



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

December 8, 2003

**MEMORANDUM FOR INDUSTRY DIRECTORS, LMSB
DIRECTORS, FIELD OPERATIONS
DIRECTOR, FIELD SPECIALISTS
DIRECTOR, PREFILING AND TECHNICAL GUIDANCE
AREA DIRECTORS, SBSE**

FROM: Robert E. Brazzil /s/ Robert E. Brazzil
Industry Director
Retailers, Food, Pharmaceuticals & Healthcare

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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 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.

Background

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

¹ I.R.C. Section 1245 can apply to certain qualified recovery nonresidential real estate placed in service after 1980 and before 1987. See I.R.C. Section 1245 (a)(5).

The difference in recovery periods has placed the Internal Revenue Service and taxpayers in adversarial positions in determining whether an asset is section 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 section 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 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 Jolanta Sander, Senior Program Analyst, Retailers Food, Pharmaceuticals and Healthcare Industry at (630) 493-5935, or Milton Pagan, SBSE Senior Program Analyst at (619) 230-8148.

Attachments

cc: Commissioner and Deputy Commissioner, LMSB
Director, Quality Assurance and Performance Management

**LMSB DIRECTIVE ON COST SEGREGATION IN THE RESTAURANT INDUSTRY
EXHIBIT A**

Asset	Description	Property Type	Recovery Period
Beverage Equipment	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 beverage equipment. The dispensing system may be gravity, pump or gas driven.	1245	57.0 Distributive Trades and Services -- 5 Years
Canopies and Awnings	Readily removable equipment or apparatus used for providing shade or cover. Includes canopies that are largely decorative. Does not include canopies that are an integral part of a building's structural shell, such as in the casino industry.	1245	57.0 Distributive Trades and Services -- 5 Years
Ceiling	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
Computers	Desktop and laptop computers, 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 systems, heating or cooling systems, etc.).	1245	00.12 Information Systems – 5 Years
Concrete Foundations and Footings	Includes formwork, reinforcement, concrete block, and precast 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.	1250	00.3 Land Improvements – 15 Years
Copy Machines	Includes copiers and other duplicating equipment, calculators and adding machines. Excludes computers and computer peripheral equipment.	1245	00.13 Data Handling Equipment, except Computers – 5 Years
Doors - Eliason	Eliason Doors are specialty kitchen doors providing easy access to and from the kitchen area to the dining area. (Usually swings in both directions.)	1245	57.0 Distributive Trades and Services -- 5 Years
Doors and Windows	Includes interior and exterior doors and their hardware (such as doorknobs, closers, kickplates, hinges, locks, etc.) regardless of decoration. Exterior windows, including drive-through service windows and carousel windows and exterior storefront and vestibule.	1250	Building or Building Component – 39 Years

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Asset	Description	Property Type	Recovery Period
Doors and Windows - Accessories	Window accessories such as drapes, curtains, louver, post-construction tinting that is readily removable and interior decorative theme décor.	1245	57.0 Distributive Trades and Services -- 5 Years
Drive-Through Equipment	Drive-through equipment includes the order taking, food delivery and payment processing systems whether mechanical or electronic. This category does not include building elements such as doors, bays, or windows; see Walls – Exterior , and Doors and Windows for drive-through bays and windows.	1245	57.0 Distributive Trades and Services -- 5 Years
Electrical	Includes all components of the building electrical system necessary to provide general building services such as lighting, heating, ventilation, air conditioning and general electrical wiring and outlets used in the operation or maintenance of the building. See also Kitchen Equipment Hook-up .	1250	Building or Building Component – 39 Years
Electrical – Light Fixtures – Interior	Includes lighting such as recessed and lay-in lighting, night lighting, exit lighting, as well as decorative lighting fixtures that are the only artificial illumination in the building and along building walkways. See Fire Protection Systems for emergency and exit lighting.	1250	Building or Building Component – 39 Years
	Decorative light fixtures are light fixtures that are decorative in nature and not necessary for the operation of the building. In other words, if all the decorative lighting were turned off, the other sources of lighting would provide sufficient light for the building. If the decorative lighting is the only source of lighting, then it will be treated as section 1250 property.	1245	57.0 Distributive Trades and Services -- 5 Years
Electrical – Light Fixtures – Exterior	Exterior lighting whether decorative or not is considered section 1250 property to the extent that the lighting relates to the operation or maintenance of the building. This category includes building mounted lighting to illuminate walkways, entrances, parking, etc.	1250	Building or Building Component – 39 Years
	Plant grow lights or lighting that highlights <u>only</u> the landscaping or building exterior (but not parking areas or walkways) does not relate to the operation or maintenance of the building.	1245	57.0 Distributive Trades and Services -- 5 Years
	Pole mounted or freestanding outdoor lighting system to illuminate sidewalks, parking or recreation areas.	1250	00.3 Land Improvements – 15 Years

