

Commercial Real Estate Remains a Big Winner in Stimulus Legislation

Special Federal tax write-offs
make 2012 another special
year to invest in Silicon Valley
commercial real estate.



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Economic Stimulus Bills Offer Unsurpassed Tax Benefits

Businesses have extraordinary incentives to buy real estate this year

Since 2008, when the U.S. and other world economies slid down into one of the worst recessions in the past 70 years, Congress has passed a number of bills designed to encourage business investment and stimulate the economy. During 2011, this legislation authorized a substantial increase in a deduction known as Internal Revenue Code (IRC) Section 179. It essentially allowed businesses to write off from their taxable income as much as \$500,000 in qualifying equipment and business property assets (including commercial real estate improvements) in the year in which a purchase was made — rather than over the typical five-, seven-, or 15-year period. In addition, the legislation provided for bonus depreciation of 100% on most types of tangible personal property that's acquired and placed into service — allowing businesses to essentially expense all qualifying new assets with useful lives of 20 years or less.

In 2012, although these Federal write-offs have been scaled back a bit, exceptional tax benefits are still available. The IRC Section 179 deduction is now an attractive \$139,000. And bonus depreciation of 50% can be taken on qualifying assets. These write-offs compare very favorably to what is anticipated in 2013, when bonus depreciation is scheduled to be eliminated entirely and the Section 179 limits are uncertain — but are unlikely to be more than 2012's amount.

In any case, these accelerated tax write-offs offer enormous advantages to commercial real estate buyers — especially if they close a transaction and occupy the new business space by the end of this year. In fact, these write-offs can be so lucrative that many buyers have found they can actually purchase a business condominium with no after-tax net cash outlay — thanks to the deductions.

While some real estate buyers may be tempted to wait to invest until the recovery picks up more steam in the coming months, the downside risk is that with 2013's expected write-off reductions, buyers may miss out on one of the best times to buy commercial real estate in recent memory — right now in 2012 while prices and interest rates remain near the bottom. In this case, time (lost) really may be money.



Cost Segregation

Detailed accounting reports are key to benefits

Commercial buildings are considered for tax purposes to generally have a useful life of 39 years. In the past, to calculate depreciation on a given commercial real estate asset, buyers would subtract the value of the land (which is non-depreciable) from the total purchase price, and then would depreciate the remaining amount on a straight-line basis over 39 years. This relatively small annual deduction did little to offset the substantial investment required for many commercial properties.



This changed with the advent of cost segregation accounting, a method that has been consistently upheld in a number of key IRS rulings over the past decade, beginning with *Hospital Corporation of America [HCA] v. Commissioner*, 109 TC 21 in 1997. Please check with your CPA or tax counsel regarding cost segregation's applicability to your individual situation.

Under cost segregation, a transaction is broken down into not only land and buildings, but also into tangible personal property and land improvements — the latter two of which are assumed to be used to support business activities or create the appropriate ambiance for business, rather than to make the building habitable or functional. These classifications can include relatively well-recognized assets such as carpeting, cabinets, and wall coverings, as well as other qualifying assets such as paving and concrete, fences, interior partitions, and electrical and plumbing infrastructures. Tangible personal property and land improvements may be depreciated over considerably shorter recovery periods — from as little as 5 years to 15 years — than the building itself, generating substantial tax savings for buyers.

To break out these various classes of assets, highly experienced engineering consultants must prepare detailed cost segregation studies, often created during construction when it's simpler to identify the cost of various components. Cost segregation studies are essential to provide the appropriate documentation to support the deductions for personal property and land improvements in a commercial real estate transaction. Cost segregation does not offer any additional deductions over what buyers have been able to take in the past. But by accelerating these deductions over the early years of ownership when cash outlays tend to be higher, this accounting method can make a real estate purchase MUCH more affordable by allowing a buyer to claim an IRC Section 179 deduction of up to \$139,000 and a bonus depreciation write-off of 50% in the first year.

Tallying the Deductions

Hundreds of thousands of dollars in potential after-tax savings

As previously note, the IRC Section 179 deduction allows for Federal write-offs of up to \$139,000 across all qualified business assets with useful lives of 20 years or less. This deduction must be taken before any bonus depreciation up to the \$139,000 limit, and it begins to phase out once a business has purchases in excess of \$560,000 of qualifying Section 179 assets during the year.

After the Section 179 deduction has been exhausted, businesses can then take bonus depreciation of 50% on qualified new assets with useful lives of 20 years or less.



Let's look at how these special deductions add up in this hypothetical example for a business person who buys a business condominium at Club Auto Sport in San Jose. Assume that on January 1, 2012 a business purchases and moves into a 822 sq ft unit at Club Auto Sport costing \$252,000.

A cost segregation study determines that there is \$38,990 worth of 5 year Section 179 property that can be written off in 2012. The study determines that there is \$40,140 worth of 15 year property that equates to \$20,070 bonus depreciation and \$1,760 of regular depreciation in 2012. In addition the remaining cost of \$172,870 can be written off over 39 years at \$4,430 in 2012. The total 2012 federal tax deduction is \$65,250. (The California tax rules are different but would allow a 2012 California deduction of \$37,840).

In this example the owner would receive federal tax write-offs in 2012 of \$65,250 or 25.9% of the purchase price, assuming all assets were placed in service on January 1, 2012.

