DYNAMIC DEPRECIATION

The Property Owner's Guide to Cost Segregation

A practical guide to accelerating depreciation, improving cash flow, and understanding the process

Turn a building into a tax-planning opportunity.

Cost segregation is a tax-planning technique that analyzes the components of a building or improvement and identifies property that may qualify for shorter depreciation recovery periods than the building's overall structural life. The IRS Cost Segregation Audit Techniques Guide explains that property often contains numerous asset types with different recovery periods, which is the foundation of the analysis.

1. What Is Cost Segregation?

Traditional depreciation generally places the structural portion of a building into a long recovery period. A cost segregation study looks more closely at the property and separates eligible components into the appropriate tax categories. Depending on the facts, those categories can include shorter-lived personal property and land improvements, while structural building property remains in the applicable real-property recovery period.

Why property owners care

- Potentially accelerate depreciation deductions into earlier tax years.
- Potentially improve near-term cash flow by reducing taxable income when deductions are usable.
- Create a more detailed depreciation basis that can be useful for future tax planning and dispositions.
- Provide a documented, component-level analysis rather than relying only on a broad building allocation.

2. Who Should Consider a Study?

- Owners of newly acquired commercial or residential rental property.
- Owners who completed major renovations, expansions, or improvements.
- Investors acquiring multifamily, hospitality, retail, medical, office, industrial, self-storage, or specialty properties.
- Owners who acquired property in an earlier year and want to investigate whether a change in depreciation method is available.
- Taxpayers with sufficient taxable income, passive-income planning opportunities, or other circumstances in which accelerated deductions may be useful.

3. Common Property Types

Cost segregation is fact-specific, but studies are commonly considered for multifamily, office, retail, restaurants, hotels, medical facilities, industrial buildings, warehouses, self-storage, assisted living, mixed-use properties, and certain specialty-use facilities.

4. What Gets Analyzed?

- Site and land improvements such as certain paving, landscaping, fencing, exterior lighting, and similar assets.
- Building systems and components, including electrical, plumbing, HVAC, fire protection, and security.
- Interior finishes and specialty installations that may have a different tax classification depending on their function and facts.
- Special-purpose or dedicated equipment and other assets that may qualify for shorter recovery periods.

5. The 5-, 7-, 15-, 27.5-, and 39-Year Buckets

Potential category	Typical concept	Examples / notes
5-year	Certain tangible personal property	Dedicated equipment, specialty components, and certain removable/non-structural assets; fact-specific.
7-year	Certain tangible personal property	Certain equipment and furnishings depending on applicable MACRS class.
15-year	Land improvements / certain qualified improvements	Certain site improvements and land-related assets; exact treatment depends on the asset and tax rules.
27.5-year	Residential rental real property	Generally residential rental building property under applicable MACRS rules.
39-year	Nonresidential real property	Generally commercial building property under applicable MACRS rules.

Recovery periods are not assigned simply by whether an item looks like part of the building. The tax classification depends on the property's use, the asset's function, applicable law, and the facts and documentation supporting the classification.

6. What Does a Quality Study Include?

- Review of acquisition, construction, renovation, and capitalization records.
- Property inspection and/or review of plans, specifications, invoices, and other source documents.
- Identification and classification of assets under the applicable tax framework.
- Allocation of costs to identified asset groups using appropriate documentation and methodology.
- A report that allows the taxpayer and tax preparer to understand the classifications and supporting rationale.
- Depreciation schedules and supporting information needed by the tax professional to implement the study.

7. Engineering-Based vs. Other Approaches

The IRS Cost Segregation Audit Techniques Guide discusses several approaches, including detailed engineering approaches using actual cost records, detailed engineering cost-estimate approaches, and survey/letter approaches. The appropriate method depends on the property, records, cost, and circumstances. A study should use a reasonable methodology and provide documentation that supports the classifications and allocations.

8. What If I Bought the Property Years Ago?

A prior-year acquisition does not automatically mean the opportunity is gone. A taxpayer may be able to change the method used to depreciate property through applicable accounting-method procedures. The IRS explains that a change in recovery period, depreciation method, or convention can constitute a change in accounting method, and Form 3115 may be involved when the taxpayer is eligible for the applicable procedures. The resulting Section 481(a) adjustment can

be important and must be calculated correctly.

9. Bonus Depreciation and Cost Segregation

Bonus depreciation can make shorter-lived property identified through a cost-segregation study particularly valuable in years when qualifying property receives accelerated first-year treatment. Current IRS guidance states that certain qualified property acquired and placed in service after January 19, 2025 may qualify for a 100% special depreciation allowance, subject to the statutory requirements and elections. Always confirm the rules applicable to the taxpayer and placed-in-service date.

10. A Simple Example

Assume an investor purchases a commercial property for $2,500,000, excluding land. A cost-segregation analysis might identify a portion of the depreciable basis as shorter-lived property and land improvements, while the remaining basis stays in the building recovery period. The tax benefit is not simply the amount reclassified; the value comes from the timing difference between deductions taken earlier and deductions that would otherwise be taken over a longer period.

11. Questions to Ask Before Hiring a Provider

- Who prepares the study and what experience do they have with similar property types?
- What methodology will be used?
- Will the report identify assets and explain the classification rationale?
- What source documents will be reviewed?
- Will the provider coordinate with the taxpayer's CPA or tax preparer?
- How are prior-year studies and method changes handled?
- What happens if the taxpayer receives an IRS examination notice?

12. What Dynamic Depreciation Delivers

Dynamic Depreciation is built around a simple idea: **clarity before classification.** We help property owners understand where their building dollars went, which assets may deserve separate tax treatment, and what information their tax professional needs to implement the result. Our goal is a study that is understandable, documented, and useful—not just a number on a spreadsheet.

Next step

Have a property in mind? Request a preliminary review. Provide the property type, approximate purchase or construction cost, land value if known, placed-in-service date, and whether major improvements were made. Dynamic Depreciation can then determine whether a full study appears worth exploring.

Website Disclaimer

Important: This resource is educational information, not tax, legal, accounting, engineering, or investment advice. Cost-segregation classifications depend on the facts, property, use, placed-in-service date, documentation, and applicable tax law. Taxpayers should rely on a qualified tax professional for return positions and elections. Dynamic Depreciation does not guarantee tax savings, audit outcomes, or eligibility.

Primary IRS references

- IRS Publication 5653 — Cost Segregation Audit Techniques Guide.
- IRS Publication 946 — How To Depreciate Property.
- IRS guidance on tangible property regulations and accounting method changes.
- Form 3115 and applicable revenue procedures for accounting method changes.