




# COST SEGREGATION STRATEGY GUIDE

*How to accelerate depreciation, reduce current taxable income, and improve real estate*



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TaxMD™ AI

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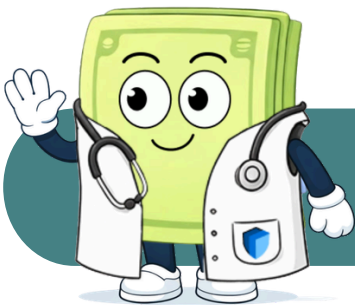
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# Executive Summary

Cost Segregation is one of the most powerful tax acceleration strategies available to real estate investors and business property owners. By identifying and reclassifying certain building components into shorter recovery periods, taxpayers can significantly increase early-year depreciation deductions, reduce current taxable income, and improve cash flow.

Rather than depreciating an entire property over 27.5 years (residential) or 39 years (commercial), a cost segregation study allocates portions of the property to 5, 7, or 15-year categories. This front-loads deductions into earlier years when they often provide the greatest tax benefit.

This guide explains how cost segregation works, who benefits most, eligibility requirements, risks to consider, and how to integrate the strategy into a broader long-term tax plan.



I'm Doc, here to guide you along the way and show you how TaxMD™ can help put these strategies into action.

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# Who This Guide Is For

This guide is designed for:

## **Real Estate Investors**

Acquiring rental properties or completing significant renovations.

## **Business Owners**

Purchasing or constructing buildings used in operations.

## **Developers**

Completing new construction projects.

## **Owners of Multifamily, Commercial, or Industrial Properties**

Managing or acquiring income-producing real estate assets.

## **High-Income Taxpayers**

Seeking accelerated deductions to offset taxable income.

# What Is Cost Segregation

Cost Segregation is a tax strategy that accelerates depreciation by identifying components of a building that qualify for shorter recovery periods under the Internal Revenue Code.

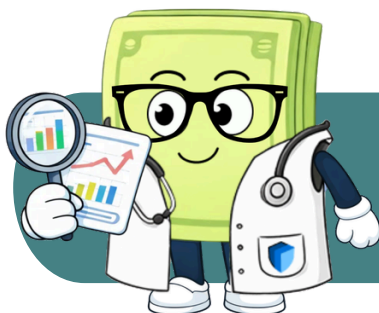
Instead of depreciating 100 percent of the property over:

- **27.5 years (residential rental), or**
- **39 years (commercial property),**

A study reallocates qualifying components into

- **5-year property**
- **7-year property**
- **15-year land improvements**

This produces larger depreciation deductions in the early years of ownership.



Using your real property numbers, TaxMD™ calculates exactly how much depreciation you can accelerate and how it impacts your taxes and cash flow.

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# What Components Can Be Reclassified

A qualified study may identify:

## **Personal Property (5 or 7-Year Life)**

- Carpeting and specialty flooring
- Certain electrical systems
- Specialized HVAC systems
- Decorative lighting
- Plumbing fixtures
- Equipment and furnishings

## **Land Improvements (15-Year Life)**

- Sidewalks
- Parking lots
- Landscaping
- Fencing
- Outdoor lighting

These items are legally distinct from the structural building shell and may qualify for shorter depreciation lives.

# How a Cost Segregation Study Works

A proper cost segregation study is conducted by a qualified engineer or specialist and includes:

- Review of building plans and specifications
- Cost breakdown and asset allocation
- Classification under IRS depreciation guidelines
- Detailed documentation to support audit defense

The final report reallocates portions of the purchase price to shorter-lived categories, increasing first-year depreciation.

## **Example: Commercial Property**

A real estate investor purchases a commercial property for \$1,000,000.

Without cost segregation:

- The entire building depreciated over 39 years
- Annual depreciation  $\approx$  \$25,641

With cost segregation:

- \$200,000 allocated to personal property
- \$200,000 depreciated over 5–7 years
- Remaining \$800,000 depreciated over 39 years

Result:

- Significantly higher deductions in early years
- Lower taxable income
- Improved after-tax cash flow

# How It Applies to You

## Real Estate Investor

If you acquire or renovate a rental property, cost segregation can:

- Offset rental income
- Potentially offset other income (subject to passive activity rules)
- Improve early-year return on investment
- Increase cash available for reinvestment

Example:

An investor purchases an apartment building for \$2,000,000. A study identifies \$400,000 in personal property. The accelerated depreciation reduces taxable income substantially in early years, potentially saving tens of thousands in taxes depending on the investor's marginal tax rate.

