



## Field Directive on the Planning and Examination of Cost Segregation Issues in the Restaurant Industry

Department of the Treasury  
Internal Revenue Service  
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**MEMORANDUM FOR:**  
**INDUSTRY DIRECTORS**  
**DIRECTORS, FIELD OPERATIONS**  
**DIRECTOR, FIELD SPECIALISTS**  
**DIRECTOR, PRE-FILING AND TECHNICAL GUIDANCE**  
**DIRECTOR OF COMPLIANCE, SBSE**

**FROM:** /s/ Henry V. Singleton  
Industry Director  
Retailers, Food, Pharmaceuticals & Healthcare Industry

/s/ Steve Burgess  
Director, Examination, SBSE

**SUBJECT:** Field Directive on the Planning and Examination of Cost Segregation Issues in the Restaurant Industry

### Introduction

This memorandum is intended to provide direction to effectively utilize resources in the classification and examination of a taxpayer who is recovering costs through depreciation of tangible property used in the operation of a restaurant business. This LMSB Directive is not an official pronouncement of the law or the position of the Service and cannot be used, cited or relied upon as such.

The American Jobs Creation Act of 2004, enacted October 22, 2004, modifies I.R.C. §168. This development has been incorporated into the guidelines through the note to Exhibit A. In addition, this directive has been modified in content and format to conform to the Field Directive issued for the retail industry on December 16, 2004.

### Background

The crux of cost segregation is determining whether an asset is I.R.C. §1245 property (shorter cost recovery period property, 5 or 7 years) or §1250 property (longer cost recovery period property, 39, 31.5 or 15 years). The most common example of §1245 property is depreciable personal property, such as equipment. The most common examples of §1250 property are buildings and building components, which generally are not §1245 property.[1]

The difference in recovery periods has placed the Internal Revenue Service and taxpayers in adversarial positions in determining whether an asset is §1245 or §1250 property. Frequently, this causes the excessive expenditure of examination resources. The Director for the Retailers, Food, Pharmaceuticals and Healthcare Industry chartered a working group to address the most efficient way to approach cost segregation issues specific to the restaurant industry. The group produced the attached matrix and related definitions as a tool to reduce unnecessary disputes and foster consistent audit treatment.

### Planning and Examination Guidance

Attached Exhibit A is a matrix recommending the categorization and general depreciation system recovery period of various restaurant assets. (For recovery periods under IRC §168(g) alternative depreciation system see Revenue Procedure 87-56, 1987-2 CB 674.) If the taxpayer's tax return position for these assets is consistent with the recommendations in Exhibit A, examiners should not make adjustments to categorization and lives. If the taxpayer reports assets differently, then adjustments should be considered. The Industry intends to update Exhibit A regularly.

See the Cost Segregation Audit Techniques Guide for additional guidance. See also Revenue Procedure 2002-12, I.R.B. 2002-3, 374 ( Jan. 07, 2002 ), for the proper treatment of smallwares.

If you have any questions, please contact Philip J. Hofmann Technical Advisor, Food at (316) 352-7434, or Ardell Mueller, Senior Program Analyst, Retailers Food, Pharmaceuticals and Healthcare Industry at (630) 493-5946.

**Attachments: Exhibit A**

**NOTE:** In the case of certain leasehold improvements and restaurant property, the classifications in this directive are superseded to the extent that the American Jobs Creation Act of 2004 modifies IRC Section 168. Thus, a 15-year straight line recovery period should replace the recovery period shown in the following matrix if the asset is "qualified leasehold improvement property" (as defined in IRC Section 168(e)(6)) or "qualified restaurant property" (as defined in IRC Section 168(e)(7)) placed in service by the taxpayer after October 22, 2004 and before January 1, 2006.