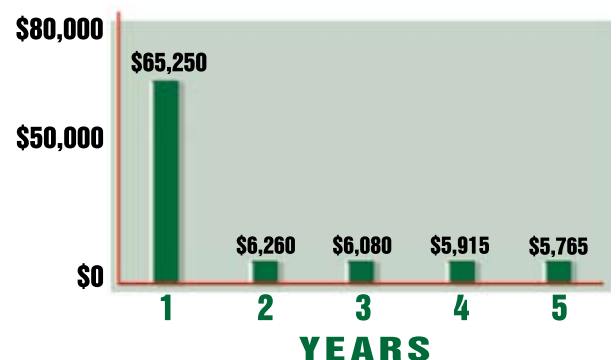
If the owner chooses to finance his purchase with an SBA loan, he would need only 10% down - or approximately \$25,200. One can see how the available tax write-offs for an owner in the highest (35%) tax bracket more than offset his down payment in after-tax dollars!

Clearly, the accelerated depreciation available through the IRC Section 179 and 50% bonus depreciation in 2012 is an extraordinary opportunity that makes it more attractive than ever for a business person to buy a business condo at Club Auto Sport.

This example is for illustration purposes only. Prospective buyers should consult with their CPA or tax counsel regarding the tax implications for their particular situation. The above graph depreciation deductions would continue out for 39 years.

Depreciation Deductions with 2012 Tax Advantages

(with cost segregation study - assumes purchase 1/1/12)



Club Auto Sport Business Condos

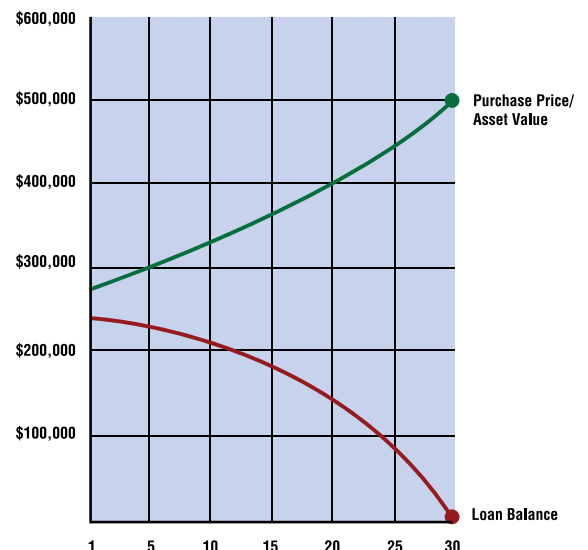
2012 tax benefits available at Club Auto Sport

The lucrative tax deductions through 2012 are available by buying a business condo at any condo complex marketed by Borelli Investment Company — featuring the condos in Club Auto Sport's fast-growing business center.

Club Auto Sport — Located at 521 Charcot Avenue in San Jose's "Golden Triangle", Club Auto Sport is a dynamic business community and event center located in the heart of Silicon Valley, as well as an exclusive club for auto enthusiasts. Club Auto Sport offers a total of 84 condominium units with 800 to 10,000 sq. ft. of space, where businesses have access to a built-in marketplace consisting of a top-tier demographic attending corporate, social, and charitable functions at the club. The club also includes a number of car collectors and motor sports enthusiasts, who store their vehicles and run businesses in private units in secure, climate-controlled spaces. Club members enjoy attending many social events and track driving days with other members and guests throughout the year. The club's 10,000-square-foot event center with breathtaking 20-foot window walls also serves as a spectacular venue for some of the most talked-about events and functions in the Valley. Every business that moves into the club becomes part of *TEAM* Club Auto Sport, a growing community of automotive and non-automotive businesses catering to club members and event guests as well as serving the general public. Monthly meetings are run by a certified chairman from Vistage International, the world's leading chief executive firm, which provides opportunities for CEOs and business owners at Club Auto Sport to improve their leadership skills, enhance decision-making and achieve greater business growth.



Should you lease or buy space for your auto business? That's the question, and your answer can significantly impact your personal wealth. As the graph illustrates, if you purchase a commercial condominium at Club Auto Sport, in 20 years you could own a half million dollars worth of business property. If you lease at \$24,000 per year, you'll have paid a half million dollars in rent (or more with escalating costs), and have nothing to show for it! Which path is best for you, your business and your family?



Conclusion

A word of warning to procrastinators

The lucrative incentives for commercial real estate investors — including both the IRC Section 179 deduction of \$139,000 and the ability to capture 50% in bonus depreciation — are not guaranteed beyond the end of 2012.

If you have been considering purchasing commercial real estate, now is the time to do it. Remember, to qualify for the tax write-offs, a transaction must not only be closed by the end of the year, but the business must also have begun operating in the new space by then. There are many steps that must be taken before a business can own and occupy a new condo unit: finding the right space, negotiating the purchase contract, handling any due diligence, arranging for financing, making design improvements, obtaining a building permit, completing improvements, and moving in — so businesses would be wise not to delay.

Even if you haven't been thinking about making a real estate investment for your business, if you have capital on hand, you might want to strongly consider doing something NOW — the incentives are that attractive.

Once again, investors are reminded to consult with their tax advisors before making any decisions. But with the unique benefits of the IRC Section 179 deduction uncertain beyond 2012 and bonus depreciation slated to be eliminated in 2013, all investors and business people are encouraged to carefully consider the possibilities of purchasing a business condominium or other commercial property before the year is out.



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