

AL ARCHER LEWIS

Cost Segregation Strategy

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01

Executive Summary

At A Glance

Cost segregation is a detailed analysis that breaks down the costs of a building or property into different asset categories for tax purposes. By front-loading depreciation, owners increase after tax cash flow. This white paper explains who benefits, how studies work, and the compliance standards that make them defensible.



#1

Accelerate deductions
over 5-15 years
instead of 27.5
(residential) or 39
years (commercial)



#2

Accelerate
depreciation
deductions to reduce
taxable income and
improve cash flow



#3

High-impact sectors:
industrial, hospitality,
health care

02

Introduction & Why It Matters

Cost segregation is not a credit; it's a defensible cost assignment to asset classes that better reflect useful life. A cost segregation study is a tax strategy that reclassifies parts of a property to accelerate depreciation and save on taxes. Instead of depreciating an entire building over 27.5 years (residential) or 39 years (commercial), a study identifies portions of the property (i.e. flooring, lighting, electrical systems, landscaping, and fixtures) that can be depreciated over shorter lives (5, 7, or 15 years). Typically, engineers, accountants, or specialized firms analyze construction documents, blueprints, and cost data.

Good Candidates

- ✓ **New construction**
- ✓ **Renovation**
- ✓ **Property acquisition**
- ✓ **Retroactively on existing buildings**

03

Do Your Properties Qualify?

Most nonresidential and multifamily properties benefit, particularly those with significant interior finishes, specialty electrical/plumbing, and site improvements.

Common assets

Land Improvements (15 year life)

- Parking lots, driveways, sidewalks, landscaping, fencing, outdoor lighting

Personal Property (5 to 7 year life)

- Office furniture, fixtures, equipment, computers, printers, electronics, manufacturing machinery and tools, specialized building components

04

Benefits & Financial Impact

Accelerated Depreciation

Reclassifies building components into shorter asset lives (5, 7, or 15 years instead of 27.5 or 39 years).

Front loads tax deductions rather than spreading them evenly over decades.

Significant Tax Savings

Larger depreciation deductions in early years reduce taxable income. Especially valuable when combined with 100% bonus depreciation (available through 2026 under current tax law).

Improved Cash Flow

Lower tax payments free up cash for reinvestment, debt repayment, or capital improvements. Can generate immediate refunds if applied retroactively using IRS Form 3115 (change in accounting method).

Strategic Tax Planning

Creates flexibility to match deductions with high-income years. Beneficial for acquisitions, new construction, renovations, and even existing buildings placed in service years ago.

Estate and Transaction Advantages

Helps with property sales by reducing gains through adjusted basis calculations. Can be integrated into estate or succession planning for real estate portfolios.

05 Industry Case Studies

Turn Buildings Into Cash—Fast

Browse the examples below across industries.

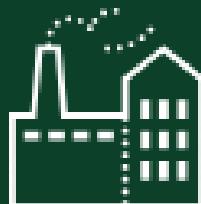
Developers: 100k-sf distribution warehouse; depreciable basis \$5.0M (excl. land).

Engineering study identifies ~28% reclassification into 5/7/15-year classes. With bonus eligibility, early deductions accelerate materially; payback often under 18–24 months at acquisition.

Hospitality: Hotels frequently reclassify 25–40% due to furniture, fixtures & equipment (FF&E) and site amenities, allowing reinvestment into property improvement plan/brand standards.

Health Care: Medical office buildings (MOBs) often qualify via exam-room build-outs, dedicated electrical, and medical gas systems, improving cash flow for equipment cycles.

Sectors We Model



Commercial
&
Residential



Select-service
&
full-service hotels



Medical office
&
outpatient facilities

06

Regulatory Landscape & IRS Focus

Audit-Ready, The Right Way

See what examiners expect and how to meet it.

The IRS Audit Technologies Guide for Cost Segregation provides the IRS's framework for evaluating studies, acceptable methods, and common errors. The IRS pays close attention to studies that reclassify an unusually high percentage of a building into short-lived property. Overly broad assumptions, missing documentation, or unsupported allocations are red flags. IRS examiners often request engineering reports, blueprints, cost data, and invoices. The IRS favors detailed, engineering-based studies with clear documentation.

