



# Cost Segregation for STR Investors: Is It Worth It?

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Cost segregation is one of the most talked-about tax strategies in the STR investing community — and for good reason. When applied correctly, it can generate significant first-year tax deductions that offset ordinary income. Here's what you need to understand before deciding if it's right for you.

## 01 — What Is Cost Segregation?

Cost segregation is an IRS-recognized tax strategy that involves reclassifying components of a real property from long-lived assets to shorter-lived assets to accelerate depreciation deductions.

- Standard residential real property depreciates over 27.5 years
- Cost segregation identifies components that qualify for 5, 7, or 15-year depreciation
- Examples include flooring, appliances, landscaping, and certain fixtures
- Bonus depreciation may allow large first-year deductions on qualifying assets
- A qualified engineer or specialized firm performs the study

**Practical Tip:** Cost segregation is not a loophole — it's an IRS-recognized strategy explicitly outlined in the tax code.

## 02 — How It Works for STR Investors

For STR investors who meet material participation requirements, cost segregation can be especially powerful because depreciation losses may offset ordinary income.

- Without material participation, depreciation losses are passive
- With material participation, losses may offset W-2 or business income
- A \$500,000 STR property could generate substantial first-year depreciation
- Tax savings depend on income level and tax bracket
- Bonus depreciation percentages vary by tax year

**Practical Tip:** The combination of cost segregation and material participation is most impactful for investors with significant W-2 or business income.

## 03 — What a Cost Segregation Study Involves

A cost segregation study is a formal engineering analysis of your property that documents components eligible for accelerated depreciation.

- Performed by a licensed engineer or specialized firm
- Includes physical inspection and review of purchase or construction documents
- Identifies and values property components separately
- Produces a detailed report supporting your tax filing
- Can be performed on new or existing properties
- Retroactive studies may also be available

**Practical Tip:** Get quotes from multiple providers. The projected tax savings should significantly exceed the study cost.

## 04 — When Does It Make Financial Sense?

Cost segregation isn't right for every STR investor. The value depends on property size, income level, tax bracket, and long-term investment plans.

- Generally worth considering for properties valued at \$250,000 or more
- Most impactful for investors in higher tax brackets
- Requires material participation to offset ordinary income
- Less impactful if you already have passive losses available
- Depreciation recapture should be considered when planning to sell
- Works best as part of a broader CPA-developed tax strategy

**Practical Tip:** Ask your CPA to run a cost-benefit analysis before commissioning a study.

## 05 — Depreciation Recapture: The Important Caveat

Cost segregation accelerates deductions but does not eliminate taxes permanently. Depreciation recapture applies when the property is sold.

- Depreciation recapture may be taxed up to 25% for real property
- Certain reclassified assets may be taxed at ordinary income rates
- A 1031 exchange may defer recapture taxes
- The strategy still offers value through tax deferral and reinvestment
- Your CPA can model long-term impacts including recapture

**Practical Tip:** Depreciation recapture is a real consideration — but deferring taxes for years still has meaningful financial value.

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## Bottom Line

Cost segregation is a legitimate and powerful strategy for the right STR investor — but it requires professional guidance, careful planning, and a clear understanding of long-term implications including depreciation recapture. Work with a CPA experienced in STR taxation and cost segregation before moving forward.