use their savings? Most put the money back into their business. But we confess, **one purchased a nice vacation home!***

Are you ready for this?

# What is Cost Segregation?



- We don't want to make this boring, but this is nothing more than redoing depreciation in a way that gives you faster and larger deductions up front
- When you see the results, it does get exciting!







# The Typical Accountants Tax Treatment for Depreciation of A Building

- Allocate 80% of the cost to the building and depreciate over 27.5 years for residential or 39 years for commercial



- Or a slightly more proactive approach might be to allocate a very small amount to landscaping for a 15 year write off, or even a smaller amount to cabinets and carpeting for 5 years—this is referred to as a “desktop cost segregation”
- Cost segregation gives a much better result. You might save hundreds of thousand of dollars

# Depreciation Could be (or could have been deducted) Under a Cost Segregation Approach—if Used Properly

- Assumption
  - Building (cost of land not included) with \$2,000,000 Depreciable basis, typically written off over 39 years

**VS**

- Same building with 25% of that basis allocated to 5 and 15 year property (tangible personal property)
- Result
  - Additional tax deduction first six years **\$300,000**
  - Cash flow savings in first year after tax is **\$120,000**

# How can you do this?

- The definition of personal property for tax (hereafter called Section 1245 property) is NOT the same definition under local law
  - Depreciation is faster (as much as 5 years vs 39 years)
- However, a majority of accountants fail to take faster depreciation, and in most cases only depreciate over 39 years

Whenever you find  
yourself on the side of  
the majority, it is time  
to pause and reflect.

Mark Twain



THORNTON

# Section 1245 Property

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- **Means**

- Property subject to depreciation, Personal property, Property that is non-inherently a permanent structure, or
- Other property used as an integral part of manufacturing or production...

The degree of clarity at which a televised image broadcast signal is received

**def·i·ni·tion** n. 1.  
The teacher gave definitions of the new words.  
of an image (picture) on a screen

# Examples

## 1245 Property which would be real estate under most local law

- Electrical outlets specially associated to items of machinery or equipment
- Decorative rockwork not functioning as part of building
- Floor covering, sheet vinyl, carpeting
- Decorative light fixtures
- Decorative carpentry
- Strippable wall paper
- Paint booth in a fabrication facility

Some cost segregation providers report that in some industries, up to 25% of a building might be allocated to 1245 property!

# How do you defend, your allocation with the IRS

- The last method is “Rule of Thumb”—a guess approach that some accountants might attempt
  - IRS warns the IRS auditor to “...view this approach with caution, since it lacks sufficient documentation to support the allocation of project costs”
- Burden of proof is always with the tax payer
- IRM discussion six methodologies



# How Even a Properly Prepared Cost Segregation Study can Go Bad!

**Alternative Minimum  
Tax**

\$\$\$

**WHAT TYPE OF  
ENTITIES**

**Elections!!!!**

**Basis and at Risk Limitations**

**Too Many Deductions?**  
What Year?

\$\$\$

# Select A Possible Company to do your Cost Segregation Study: *With Care And Competent Advice*

- There is no IRS restriction and almost anyone can purportedly do a cost segregation analysis referred to as study, sometimes “anybody” does
  - Google “cost segregation” yields 3,170,000 hits
  - Google “cost segregation provider” yields 216,000 hits
- Do you think the IRS knows this?
- *Who has the burden of proof? —you do!*



# Select A Possible Company to do your Cost Segregation Study: *With Care And Competent Advice*

- Do they use a “Rule of Thumb”? –Stay Away!
- How factually intensive are their reports, and are they supported by corroborating evidence?
- Are the cost segregation company’s personnel competent in; design, construction, auditing, and estimating procedures related to construction?

*Sources: IRS Rev Rule 73-4401, PLR 7941002. Chief Counsel Advice Memo 19921045, PLR 7941002*

# ...With Care and Competent Advice

- Providers of cost segregation sometimes approach you to use their services
- Most are not CPA's. They do not know of your situation, nor can or will they provide a candid assessment of your need or use for a study
- If you seek help from your own tax advisor, inquire:
  - Have they been involved extensively with the use of cost segregation studies?
  - Do they know the criteria that should be used in the selection of a cost segregation company—are they familiar and have they read the audit guide?

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# Do CPA's Generally Advise on Cost Segregation Studies?

Some undoubtedly do

We believe, however, that most do not and have little knowledge in this specialty, the discovery and relevance of the timing, and need of a study.