What Examiners Expect:



Engineering
methodology &
photos



Credible cost sources
(e.g., RSMeans)



Clear asset
descriptions
& class lives

07

Implementation Process & Best Practices

Scope to savings—audit-ready at every step.

#1

Scoping & Feasibility — Gather drawings, cost data, and closing docs.

#2

Field Work — Engineering walk-through, photos, and validation of systems/site

#3

Cost Modeling — Use contractor data, RSMeans, invoices, and allocations.

#4

Classification & Report — Map assets to 5/7/15/39-year lives; provide schedules and narrative support.

#5

Tax Integration — Coordinate with bonus/§179 planning, partial dispositions, and state conformity.

#6

Audit Readiness — Retain workpapers, photos, and assumptions for IRS/state review.

Project Stages



Scoping & feasibility



Field verification



Cost modeling & classification

08

Strategic Planning Considerations

It is possible to perform studies at acquisition, construction, retroactively (look back studies), completion, or before disposition to maximize benefits. The strategic considerations boil down to timing, tax position, property type, legislative environment, exit strategy, and compliance. A well-timed study can be a powerful cash flow tool, but it needs to be aligned with the owner's broader tax and investment strategy.

Use Cases For Cost Segregation Studies

1. Property Acquisition

- **Scenario:** Purchasing a commercial or residential rental property.
- **Benefit:** Accelerate depreciation on building components (carpeting, lighting, landscaping, etc.) instead of waiting 27.5 or 39 years.

2. New Construction

- **Scenario:** Building a hotel, office, warehouse, or multifamily property.
- **Benefit:** Break out construction costs into shorter-lived assets right from the start to maximize first-year deductions.

3. Renovations / Remodels / Expansions

- **Scenario:** Major upgrades such as lobby remodels, tenant improvements, or mechanical replacements.
- **Benefit:** Allows reclassification of new improvements into 5-, 7-, or 15-year property, creating accelerated deductions.

4. Look-Back Studies (Existing Properties)

- **Scenario:** Owning a property for several years without having done a cost segregation study.
- **Benefit:** Retroactive catch-up depreciation through **Form 3115**, often producing a large one-time deduction

5. Disposition or Sale Planning

- **Scenario:** Preparing to sell a property.
- **Benefit:** Identifies remaining basis in short-life assets, reducing taxable gain and optimizing recapture planning.

6. Estate & Succession Planning

- **Scenario:** Transferring real estate to heirs or trusts.
- **Benefit:** Aligns depreciation benefits with step-up in basis rules and long-term family wealth planning.

7. Industries with High FF&E or Land Improvements

Certain industries benefit disproportionately:

- **Hospitality:** Hotels, resorts (lots of FF&E, room furnishings, amenities).
- **Healthcare:** Medical office buildings, hospitals (specialized equipment, tenant improvements).
- **Retail:** Restaurants, shopping centers (signage, lighting, fixtures).
- **Manufacturing/Industrial:** Plants, warehouses (machinery, electrical, specialized buildouts).

Cost segregation is most valuable whenever there's a large investment in real estate and a need to accelerate cash flow and reduce current taxes.

09 Get Started Checklist

Your study starter pack—collect these, save hours

<input type="radio"/>	Property address, placed-in-service date, purchase price / construction costs
<input type="radio"/>	Blueprints or as-builts; site plan; MEP drawing
<input type="radio"/>	Contractor cost detail, pay apps, or cost ledgers; FF&E schedules
<input type="radio"/>	Closing statements and appraisal (if available)
<input type="radio"/>	Current depreciation schedules and fixed asset subledgers
<input type="radio"/>	Renovation history and planned projects
<input type="radio"/>	Tax posture and modeling assumptions (bonus /§179, rates)

Bring These Items



Placed-in-service date,
purchase price/costs



Blueprints/as-builts; site &
MEP drawings



Contractor detail; FF&E;
depreciation ledgers

10 About Archer Lewis

Archer Lewis is a nationwide network of boutique accounting firms delivering specialized tax, assurance, and advisory services. Our cost segregation professionals combine engineering rigor with tax expertise to produce defensible, audit-ready studies that unlock cash flow.

Who We Serve

We serve individuals and businesses across a multitude of industries, including:



Developers &
owners



Hospitality
groups



Health care
organizations

Let's Talk

#1

Preliminary feasibility review

#2

Property scoping call

#3

Timeline & deliverables



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