<b>Asset</b>	<b>Description</b>	<b>Property Type</b>	<b>Recovery Period</b>
<b>Beverage Equipment</b>	Equipment for storage and preparation of beverages and beverage delivery systems. Beverage equipment includes the refrigerators, coolers, dispensing systems, and the dedicated electrical, tubing or piping for such equipment. The dispensing system may be gravity, pump or gas driven.	1245	57.0 Distributive Trades and Services --  5 Years
<b>Canopies &amp; Awnings</b>	Readily removable overhang or covering, often of canvas or plastic, used to provide shade or cover over a storefront, window, or door; or used inside a structure to identify a particular area. Examples include applications over an exterior door or window, or attached to interior walls or suspended from ceilings to identify a buffet line or bar area of the restaurant. Does not include canopies that are an integral part of a building's structural shell, such as in the casino industry, or over docks.	1245	57.0 Distributive Trades and Services --  5 Years
<b>Ceilings</b>	Includes all interior ceilings regardless of finish or décor, e.g. drywall or plaster ceilings, acoustic ceilings, suspended ceilings (including all hangers, frames, grids, and tiles or panels), decorative metal or tin finishes, kitchen plastic panels, decorative panels, etc.	1250	Building or Building Component –  39 Years
<b>Computers</b>	Processors (CPU), direct access storage device (DASD), tape drives, desktop and laptop computers, CRT, terminals, monitors, printers, and other peripheral equipment. Excludes Point of Sale (POS) systems and computers that are an integral part of other equipment (e.g., fire detection, heating, cooling, or energy management systems, etc.).	1245	00.12 Information Systems –  5 Years
<b>Concrete Foundations &amp; Footings</b>	Includes formwork, reinforcement, concrete block, and pre-cast or cast-in-place work related to foundations and footings necessary for the proper setting of the building.	1250	Building or Building Component –  39 Years
	Foundations or footings for signs, light poles, canopies and other land improvements (except buildings).	1250	00.3 Land Improvements –  15 Years
<b>Data Handling Equipment</b>	Includes adding and accounting machines, calculators, copiers and duplicating machines. Excludes computers and computer peripheral equipment, see <b>Computers</b> .	1245	00.13 Data Handling Equipment, except Computers –  5 Years
<b>Doors</b>	Interior and exterior doors, regardless of decoration, including but not limited to, double opening doors, overhead doors, revolving doors, mall entrance security gates, roll-up or sliding wire mesh or steel grills and gates, and door hardware (such	1250	Building or Building

	as doorknobs, closers, kick plates, hinges, locks, automatic openers, etc.).		Component – 39 Years
	Special lightweight, double action doors installed to prevent accidents in a heavily trafficked area. For example, Eliason doors providing easy access between the kitchen and dining areas.	1245	57.0 Distributive Trades and Services – 5 Years
<b>Doors – Air Curtains</b>	Air doors or curtains are air systems located above doors and windows that circulate air to stabilize environments and save energy by minimizing the heated/air conditioned air loss through open doorways and windows. They also effectively repel flying insects, dust, and pollutants.	1250	Building or Building Component – 39 Years
<b>Drive-Through Equipment</b>	Drive-through equipment includes order taking, food delivery and payment processing systems whether mechanical or electronic. Excludes building elements such as doors, bays, or windows. See also <b>Walls – Exterior</b> , and <b>Windows</b> for drive-through bays and windows.	1245	57.0 Distributive Trades and Services -- 5 Years
<b>Electrical</b>	Includes all components of the building electrical system used in the operation or maintenance of the building or necessary to provide general building services such as electrical outlets of general applicability and accessibility, lighting, heating, ventilation, air conditioning and electrical wiring. See also <b>Kitchen Equipment Hook-ups</b> .	1250	Building or Building Component – 39 Years
	Special electrical connections which are necessary to and used directly with a specific item of machinery or equipment or connections between specific items of individual machinery or equipment; such as dedicated electrical outlets, wiring, conduit, and circuit breakers by which machinery and equipment is connected to the electrical distribution system. Does not include electrical outlets of general applicability and accessibility. See Chapter 5 of the Cost Segregation Audit Techniques Guide for allocation examples.	1245	57.0 Distributive Trades and Services -- 5 Years
<b>Elevators &amp; Escalators</b>	Elevators and escalators, which include handrails and smoke baffles, are permanently affixed to the building and intended to remain in place. They relate to the operation or maintenance of the building and are structural components.	1250	Building or Building Component – 39 Years
<b>Equipment Installation</b>	Expenses incurred in the installation of furnishings and restaurant equipment. Some examples include booths, tables, counters and interior theme décor.	1245	57.0 Distributive Trades and Services -- 5 Years
<b>Exit Signs</b>	Signs posted along exit routes that indicate the direction of travel to the nearest exit. These signs typically read "EXIT" and may have distinctive colors, illumination, or arrows indicating the direction to the exit.	1250	Building or Building Component – 39 Years
<b>Fire Protection &amp; Alarm Systems</b>	Includes sensing devices, computer controls, sprinkler heads, piping or plumbing, pumps, visual and audible alarms, alarm control panels, heat and smoke detection devices, fire escapes, fire doors, emergency exit lighting and signage, and wall mounted fire extinguishers necessary for the protection of the building.	1250	Building or Building Component – 39 Years
<b>Fire Protection Equipment</b>	Includes special fire detection or suppression systems located in equipment hoods or directly associated with a piece of equipment. For example, a fire extinguisher designed and used for protection against a particular hazard created by the business activity.	1245	57.0 Distributive Trades and Services -- 5 Years
<b>Fireplaces</b>	Includes masonry and gas fireplaces, flues, chimneys and other components of built-in fireplaces.	1250	Building or Building

