

Soukup, Bush & Associates

Certified Public Accountants, P.C.

Month X, 20XX

Name
Company
Address
City, State Zip Code

Dear Name:

We are writing to inform you of a potential tax savings opportunity that could result in a significant financial benefit to you. The Tax Court recently held, in *Hospital Corp of America*, for taxpayers, which will provide a **significant tax planning opportunity** to those investing in commercial real estate.

This case is a big win for taxpayers, and allows the owner of a purchased or constructed building to segregate the costs of the building into real property and personal property components. This is a critical distinction as the components of personal property are allowed an accelerated depreciable life of 5 or 7 years instead of the depreciable life of 39 years allowed for nonresidential real property.

The chart below illustrates the potential benefits of performing a cost segregation analysis on a building. By reclassifying \$100,000 of project related costs from 39 year nonresidential real property to a shorter depreciable life, assuming a 35% federal income tax rate and a 7% return on investment, the following benefits could be realized.

| | <i>5 Year Property</i> | <i>7 Year Property</i> | <i>15 Year Property</i> |
|--|------------------------|------------------------|-------------------------|
| Potential Depreciation Increase | \$ 18,600 | \$ 12,900 | \$ 3,600 |
| Federal Income Tax Benefit | \$ 6,500 | \$ 4,500 | \$ 1,250 |
| Investment return, if invested for 39 years | \$ 17,600 | \$16,100 | \$10,000 |

You may benefit from performing a cost segregation analysis on your building. In most cases, the amount of personal property reclassified to a shorter life averages from 10% to 30% of the total project cost. In completing your cost segregation, we will review project information to determine the capitalized cost basis for buildings, land improvements and personal property. These sources include the project cost information, project construction drawings, and various

Company
Month X, 20XX
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construction cost estimating techniques. A tour of your facility will be conducted to identify specific assets, which will qualify for accelerated federal income tax depreciation. We will only recommend a Cost Segregation Engagement, if the professional fees are exceeded by preliminary estimates of tax benefits.

If you are interested in completing a Cost Segregation Engagement for your building or if you are interested in obtaining more information about these services, please contact us at your convenience.

Very truly yours,

SOUKUP, BUSH & ASSOCIATES, P.C.

Mark J. Soukup, CPA

MJS:sfr

Soukup, Bush & Associates
Certified Public Accountants, P.C.

2032 Caribou Drive, Suite 200
Fort Collins, Colorado 80525

Cost Segregation Report



Company Name

Project Name

Project Street Address

Project City and State

Soukup, Bush & Associates

Certified Public Accountants, P.C.

January 1, 2008

Entity Name
Project Name
Project Address
Project City, State

We have reviewed the costs for (insert entity name). The purpose of this cost segregation study was to identify, reclassify and recommend the appropriate federal income tax class recovery lives for federal and state income tax purposes. Unless otherwise indicated in this report, we have not determined the appropriate classifications of the subject property for any purpose other than federal and state income taxes.

We have examined the project information you have provided us, such as the site plan and survey. The completed study is based solely upon existing federal income tax law as applied to the information that you furnished to us and contains our recommendations, as well as all supporting documentation upon which our report was based. We have not independently verified this information, and accordingly, any facts recited herein that are believed to be incorrect or incomplete should be brought to our immediate attention.

If you have any questions concerning this report, please call us at (970) 223-2727.

Very truly yours,

SOUKUP, BUSH & ASSOCIATES, P.C.

Mark J. Soukup

MJS:sfr

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Exhibits

- Exhibit 1 – Site and Floor Plans
- Exhibit 2 – Summary of Project Costs and Depreciation Schedule
- Exhibit 3 – Construction Costs
- Exhibit 4 – Photographs
- Exhibit 5 - Resumes

Cost Segregation Engagement

We have prepared a cost segregation report for (insert entity name), located at (insert address). This report assigns cost components of your portion of the building to the Modified Accelerated Cost Recovery System (MACRS) classifications pursuant to the Internal Revenue Service or U.S. Tax Court rules and regulations. The purpose of this cost segregation study was to identify, reclassify, and recommend the appropriate federal income tax class recovery lives for federal and state income tax purposes.