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Asset	Description	Property Type	Recovery Period
Elevators and Escalators	Elevators and escalators are permanently affixed to the building and intended to remain in place. They relate to the operation or maintenance of the building, and are therefore considered structural components.	1250	Building or Building Component – 39 Years
Equipment Installation	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
Fire Protection Equipment	Includes special fire detection or suppression systems located in equipment hoods or directly associated with a piece of equipment, and fire extinguishers for the protection against a particular hazard.	1245	57.0 Distributive Trades and Services -- 5 Years
Fire Protection Systems	Includes 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
Fireplace	Includes masonry and gas fireplaces, flues, chimneys and other components of <u>built-in</u> fireplaces.	1250	Building or Building Component – 39 Years
Floor Covering - Carpet	For purposes of the restaurant industry, all carpeting will be treated as not permanently attached and not intended to be permanent. This category does not include rugs or tapestries that are considered artwork and do not suffer wear and tear (e.g. Persian rugs that may appreciate in value are considered artwork).	1245	57.0 Distributive Trades and Services -- 5 Years
Floor Covering - Permanent	Examples include ceramic or quarry tile, paving brick and other coverings cemented, mudded, or grouted to the floor; epoxy or sealers; wood flooring affixed with permanent adhesive or nailed or screwed in place and vinyl flooring affixed with permanent adhesive.	1250	Building or Building Component – 39 Years
Floors	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 or raised perimeter and serving line curb or cooler, freezer and garbage room floors.	1250	Building or Building Component – 39 Years
Food Storage and Preparation Equipment	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

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Asset	Description	Property Type	Recovery Period
Furnishings	Booths, tables, chairs, lockers, benches and other furniture needed in the business operation that is not a building component. See also Office Furnishings .	1245	57.0 Distributive Trades and Services -- 5 Years
Heating Ventilating and Air Conditioning (HVAC)	Includes all components of a central heating, ventilating and air conditioning system not specifically identified elsewhere.	1250	Building or Building Component – 39 Years
HVAC - Kitchen	Allocation of HVAC is not appropriate. 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.	1245	57.0 Distributive Trades and Services -- 5 Years
Kitchen Equipment Hook-up	The kitchen equipment hook-ups include electrical, water, gas, sanitary plumbing, and ventilation systems for the kitchen equipment. Items in this category include wiring and outlets, plumbing, drainage and a hot water heater <u>only in the kitchen area</u> . The hook-up costs include all items used directly with a specific item of equipment and necessary to connect the equipment to the service source. For example, a dishwasher requires electric and plumbing hook-ups. Costs associated with connecting the dishwasher would only include the costs of wiring and plumbing from the dishwasher to the source of electricity (such as an outlet or junction box), plumbing, and drainage within the kitchen room. Use of reasonable functional allocation methods to determine the electrical and plumbing components directly related to the equipment is acceptable. This category does not include outlets in the dining area or kitchen hand sink plumbing; see Electrical and Plumbing categories.	1245	57.0 Distributive Trades and Services -- 5 Years