# Does RC Thornton and Associates CPA's do Cost Segregation Studies?

*No we do not do studies—are you surprised?*

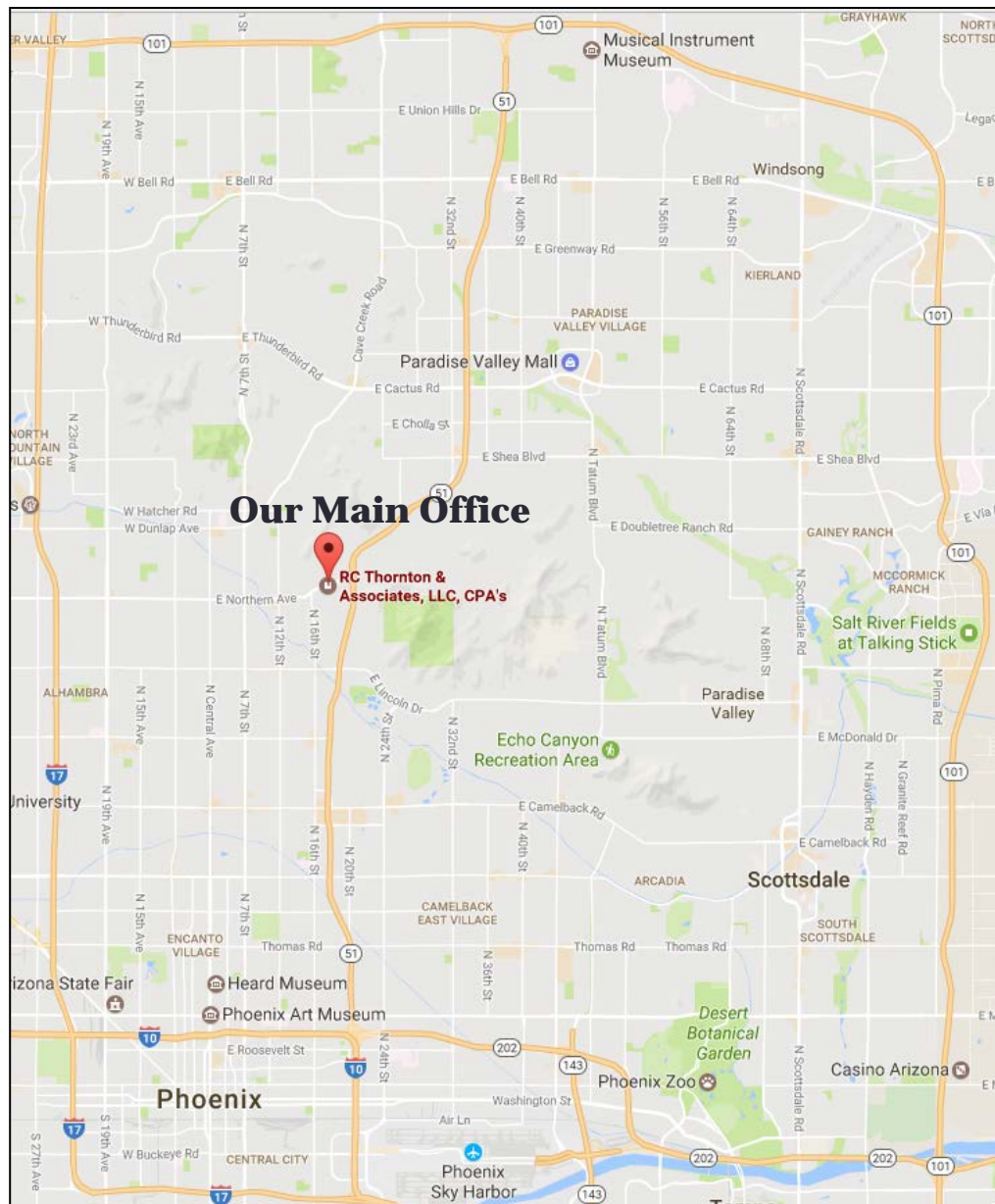
Although there is no specific requirement by the IRS on who does these studies and reports, we feel, as many other's do, this is a discipline better suited to the skills of engineers, architects, and construction related personnel familiar in cost estimates.

And

Who have good understanding of the internal revenue audit guideline on acceptable studies.

# How Can We Help You?

- We can answer the questions
  - Should you have one
  - When is the best time
  - Do you have any unique situations
- We can help you with the selection of your cost segregation provider—we are independent
- We can help you properly implement this in your tax return, report it correctly, and consider all presentations and elections to go on your return.
- We have worked on many cases with our clients over the years, ensuring solid results and hundreds of thousands of tax savings.



**For More Information on  
Cost Segregation Studies**

***Please Contact  
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