Methodology

We have completed the following procedures in preparing this report:

- Obtained and read the site drawings and appraisal
- Obtained the financial statements and general ledger for the entity as of December 31, XXXX
- Visited and toured the property
- Interviewed the owner
- Photographed the property and prepared exhibits in the report to demonstrate applicability of certain asset classifications to the existence of the physical asset(s)
- Obtained and read the final construction pay application dated XXXX including the schedule of values and change orders
- Interviewed the general contractor and the plumbing, electrical and HVAC subcontractors
- Obtained a written representation from the owner or owner representative regarding the report and other related matters
- Prepared various computations and analysis to assist in classification of the depreciable life of various assets on the property

Description of Property



On June 15, XXX, (insert entity name) broke ground on a parcel located at XXXX in XXXX, Colorado. The contractor for the project was XXX and the project was completed on December 31, XXXX. The property consists of one two-story office building and includes a total of XXX square feet on a land area of XXX square feet.

This report includes recommendations for the classification of construction costs and costs paid outside of construction.

Scope and Limitations of the Report

This report is intended solely for your federal and state income tax information and should not be used by anyone else or for any other purpose. We did not determine the appropriate classification of the subject property for any purpose other than for federal and state income tax classifications. This report cannot be relied on for classification for other state or local tax purposes.

We understand that you have provided us with all information you deemed necessary for our engagement. The information required for this engagement was obtained primarily from review of construction documents and the facility.

Management is responsible for the substantive outcomes of the work and, therefore, has responsibility to be in a position in fact and appearance to make an informed judgment on the results of the cost segregation analysis, and you agreed to:

1. Designate a management-level individual to be responsible and accountable for overseeing the cost segregation analysis service.
2. Establish and monitor the performance of the cost segregation analysis service to ensure that it meets management's objectives.
3. Make any decisions that involve management functions related to the cost segregation analysis service and accept full responsibility for such decisions.
4. Evaluate the adequacy of the services performed and any findings that result.

Further limitations and conditions include, but are not limited to, the following:

1. This report must be considered and used only in its entirety, and may not be disassembled or in any manner segmented for viewing.
2. We do not warrant the accuracy of the information upon which this report is based.

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3. We do not assume responsibility for the verification of, or discovery of any errors in, representations or facts upon which the conclusions reached in this report are based.
 4. Neither this report nor any portion of its contents (including conclusions, the identity of the issuer, and references to professional designations) shall be disseminated to anyone other than XXX without our prior written consent.
 5. Unless otherwise stated, we have assumed full compliance by XXX with all applicable federal, state, and local zoning, use, environmental and similar laws and regulations. We have not independently verified that there has been compliance with such laws and regulations, and assume no responsibility in the event that full compliance does not exist.
 6. No investigation was made of, and no responsibility is assumed for, the legal description of the property, which is the subject of this report, or for any other legal matters, including title or encumbrances. Unless otherwise stated, title to the property is assumed to be good and marketable. The property is further assumed to be free and clear of any and all liens, easements or encumbrances, unless otherwise stated.
 7. The services provided hereunder are limited to cost segregation analyses and do not include audit, consulting, valuation, or other tax-related services that we may provide.
 8. No investigation was made of the soil, structural or operating conditions of the property which is the subject of this report, and XXX makes no warranty as to their conditions. Further, the services provided in connection with this report did not include inspecting for or reporting the existence of hazardous, toxic, or contaminating material or substances.
 9. The conclusions reached in this report do not take into consideration whether XXX is in compliance with the Americans with Disabilities Act of 1990, or the effect that any non-compliance might have on such conclusions.
 10. We have no present or contemplated future interest in the property. Our fees will not be based upon or contingent upon the conclusions reached or the values assigned to property classifications.