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Millwork - Decorative	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. Cabinets and counters in a restroom are excluded from this category; see Restroom Accessories .	1245	57.0 Distributive Trades and Services -- 5 Years
Millwork - General Building or Structural	General millwork is all building materials made of finished wood for example, doors and frames, window frames, sashes, porch work, mantels, panel work, stairways, and special woodwork. 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
Music and PA System	Equipment and apparatus used to provide amplified music or sound; also includes wiring. Does not include a public address system that is an integral part of a fire protection system.	1245	57.0 Distributive Trades and Services -- 5 Years
Office Furnishings	Includes desk, chair, credenza, file cabinet, table, or other furniture. Also includes telephone equipment. See Furnishings for tables, chairs, and other furniture in the dining area.	1245	00.11 Office Furniture, Fixtures, and Equipment – 7 Years
Plumbing	Includes all restroom plumbing fixtures (e.g. toilets) and piping; kitchen hand sinks; electric water coolers and all components of the building plumbing system not specifically identified elsewhere. Does not include water or gas connections directly to appliances or kitchen drainage and kitchen hot water heater; see Kitchen Equipment Hook-up .	1250	Building or Building Component – 39 Years
Point of Sale Equipment (POS)	Cash registers, computerized sales systems, and related peripheral equipment.	1245	57.0 Distributive Trades and Services -- 5 Years
Poles and Pylons	Light poles for parking areas and poles used in concrete footings for signage.	1250	00.3 Land Improvements – 15 Years
Restaurant Décor Accessories	Items in this category include decorative mobile props (interior or exterior). For example 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., provided these items are not non-depreciable artwork, antiques or collectibles).	1245	57.0 Distributive Trades and Services -- 5 Years

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Asset	Description	Property Type	Recovery Period
Restaurant Non-structural Theme Elements	Items in this category include 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. On the other hand, a half wall whose function is to provide traffic control or space subdivision is not considered in this category, see Walls - Interior Partitions . Does not include decorative ceilings, see Ceiling .	1245	57.0 Distributive Trades and Services -- 5 Years
Restroom Accessories	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 and ashtrays 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
Restroom Partitions	Includes shop made and standard manufacture toilet partitions; typically metal, but may be plastic or other materials.	1250	Building or Building Component – 39 Years
Roof	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
Security Systems	Includes security equipment for the protection of the building (and its contents) from theft or vandalism and protection of employees from assault. Examples include window and door locks, card key access systems, keyless entry systems, motion detection and alarm systems, etc.	1250	Building or Building Component – 39 Years

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Signs	Interior and Exterior Signs used for menu display, theme identity, and any signage not pertinent to the operation of the building. Does not include exit signs; see Fire Protection Systems for exit signs.	1245	57.0 Distributive Trades and Services -- 5 Years
Site Grading and Excavation	In general, land preparation costs are not considered to be tangible property subject to depreciation. The grading of land involves moving soil for the purpose of changing the ground surface. It produces a more level surface and generally provides an improvement that adds value to the land. Includes one time cost of demolition, clearing, fill or excavation to allow development of 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
Site Utilities	Site utilities are the systems that are used to distribute utility services from the property line to the restaurant building. Water and gas services are connected to the building by underground piping. Overhead or underground lines connect electric service. Not all restaurants will have such costs. For example, mall food court restaurants would not incur costs for site utilities since the lessor already has provided them.	1250	Building or Building Component – 39 Years
Site Work	Site work includes site drainage, sewers, roads, sidewalks, paving, curbing, general site improvements, landscaping not adjacent to the building, site fencing and enclosures, playground fencing, and all other site improvements not directly related to the building.	1250	00.3 Land Improvements – 15 Years
Stonework	This category includes exterior decorative stonework embedded in exterior half walls, such as patio half walls, that are an integral part of a building's structural shell. In the context of the restaurant industry, such half walls are related to the operation or maintenance of the building.	1250	Building or Building Component – 39 Years
	Includes patio stonework imbedded in the ground and applied to exterior half walls that are not an integral part of the building's structural shell.	1250	00.3 Land Improvements – 15 Years

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Trash Enclosure	Enclosures for waste receptacles that are attached to the 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.	1250	Building or Building Component – 39 Years
Upholstery	Any material used in the coverage and protection of furnishings.	1245	57.0 Distributive Trades and Services -- 5 Years
Wall Coverings - Permanent	Includes interior and exterior paint; ceramic or quarry tile, 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, stainless steel and plastic wall panels.	1250	Building or Building Component – 39 Years
Wall Coverings - Removable	Includes strippable wallpaper that causes no damage to the underlying wall or wall surface.	1245	57.0 Distributive Trades and Services -- 5 Years
Walls - Exterior Walls - Interior Partitions	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
	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 where the partition cannot 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. Includes rough carpentry and plaster, dry wall or gypsum board, and other finishes.	1250	Building or Building Component – 39 Years