			Component –  39 Years
<b>Floor Coverings</b>	Floor covering affixed with permanent adhesive, nailed, or screwed in place. Examples include ceramic or quarry tile, marble, paving brick, and other coverings cemented, mudded, or grouted to the floor; epoxy or sealers; and wood flooring.	1250	Building or Building Component –  39 Years
	Floor covering that is installed by means of strippable adhesives. For the restaurant industry, all carpeting will be treated as not permanently attached and not intended to be permanent. Excludes rugs or tapestries that are considered artwork and do not suffer wear and tear (e.g. Persian rugs that may appreciate are considered artwork).	1245	57.0 Distributive Trades and Services --  5 Years
<b>Floors</b>	Includes concrete slabs and other floor systems. Floors include special treatments applied to or otherwise a permanent part of the floor. For example, "superflat" finish, sloped drainage basins, raised perimeter, serving line curb, or cooler, freezer and garbage room floors.	1250	Building or Building Component –  39 Years
<b>Food Storage &amp; Preparation Equipment</b>	Food storage, cleaning, preparation, and delivery systems including all machinery, equipment, furniture and fixtures used to process food items from storage through delivery to the customer.	1245	57.0 Distributive Trades and Services --  5 Years
<b>Heating Ventilating &amp; Air Conditioning (HVAC)</b>	Includes all components of a central heating, ventilating and air conditioning system not specifically identified elsewhere. HVAC systems that are installed not only to meet the temperature and humidity requirements of machinery, but are also installed for additional significant purposes, such as customer comfort and ventilation, are building components.	1250	Building or Building Component –  39 Years
	Only separate kitchen HVAC units that meet the sole justification test are included (i.e., machinery the sole justification for the installation of which is the fact that such machinery is required to meet temperature or humidity requirements which are essential for the operation of other machinery or the processing of materials or foodstuffs.) Kitchen HVAC may meet the sole justification test even though it incidentally provides for the comfort of employees, or serves, to an insubstantial degree, areas where such temperature or humidity requirements are not essential. Includes refrigeration units, condensers, compressors, accumulators, coolers, pumps, connecting pipes, and wiring for the mechanical equipment for climate controlled rooms such as walk-in freezers and coolers. Allocation of HVAC is not appropriate.	1245	57.0 Distributive Trades and Services --  5 Years
<b>Kitchen Equipment Hook-ups</b>	Includes separate water lines from the incoming water main to equipment (such as steam trays, cooking vessels, or ice machines), gas lines from the building's main gas line to equipment (such as fryers or ovens), and special drain lines from equipment (such as refrigerator or dishwasher) to the drain. Also includes ventilation system or kitchen air makeup unit solely to maintain specific ventilation requirements essential for operation of kitchen equipment, equipment exhaust hoods, and electric outlets and conduit extending back to the circuit box to provide a localized power source for specialized equipment. For example, a dishwasher requires electric and plumbing hook-ups, electrical from the dishwasher to the source of electricity (such as an outlet or junction box), and plumbing to connect the dishwasher to the water line and the drain. Excludes outlets of general applicability and accessibility or kitchen hand sink plumbing; see also <b>Electrical, HVAC, and Plumbing.</b>	1245	57.0 Distributive Trades and Services --  5 Years
<b>–Light Fixtures –</b>	Includes lighting such as recessed and lay-in lighting, night	1250	Building or