Summary of Recommended Federal and State Income Tax Allocations for (insert name of project)

Our study identifies and recommends the appropriate federal income tax classifications for federal and state income tax purposes. This report is intended solely for federal and state income tax information and should not be used by anyone else or for any other purpose. This report is a recommendation and decisions to reclassify assets will be made by the owner, (insert entity name).

Based on the information you provided to us and following the MACRS federal income tax classifications, we recommend the following classifications for all property acquired through December 31, XXXX:

ELIGIBLE FOR 5-YEAR DEPRECIATION

Asset Class #57.0 (Distributive Trades and Services)

MACRS 200% declining balance \$ 800,000

ELIGIBLE FOR 15-YEAR DEPRECIATION

Asset Class #00.3 (Land Improvements)

MACRS 150% declining balance 500,000

ELIGIBLE FOR 39-YEAR DEPRECIATION

Non-Residential Real Property

Straight Line 3,500,000

NON-DEPRECIABLE LAND

Land 200,000

TOTAL PROJECT COSTS \$ 5,000,000

Review of Federal Tax Law, Regulations, and Federal Tax Court Cases Relating to Cost Segregation Studies

Internal Revenue Code (IRC) Section 167 allows a depreciation deduction for property used in a trade or business and IRC Section 168 determines the method of calculating a depreciation deduction. Revenue Procedure 87-56, 1987-2 C.B. 674 provides asset classes and recovery periods under the Modified Accelerated Cost Recovery System (MACRS). MACRS became effective in 1986 and provides cost recovery tables for realty (real property which is generally land and buildings permanently affixed to the land) and personalty (personal property such as furniture, machinery and equipment).

In addition to depreciation methods, asset classes and recovery periods, conventions are used to determine the period of time for which depreciation may be claimed in the year the property is placed in service. MACRS views property as placed in service in the middle of the first year and allows a half-year of cost recovery in the year of acquisition and in the final year of cost recovery (the half-year convention). If more than 40 percent of the value of property is placed in service during the last quarter of the year, a mid-quarter convention must be used. Under the convention, property acquisitions are grouped by the quarter they were acquired for cost recovery purposes. All eligible real estate is depreciated using the mid-month convention. Regardless of when during the month the property is placed in service, it is deemed to have been placed in service at the middle of the month.

A ruling in the 1997 Tax Court case, Hospital Corp of America (109 TC No. 21), held that certain building components previously considered structural and depreciated over 27.5 or 39 years, can be classified as personal property or land improvements and depreciated over five to 15 years. Specifically, the elements of a building that are treated as personal property under the former investment tax credit rules (Reg. Section 1.48-1(c)) may be separately depreciated as personal property.

Two years later, the IRS issued a memorandum in which it acquiesced to the Tax Court ruling, stating that the tests developed under the investment tax credit before the 1981 adoption of the cost recovery system “are applicable in determining a structural component” for purposes of MACRS. The IRS stated that it disagreed with the Tax Court’s classification of some of the items as personal property, but they did not identify those items.

Federal Income Tax Classifications

The relevant asset classifications for this project are as follows:



Nonresidential Real Property (39-Year Property, MACRS Straight Line Method)

Building construction costs include items inherently permanent and related to the overall operation and maintenance of the building. Regulation Section 1.48-1(e) defines “building” as any structure or edifice enclosing a space within its walls, and usually covered by a roof, the purpose of which is, for example, to provide shelter or housing, or to provide working, office, parking, display, or sales space. Further examples of real property are the masonry work, general building electrical, plumbing, heating, ventilation and air conditioning, roofing, windows, excavation work, building foundations, structural steel, interior concrete floor, hardware costs and interior building finishes.

An IRS Field Directive on the Planning and Examination of Cost Segregation Issues in the Restaurant Industry dated December 27, 2004 (Field Directive) provides additional guidance in the classification of property. Assets categorized as real property in the Field Directive include interior ceilings, permanent floor and wall coverings, interior and exterior doors, and restroom accessories and restroom partitions.



