

# Real Estate Journal

COVERING ALL OF LONG ISLAND, NEW YORK CITY AND UPSTATE NEW YORK

## Practical applications for cost segregation studies: Using a CSS for redevelopment projects

### gb Gregory Bryant



Bedford  
Capital  
Consulting

While cost segregation studies (CSS) are routinely performed after acquisition or new construction, the additional benefits of these studies are too often overlooked in the case of redevelopment, renovation of existing structures or abandonment of previously occupied lease space. However, since the IRS will not allow a taxpayer to write off arbitrary amounts based on cost per s/f, or other internally developed methods, it is important that a CSS be performed to maximize tax benefits.

Careful consideration should be given when using a CSS with a redevelopment project as the *timing* is critical. A poorly timed study can result in significant lost opportunities. Important distinctions also exist with respect to the actual definitions of "demolition" vs. "renovation." With current market trends towards redevelopment, real estate developers now have the option of turning to their cost segregation consultants much earlier in order to maximize their depreciation deductions.

#### Remodel vs. Demolition - What a Difference a Word Makes

Current tax code (sect. 280B) does not allow an owner to deduct expenses for demolition of a building

### jh Jacob Hopper



Bedford  
Capital  
Consulting

or any loss sustained due to the demolition. However, a renovation can be subject to a different set of parameters. If one is weighing the option to renovate rather than demolish a property, it is important to know the details; renovation is not considered demolition if:

1.) 75% of the external walls are

**Careful consideration should be given when using a CSS with a redevelopment project as the *timing* is critical. A poorly timed study can result in significant lost opportunities.**

retained.

2.) 75% of the existing internal structural framework of the building is retained.

If both requirements are met, then all expenses are deductible as a renovation. If not, the basis of the demolished structure and any demolition costs are added to land, which are not depreciable.

In addition to identifying costs that can be allocated to shorter recovery periods a CSS can be used to help determine the project scope with respect to how much of the existing facility is going to be demolished.

#### Demolition

If your project does not comply with the above criteria, and is considered a total demolition, hope of a deduction is not entirely lost. Regulation sect. 1.48-1 defines the structure as a building and its structural components. However, the tangible personal property within the structure (or a part of it) *can* be written off when the building is demolished, provided (1) the personal property is to be abandoned, (2) it was not purchased with the intent to demolish, and (3) it is identified and valued *prior to demolition*. Determining the value of personal property through a cost segregation study is the only acceptable way to satisfy the IRS.

#### Redevelopment

The most important thing to remember in a redevelopment scenario is that a CSS should be done immediately following acquisition. Continued involvement of the CSS consultant during the design and redevelopment stage will ensure that capitalization of expensed costs is properly documented. If the 75% demolition rules are met, then the cost of improvements removed would likely be expensed in one year. Soft costs such as architectural and engineering fees as well as construction period interest can

also be captured as allocated costs and are subject to the ultimate percentage allocations of 39, 15, 7 and 5-year recovery periods for the completed project.

#### Abandonment of Tenant Improvements

Tenant improvement expenses can be significant, especially in larger facilities. When a tenant vacates, the leased premises is often gutted and refitted for a new occupant. So, what about the improvements that were abandoned? If a CSS had been performed prior to the renovation, the owner would have a defensible position to write off the remaining depreciable basis for all improvements taken out of service. These studies, typically known as abandonment studies can be part of a CSS. The completion of detailed tenant studies for ultimate abandonment calculations has become an important strategy; especially for developers who are contemplating acquisition of existing properties with the intent to reposition or retenant in the near term.

Due to complexity of these issues, close communication with your cost segregation consultant and tax advisor will ensure that depreciation deductions and demolition expenses can be maximized. Timing is important! It is impossible to place a value on a pile of construction debris that was once a building or tenant improvement.

**Gregory Bryant is president and Jacob Hopper is regional vice president of Bedford Capital Consulting, New York, N.Y.**