<b>Interior</b>	lighting, and exit lighting, as well as decorative lighting fixtures that provide substantially all the artificial illumination in the building or along building walkways. For emergency and exit lighting, see <b>Fire Protection &amp; Alarm Systems</b> .		Building Component –  39 Years
	Decorative light fixtures are light fixtures, such as neon lights or track lighting, which are decorative in nature and not necessary for the operation of the building. In other words, if the decorative lighting were turned off, the other sources of lighting would provide sufficient light for operation of the building. If the decorative lighting is the <i>primary</i> source of lighting, then it is section 1250 property.	1245	57.0 Distributive Trades and Services -  5 Years
<b>-Light Fixtures – Exterior</b>	Exterior lighting whether decorative or not is considered section 1250 property to the extent that the lighting relates to the maintenance or operation of the building. Includes building mounted lighting to illuminate walkways, entrances, parking, etc.	1250	Building or Building Component –  39 Years
	Pole mounted or freestanding outdoor lighting system to illuminate sidewalks, parking or recreation areas. See also <b>Poles &amp; Pylons</b> . Note* asset class 00.3 Land improvements includes both section 1245 and 1250 property per Rev. Proc. 87-56.	See Note*	00.3 Land Improvements –  15 Years
	Plant grow lights or lighting that highlights <i>only</i> the landscaping or building exterior (but not parking areas or walkways) does not relate to the maintenance or operation of the building.	1245	57.0 Distributive Trades and Services --  5 Years
<b>Millwork – Decorative</b>	Decorative millwork is the decorative finish carpentry in the restaurant. Examples include detailed crown moldings, lattice work placed over finished walls or ceilings, cabinets and counters. The decorative millwork serves to enhance the overall theme of the restaurant and is not related to the operation of the building. Excludes cabinets and counters in a restroom; see <b>Restroom Accessories</b> .	1245	57.0 Distributive Trades and Services --  5 Years
<b>Millwork - General Building or Structural</b>	General millwork is all building materials made of finished wood (e.g., doors and frames, window frames, sashes, porch work, mantels, panel work, stairways, and special woodworking). Includes pre-built wooden items brought to the site for installation and items constructed on site such as restroom cabinets, door jambs, moldings, trim, etc.	1250	Building or Building Component –  39 Years
<b>Office Furnishings</b>	Includes desk, chair, credenza, file cabinet, table, or other furniture such as workstations. Also includes telephone equipment, fax machines, and other communications equipment. Does not include communications equipment included in other asset classes in Rev. Proc. 87-56.	1245	00.11 Office Furniture, Fixtures, and Equipment –  7 Years
<b>Parking Lots</b>	Grade level surface parking area usually constructed of asphalt, brick, concrete, stone or similar material. Category includes bumper blocks, curb cuts, curb work, striping, landscape islands, perimeter fences, and sidewalks.	1250	00.3 Land Improvements – 15 Years
<b>Plumbing</b>	All piping, drains, sprinkler mains, valves, sprinkler heads, water flow switches, restroom plumbing fixtures (e.g. toilets) and piping, kitchen hand sinks, electric water coolers, and all other components of a building plumbing system (water or gas) not specifically identified elsewhere. Excludes water or gas connections directly to appliances or kitchen drainage and kitchen hot water heater; see <b>Kitchen Equipment Hook-ups</b> .	1250	Building or Building Component –  39 Years
	Includes water, gas, or refrigerant hook-ups directly connected to appliances or equipment, eyewash stations, kitchen drainage, and kitchen hot water heater. For example, a dishwasher would require special water hook-up.	1245	57.0 Distributive Trades and Services --  5 Years