Asset Class #00.3 – Land Improvements (15-Year Property, MACRS 150% Declining Balance)

This asset class includes improvements directly to or added to land, provided such improvements are depreciable. Examples of such assets might include sidewalks, roads, canals, waterways, drainage facilities, sewers (not including municipal sewers in Class 51), bridges, fences, landscaping, shrubbery, or radio and television transmitting towers. This asset class does not include land improvements that are explicitly included in any other class or buildings and structural components. This asset class excludes public utility initial clearing and grading land improvements as specified in Rev. Rul. 72-403, 1972-2 C.B. 102 and Rev. Proc. 87-56, 1987-2 C.B. 674.

Although many land improvements are considered part of land and therefore not depreciable, several types of improvements do qualify for 15-year depreciation under MACRS. Revenue Ruling 74-265 states in part, “Accordingly, the landscaping consisting of the perennial shrubbery and ornamental trees immediately adjacent to the apartment buildings is depreciable property under Section 167 of the Code since the replacement of the buildings will destroy this landscaping.” In *Trailmont Park, Inc.*, TC Memo 1971-212, the Court found that the cost of clearing, grading, terracing, and landscaping a slope for a mobile home park was to be depreciated as land improvements.

The Field Directive also identified certain land improvements as recoverable over 15 years. These include foundations or footings for signs, light poles for parking areas, canopies, patio stonework and site work not directly related to the building such as site drainage, sewers, sidewalks, paving, curbing, landscaping and fencing.



Asset Class #57.0 – Distributive Trades and Services (5-Year Property, MACRS 200% Declining Balance)

This asset class includes assets used in wholesale and retail trade, and personal and professional services. It also includes IRC Section 1245 assets used in marketing petroleum and petroleum products. Rev. Proc. 87-56, 1987-2 C.B. 674. For example, furniture, fixtures, desks and communication equipment used by a wholesale and retail trade business qualify for five-year property. A professional library used by an accountant or attorney is five-year property. The Internal Revenue Service has held in Announcement 99-82 that certain personal property used in a rental real estate activity should be included in Asset Class #57.0 and depreciated over five years. Examples of personal service businesses include hotels and motels, laundry and dry cleaning establishments, beauty and barber shops, photographic studios and mortuaries. Examples of professional service businesses include services offered by doctors, dentists, lawyers, accountants, architects, engineers, and veterinarians.

The Field Directive classified assets such as separate kitchen HVAC units and other machinery and restaurant items that do not function as part of the building as recoverable over 5 years.



Other Classifications

Decorative and Emergency Lighting

Several cases have identified certain types of lighting as personal property for MACRS asset classification. In *Shoney's South, Inc.*, TC Memo 1984-413, the Court ruled that decorative lanterns and chandeliers were personal property since they were easily disassembled and moved and were not the primary source of illumination. In *Metro National Corporation*, TC Memo 1987-38, both decorative accent lighting and emergency lighting were ruled to be personal property since both were "incidental to the operation of the building." In the *Metro National Corporation* ruling, the Court referred to Senate Report No. 95-1263 (1978), which specifies personal property to include "special lighting (including lighting to illuminate the exterior of a building or store, but not lighting to illuminate parking areas), false balconies and other exterior ornamentation that have no more than an incidental relationship to the operation or maintenance of a building."

The Field Directive identified interior light fixtures that are decorative in nature and not necessarily for the operation or maintenance of the building and exterior light fixtures such as plant grow lights as recoverable over 5 years.



Cabinetry and Display Fixtures

Various types of cabinets and other fixtures have been identified as personal property. In *Metro National Corporation*, cabinets were classified as personal property because they could be moved or eliminated. The Court ruled that the cabinets were “accessory to a business,” citing Senate Report No. 1881, 87th Cong. 2nd Sess. (1962), 1962-3 C.B. 707, 722, which states in part, “Tangible personal property is not intended to be defined narrowly here, nor to necessarily follow the rules of state law. It is intended that assets accessory to a business such as grocery store counters, printing presses, individual air conditioning units, etc., even though fixtures under local law, are to qualify for the credit.”