## Business Owner

If you own the building where your business operates:

- Accelerated depreciation lowers business taxable income
- Improves operating cash flow
- Provides capital for reinvestment

Example:

A business owner purchases a warehouse for \$1,000,000. A study identifies \$250,000 in shorter-life property. The resulting tax reduction can significantly improve liquidity during expansion phases.

# Eligibility Requirements

## General Requirements

- Property must be owned by the taxpayer
- Property must be used for business or income-producing purposes
- Property must be placed in service

## Eligible Property Types

- Commercial buildings
- Multifamily residential properties
- Industrial properties
- Renovated properties
- Newly constructed buildings

## Depreciable Assets

- Personal property components
- Land improvements
- Qualified improvement property (where applicable)

## Tax Benefits

### Accelerated Depreciation

Larger deductions occur in earlier years.

### Improved Cash Flow

Lower tax liability increases available capital.

### Time Value of Money

Deductions today are more valuable than deductions decades later.

# Key Risks and Considerations

## Qualified Study Required

Improper classification increases audit risk. Studies must be defensible and engineering-based.

## Depreciation Recapture

Upon sale, accelerated depreciation may be subject to recapture rules. Recapture rates vary depending on asset classification and holding period.

## IRS Scrutiny

Cost segregation can increase audit likelihood, particularly if aggressive allocations are used without documentation.

## Timing Matters

The study is most beneficial shortly after acquisition or construction completion. Retroactive studies may require Form 3115 (Change in Accounting Method).

## Recordkeeping

Detailed documentation must be retained to support asset classification.

# Assumptions

- The taxpayer qualifies for depreciation under IRS rules
- The property contains components eligible for shorter recovery periods
- The study is conducted by a qualified professional
- Accurate records are maintained

## Estimated 1-Year Savings

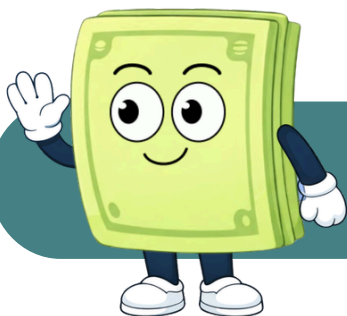
Savings depend on:

- Property value
- Allocation percentage
- Marginal tax rate
- Passive activity limitations
- Bonus depreciation availability

Example:

If \$250,000 is accelerated and the taxpayer is in a 30% marginal bracket, the early-year tax savings could exceed \$75,000.

Actual savings depend on facts and circumstances.



Login to your TMD workspace to see actual tax savings in your tax bracket (not just the estimated amount in the example).

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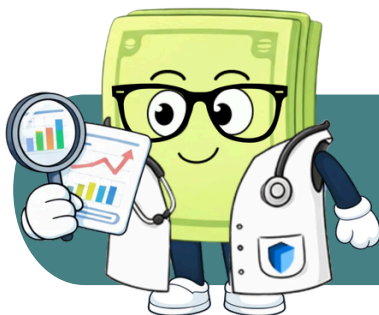
# Strategic Considerations

## Advanced Tax Planning

- Evaluate bonus depreciation availability
- Review Section 179 expensing eligibility
- Coordinate with passive activity rules
- Consider impact on future 1031 exchanges

## Wealth & Estate Planning

- Analyze long-term recapture implications
- Coordinate with generational transfer planning
- Integrate into portfolio-level strategy



Login to TaxMD™ to evaluate, review, and coordinate all of these things using your real numbers, so every decision is based on your actual financial picture.

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# Next Step Checklist

## Immediate (Next 7 Days)

- Identify recently acquired or renovated properties
- Determine placed-in-service date
- Contact a qualified cost segregation specialist

## Implementation (Days 8–30)

- Engage specialist
- Provide construction costs and documentation
- Review allocation report
- Integrate findings into the tax return

## Ongoing (Annually)

- Monitor depreciation schedules
- Track improvements
- Evaluate the impact on long-term exit strategy



Need a detailed tracker? Login to your TMD™ workspace to track your progress, and see the tax savings from each strategy.

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Tax Engine



#AVATAR 2  
Business Owner



Entity Structuring



#AVATAR 1  
Real State Investor



#AVATAR 5  
Retiree



#AVATAR 6  
W-2 Employee



#AVATAR 3  
Side Hustler



Event Driven Planning



# How TaxMD™ Helps You Implement Cost Segregation

**TaxMD™ allows you to:**

- Model accelerated vs straight-line depreciation
- Compare year-by-year tax impact
- Evaluate passive loss limitations
- Assess recapture scenarios
- Integrate cost segregation into multi-year strategy


Cost segregation is not just about maximizing deductions this year. It is about improving after-tax returns over the life of the investment.



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