<b>Point of Sale (POS) Systems</b>	A register or terminal based data collection system used to control and record all sales. Includes cash registers, computerized sales systems, and related peripheral equipment. See also <b>Electrical</b> for hook-ups.	1245	57.0 Distributive Trades and Services --  5 Years
<b>Poles &amp; Pylons</b>	Light poles for parking areas and other poles poured in concrete footings or bolt-mounted for signage, flags, etc. Note* asset class 00.3 Land Improvements includes both section 1245 and 1250 property per Rev. Proc. 87-56.	See Note*	00.3 Land Improvements –  15 Years
<b>Restaurant Décor Accessories</b>	Decorative mobile props such as playground equipment, potted plants, hanging mirrors, ceiling fans, and theme related props (such as coat of arms, sporting equipment or memorabilia, artifacts, pictures, plaques, etc., excluding non-depreciable artwork, antiques or collectibles).	1245	57.0 Distributive Trades and Services --  5 Years
<b>Restaurant Furniture</b>	Includes furniture unique to restaurants and distinguishable from office furniture. For example, a high stool in a bar, dining room table and chairs, booths, lockers, or benches. See also <b>Office Furnishings</b> .	1245	57.0 Distributive Trades and Services --  5 Years
<b>Restaurant Non-structural Theme Elements</b>	Interior non-load bearing decorative structures. These are items that do not function as part of the building and are not integrated with building elements such as wiring, plumbing or ventilation. For example a model castle constructed of gypsum board or plaster and wood studs would be considered a non-structural theme element that functions merely as ornamentation. Excludes a half wall whose function is to provide traffic control or space subdivision, see <b>Walls - Interior Partitions</b> . Excludes decorative ceilings, see <b>Ceilings</b> .	1245	57.0 Distributive Trades and Services --  5 Years
<b>Restroom Accessories</b>	Includes paper towel dispensers, electric hand dryers, towel racks or holders, cup dispensers, purse shelves, toilet paper holders, soap dispensers or holders, lotion dispensers, sanitary napkin dispensers and waste receptacles, coat hooks, grab bars, mirrors, shelves, vanity cabinets, counters, ashtrays, baby changing stations, and other items generally found in public restrooms that are built into or mounted on walls or partitions.	1250	Building or Building Component –  39 Years
<b>Restroom Partitions</b>	Includes shop made and standard manufacture toilet partitions, typically metal, but may be plastic or other materials.	1250	Building or Building Component –  39 Years
<b>Roof</b>	All elements of the roof including but not limited to joists, rafters, deck, shingles, vapor barrier, skylights, trusses, girders and gutters. Determination of whether decorative elements of a roof (e.g. false dormers, mansard) constitute structural building components depends on their integration with the overall roof not their load bearing capacity. If removal of the decorative element results in the direct exposure of building components to water, snow, wind, or moisture damage, or if the decorative element houses lighting fixtures, wiring, or other structural components, then the decorative elements are part of the overall roof system and are structural components of the building.	1250	Building or Building Component –  39 Years
<b>Security Systems</b>	Includes security equipment for the protection of the building (and its contents) from burglary or vandalism and protection of employees from assault. Examples include window and door locks; card key access systems; keyless entry systems; security cameras, recorders, monitors and related equipment; perimeter and interior building motion detectors; security lighting; alarm systems; and security system wiring and conduit.	1250	Building or Building Component –  39 Years