In the Field Directive, decorative millwork or decorative finish carpentry in a restaurant is identified as recoverable over 5 years. Examples include detailed crown moldings, latticework placed over finished walls or ceilings, and cabinets and counters except for those in a restroom.



Electrical and Mechanical Requirements for Industry-Specific Equipment

Generally, electrical, plumbing, and sprinkler systems are considered a part of the building structure and therefore real property. However, additional electrical and mechanical requirements for machinery used in a business can be classified as personal property. Revenue Ruling 69-558 states in part, “However, the electrical wiring and special outlets, the secondary steam lines, the water lines, and pipe insulation, leading directly to, within, and interconnecting with special items of processing machinery or equipment are not parts of the electrical, steam and water service systems, but are parts of the particular items of processing machinery or equipment to which they directly lead, are within, or interconnect.”

The Field Directive identified equipment and apparatus used to provide amplified music or sound including wiring is recoverable over 5 years.

Following is a chart of items classified, given specific facts, as real property, land improvements and personal property by the Courts. The list is not intended to be all-inclusive but is provided to offer examples.

| Type of Asset | Recovery Period | Examples |
|--------------------------|------------------|--|
| Real Property (Building) | 27.5 or 39 years | Structural and inherently permanent components, basic illumination, core and shell |
| Land Improvements | 15 years | Sidewalks, driveways, curbs, roads, parking lots, certain landscaping |
| Personal Property | 5 or 7 years | Internal communications equipment, temporary wall coverings, display, emergency and security lighting, specialized equipment, certain cabinetry, flooring, electrical and plumbing |

SAMPLE REPORT

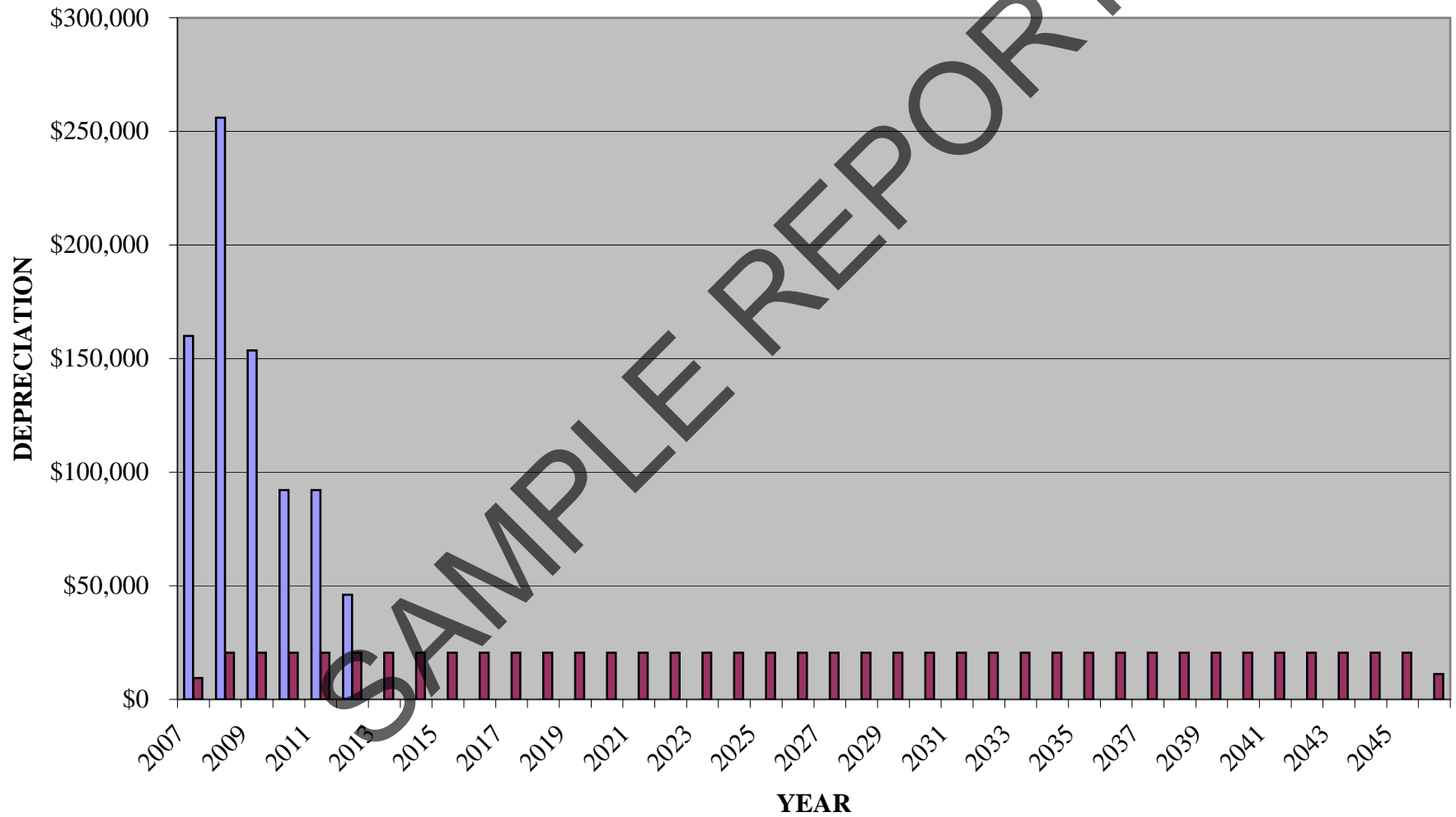
**COMPANY NAME
NPV ANALYSIS
TAX YEAR END 12/31/07**

