DUER URAKAMI GROUP | INVESTOR EDUCATION

The Real Estate Tax Playbook

How depreciation lowers taxable income, what the catch is, and what to plan for at sale.

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THE SHORT VERSION

Depreciation in 60 seconds

When you own an apartment building, the IRS lets you deduct a slice of its cost every year, as if the building is wearing out. That is **depreciation**. It is a **paper** expense. No cash leaves the property.

- **Real cash:** distributions land in your bank account.
- **Paper loss:** your share of depreciation can reduce the taxable income from the investment.
- **The catch:** it defers tax. It does not erase it. When the property sells, the IRS recaptures the depreciation.

> THE POINT
> Depreciation is a timing tool. You get the deduction now, and you plan for the recapture later.

The math, with an example

Step	Example
Purchase price	$7,000,000
Less land (20%, land cannot be depreciated)	($1,400,000)
Building	$5,600,000
Divided by 27.5 years	$203,636 a year
Your share at 5% ownership	**$10,182 a year**

Example only. Your operating agreement and your K-1 control your actual share.

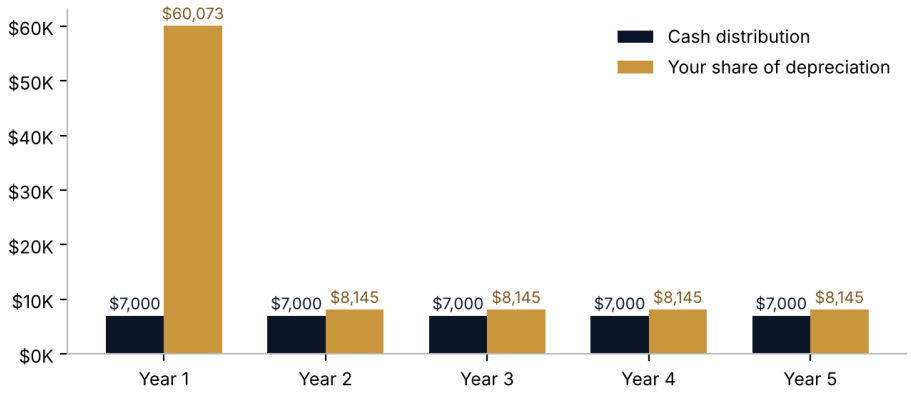
> IMPORTANT
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WHY YEAR 1 CAN BE BIG

Faster deductions

A **cost segregation study** splits a building into parts, like appliances, flooring, fixtures, parking lots, and landscaping. Those parts depreciate over 5 to 15 years instead of 27.5. With **bonus depreciation**, which is 100% for property acquired after January 19, 2025, much of that can be deducted in Year 1.

In the example, the project deducts $1,201,455 in Year 1. Your 5% share is **$60,073**, against a $7,000 distribution. That is a **$53,073 paper loss**.



Example: $100,000 invested at 5% ownership, 7% distribution, cost segregation with 100% bonus. Not a DUG result.

THE TRADE-OFF

Faster deductions today mean more recapture at sale. The 5- and 7-year portion is taxed as ordinary income. The 15-year portion (parking lots, landscaping) is split: the part above straight-line is ordinary and the rest is taxed up to 25%. Cost segregation moves the tax around in time. It does not remove it.

THE CATCH

Who can use the loss, and what happens at sale

1. The passive loss rules

THE RULE

Passive losses can generally offset only passive income. A loss you cannot use this year carries forward, and is generally released when the partnership sells all of the property, or you sell your entire interest to an unrelated buyer.

If you are...	Can the loss offset your wages?
A W-2 earner with no other passive income	Generally no. It carries forward.
An investor with other passive income	Against that passive income, yes.
A qualifying real estate professional	Possibly. The test is demanding. Ask your CPA.

2. At sale: recapture

When the property sells, the IRS taxes the depreciation you took. In the example, your 5% share breaks down like this:

Bucket	Generally taxed as	Your example share
Equipment and flooring (5- and 7-year)	Ordinary income	$56,000
Building depreciation	Up to 25%	$36,655
Appreciation	Capital gains rates	$57,400

At example rates of 32% ordinary and 25% on the building portion, about **$27,000** of tax comes straight from recapturing depreciation. That is the tax you deferred. The example assumes the cost segregation portion is all 5- and 7-year property. Your numbers will differ.

WHAT TO DO ABOUT IT

What investors commonly do

Approach	In general
Reinvest in another depreciating asset	New depreciation can offset the gain from this sale.
Use suspended passive losses	Losses you could not use earlier can offset the gain at sale.
Reinvest gains in a qualified fund (such as an Opportunity Zone fund)	Can defer tax on capital gains. Strict rules, and new rules for investments after Dec 31, 2026.
Charitable planning	Can reduce the tax on a sale. Usually set up before the sale.
Offset with other losses	Losses realized in the same year can net against the gain.

A 1031 exchange works at the property level, not the investor level. If a sale uses one, we will tell you. Individual investors generally cannot 1031 their own share.

> **THE TIMING RULE**
> Call your CPA when you learn a property will sell. Several options have deadlines that start at closing or earlier. Do not wait for tax season.

Ask your CPA

- Do I have passive income that my losses can offset, or are mine being suspended?
- How much suspended passive loss do I carry right now, and where is it tracked?
- How much depreciation have I taken on this investment so far?
- If this property sells this year, what is my estimated recapture and total tax?
- How are the 5-, 7-, and 15-year portions of my depreciation taxed at sale?
- Does my state follow the federal bonus depreciation rules?
- Would reinvesting in another depreciating asset change my sale-year tax, and by how much?
- Could an Opportunity Zone fund or a charitable strategy fit my situation, and what are the deadlines?
- Do I need to make estimated tax payments in the year of the sale?
- What should I do differently in the year before a sale?

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