<b>Signs</b>	Exit signs, restroom identifiers and other signs relating to the operation or maintenance of a building.	1250	Building or Building Component – 39 Years
	Interior and Exterior Signs used for menu display or theme identity.  For pylon signs, includes only sign face. See also <b>Poles &amp; Pylons</b> .	1245	57.0 Distributive Trades and Services --  5 Years
<b>Site Preparation, Grading, &amp; Excavation</b>	In general, land preparation costs include one time cost of clearing and grubbing, site stripping, fill or excavation, and grading to allow development of land. Clearing and grubbing is the removal of debris, brush, trees, etc. from the site. Stripping is the removal of the topsoil to provide a stable surface for site and building improvements. The grading of land involves moving soil to produce a more level surface to allow development of the land.		Land
	Clearing, grading, excavating and removal costs directly associated with the construction of buildings and building components are part of the cost of construction of the building.	1250	Building or Building Component –  39 Years
	Clearing, grading, excavating and removal costs directly associated with the construction of sidewalks, parking areas, roadways and other depreciable land improvements are part of the cost of construction of the improvements.	1250	00.3 Land Improvements –  15 Years
<b>Site Utilities</b>	Site utilities are the systems that are used to distribute utility services from the property line to the restaurant building. Includes water, sanitary sewer, gas, and electrical services.	1250	Building or Building Component –  39 Years
<b>Site Work</b>	Site work includes curbing, paving, general site improvements, fencing, landscaping, roads, sewers, sidewalks, site drainage and all other site improvements not directly related to the building. For sanitary sewers, see <b>Site Utilities</b> .	1250	00.3 Land Improvements –  15 Years
<b>Sound Systems</b>	Equipment and apparatus, including wiring, used to provide amplified music or sound. For example, public address by way of paging a customer or background music. Excludes applications linked to fire protection and alarm systems.	1245	57.0 Distributive Trades and Services --  5 Years
<b>Stonework</b>	Exterior decorative stonework embedded in half walls, such as patio half walls, that are an integral part of a building's structural shell. Such half walls relate to the operation or maintenance of the building.	1250	Building or Building Component –  39 Years
	Includes patio stonework imbedded in the ground or applied to exterior half walls that are not an integral part of the building's structural shell.	1250	00.3 Land Improvements –  15 Years
<b>Trash Enclosures</b>	Enclosures for waste receptacles that are attached to the	1250	Building or

	building. Typically constructed of the same materials as the building shell with either interior or exterior access. These trash enclosures are an integral part of the building shell and cannot be moved without damage to the underlying building.		Building Component –  39 Years
	Freestanding enclosures for waste receptacles, typically constructed on a concrete pad with its posts set in the concrete. Serves both safety and decorative functions.	1250	00.3 Land Improvements –  15 Years
<b>Upholstery</b>	Any material used in the coverage and protection of furnishings.	1245	57.0 Distributive Trades and Services --  5 Years
<b>Wall Coverings</b>	Includes interior and exterior paint; ceramic or quarry tile, marble, stone, brick and other finishes affixed with mortar, cement or grout; paneling, wainscoting and other wood finishes affixed with nails, screws or permanent adhesives; and sanitary kitchen wall panels such as Fiberglass Reinforced Plastic (FRP), stainless steel or plastic wall panels.	1250	Building or Building Component –  39 Years
	Strippable wallpaper that causes no damage to the underlying wall or wall surface.	1245	57.0 Distributive Trades and Services --  5 Years
<b>Walls – Exterior</b>	Includes all exterior walls and building support regardless of construction materials. Exterior walls may include columns, posts, beams, girders, curtain walls, tilt up panels, studs, framing, sheetrock, insulation, windows, doors, exterior façade, brick, masonry, etc. Also includes drive-through bay, windows, and doors.	1250	Building or Building Component –  39 Years
<b>Walls - Interior Partitions</b>	Includes all load bearing interior partitions regardless of construction. Also includes non-load bearing partitions regardless of height (typically constructed of studs and sheetrock or other materials) that divide or create rooms or provide traffic control. Includes rough carpentry and plaster, dry wall or gypsum board, and other finishes.	1250	Building or Building Component –  39 Years
	Interior walls where the partition can be 1) readily removed and remain in substantially the same condition after removal as before, or 2) moved and reused, stored or sold in its entirety.	1245	57.0 Distributive Trades and Services --  5 Years
<b>Windows</b>	Exterior windows, including store front windows, drive-through service and carousel windows, and vestibule.	1250	Building or Building Component –  39 Years
<b>Window Treatments</b>	Window treatments such as drapes, curtains, louvers, blinds, post construction tinting or interior decorative theme décor that are readily removable.	1245	57.0 Distributive Trades and Services --  5 Years