| Year | \$ 800,000 Reclass Amount | | | | \$ 500,000 Reclass Amount | | | | Tax Benefit for Year |
|--------|---------------------------|------------|------------|----------------------------|---------------------------|------------|------------|----------------------------|----------------------|
| | 5-Year | 39-Year | Difference | Benefit/(Cost) Assumes 35% | 15-Year | 39-Year | Difference | Benefit/(Cost) Assumes 35% | |
| 2007 | \$ 160,000 | \$ 9,416 | \$ 150,584 | \$ 52,704 | \$ 25,000 | \$ 5,885 | \$ 19,115 | \$ 6,690 | \$ 59,394 |
| 2008 | 256,000 | 20,512 | 235,488 | 82,421 | 47,500 | 12,820 | 34,680 | 12,138 | 94,559 |
| 2009 | 153,600 | 20,512 | 133,088 | 46,581 | 42,750 | 12,820 | 29,930 | 10,476 | 57,057 |
| 2010 | 92,160 | 20,512 | 71,648 | 25,077 | 38,500 | 12,820 | 25,680 | 8,988 | 34,065 |
| 2011 | 92,160 | 20,512 | 71,648 | 25,077 | 34,650 | 12,820 | 21,830 | 7,641 | 32,718 |
| 2012 | 46,080 | 20,512 | 25,568 | 8,949 | 31,150 | 12,820 | 18,330 | 6,416 | |
| 2013 | - | 20,512 | (20,512) | (7,179) | 29,500 | 12,820 | 16,680 | 5,838 | |
| 2014 | - | 20,512 | (20,512) | (7,179) | 29,500 | 12,820 | 16,680 | 5,838 | |
| 2015 | - | 20,512 | (20,512) | (7,179) | 29,550 | 12,820 | 16,730 | 5,856 | |
| 2016 | - | 20,512 | (20,512) | (7,179) | 29,500 | 12,820 | 16,680 | 5,838 | |
| 2017 | - | 20,512 | (20,512) | (7,179) | 29,550 | 12,820 | 16,730 | 5,856 | |
| 2018 | - | 20,512 | (20,512) | (7,179) | 29,500 | 12,820 | 16,680 | 5,838 | |
| 2019 | - | 20,512 | (20,512) | (7,179) | 29,550 | 12,820 | 16,730 | 5,856 | |
| 2020 | - | 20,512 | (20,512) | (7,179) | 29,500 | 12,820 | 16,680 | 5,838 | |
| 2021 | - | 20,512 | (20,512) | (7,179) | 29,550 | 12,820 | 16,730 | 5,856 | |
| 2022 | - | 20,512 | (20,512) | (7,179) | 14,750 | 12,820 | 1,930 | 676 | |
| 2023 | - | 20,512 | (20,512) | (7,179) | - | 12,820 | (12,820) | (4,487) | |
| 2024 | - | 20,512 | (20,512) | (7,179) | - | 12,820 | (12,820) | (4,487) | |
| 2025 | - | 20,512 | (20,512) | (7,179) | - | 12,820 | (12,820) | (4,487) | |
| 2026 | - | 20,512 | (20,512) | (7,179) | - | 12,820 | (12,820) | (4,487) | |
| 2027 | - | 20,512 | (20,512) | (7,179) | - | 12,820 | (12,820) | (4,487) | |
| 2028 | - | 20,512 | (20,512) | (7,179) | - | 12,820 | (12,820) | (4,487) | |
| 2029 | - | 20,512 | (20,512) | (7,179) | - | 12,820 | (12,820) | (4,487) | |
| 2030 | - | 20,512 | (20,512) | (7,179) | - | 12,820 | (12,820) | (4,487) | |
| 2031 | - | 20,512 | (20,512) | (7,179) | - | 12,820 | (12,820) | (4,487) | |
| 2032 | - | 20,512 | (20,512) | (7,179) | - | 12,820 | (12,820) | (4,487) | |
| 2033 | - | 20,512 | (20,512) | (7,179) | - | 12,820 | (12,820) | (4,487) | |
| 2034 | - | 20,512 | (20,512) | (7,179) | - | 12,820 | (12,820) | (4,487) | |
| 2035 | - | 20,512 | (20,512) | (7,179) | - | 12,820 | (12,820) | (4,487) | |
| 2036 | - | 20,512 | (20,512) | (7,179) | - | 12,820 | (12,820) | (4,487) | |
| 2037 | - | 20,512 | (20,512) | (7,179) | - | 12,820 | (12,820) | (4,487) | |
| 2038 | - | 20,512 | (20,512) | (7,179) | - | 12,820 | (12,820) | (4,487) | |
| 2039 | - | 20,512 | (20,512) | (7,179) | - | 12,820 | (12,820) | (4,487) | |
| 2040 | - | 20,512 | (20,512) | (7,179) | - | 12,820 | (12,820) | (4,487) | |
| 2041 | - | 20,512 | (20,512) | (7,179) | - | 12,820 | (12,820) | (4,487) | |
| 2042 | - | 20,512 | (20,512) | (7,179) | - | 12,820 | (12,820) | (4,487) | |
| 2043 | - | 20,512 | (20,512) | (7,179) | - | 12,820 | (12,820) | (4,487) | |
| 2044 | - | 20,512 | (20,512) | (7,179) | - | 12,820 | (12,820) | (4,487) | |
| 2045 | - | 20,512 | (20,512) | (7,179) | - | 12,820 | (12,820) | (4,487) | |
| 2046 | - | 11,128 | (11,128) | (3,902) | - | 6,955 | (6,955) | (2,438) | |
| Totals | \$ 800,000 | \$ 800,000 | \$ - | \$ - | \$ 500,000 | \$ 500,000 | \$ - | \$ - | |

NET PRESENT VALUE SAVINGS:

| | |
|------------------------|-------------------|
| NPV - 5 year property | \$ 140,973 |
| NPV - 15 year property | 50,297 |
| Report Fee | (7,500) |
| Total NPV | \$ 183,770 |

NPV ANALYSIS 5-YEAR ASSETS



**NPV ANALYSIS
15-YEAR ASSETS**

