

Whitepaper

Tax Efficient Investing

Maximizing the Efficiency of Depreciation

BY: **ERIK CONRAD** *CEO of InCommercial Property Group*

INTRODUCTION

After the macroeconomic roller coaster triggered by the COVID-19 pandemic, 2025 remains a volatile landscape for investors across asset classes. While inflation has eased somewhat due to the Federal Reserve's monetary tightening, this relief may prove temporary as risks like shifting trade policies, commodity price volatility, and supply chain pressures continue to create uncertainty.

In this environment, success requires a disciplined focus on assets that generate durable, necessity-based income backed by strong operators in resilient industries. Equally important is understanding how to protect those gains from today's headwinds, including the erosion of returns through excessive tax burdens. Smart investing in 2025 isn't just about generating income – it's about preserving it.

DEPRECIATION GENERALLY

Real property includes both land and the things we do to improve the land, such as the construction of infrastructure, buildings, parking lots, etc. While tax law recognizes that land may appreciate in value – something most real estate investors are familiar with and have long enjoyed – it conversely assumes that real property improvements depreciate because they age and eventually become obsolete. In actuality, these improvements may not always depreciate at an anticipated rate. Regardless, this is an established principle for federal income tax laws.

These competing processes – the appreciation of land versus the depreciation of improvements – are what often result in real estate investors achieving long term gains with low effective tax rates. The income derived from the property over many years is offset by depreciation expenses that effectively reduce the tax burden of their investment. This impact compounds over time to create a net benefit to investors that few asset classes can match.

Importantly, appreciation and depreciation do not involve cash. Instead, they are paper gains and losses. The IRS doesn't (yet) tax on unrealized appreciation, but it does allow the real estate investor to depreciate a portion of the improvements each year, offsetting the income produced by the property.

Depreciation schedules have been set for most property types, broadly classifying each with a "useful life" over which the purchase price (excluding land) can be depreciated to zero. Many commercial rental properties are broadly classified as having a useful life of 39 years, while Retail Motor Fuel Outlets, for example, are classified as having a 15-year depreciation period.

LEVERAGED DEPRECIATION

Depreciation, as powerful as it is, becomes even more impactful with leverage. Most real estate is purchased with some form of loan in place. By borrowing additional funds from a lender, an investor is able to buy property with a value greater than their cash on hand. This larger purchase also likely increases the opportunity for improvements that can be depreciated. Thus, more income – from the larger purchase and additional improvements – can be offset.

Cash Vs Loan Purchase



BONUS DEPRECIATION

The One Big Beautiful Bill Act has officially reinstated 100% bonus depreciation for qualified property, restoring one of the most significant tax advantages for real estate investors. Originally introduced under the 2017 Tax Cuts and Jobs Act, bonus depreciation allows investors to fully depreciate the eligible portion (purchase price, excluding land) of qualified property in the year of acquisition.

Without making some other elections, most real property will not qualify for bonus depreciation because the scheduled depreciation is greater than 20 years. This is where cost segregation studies are often employed to maximize depreciation, a percentage of every property likely has a shorter useful life than the property as a whole. For example, site improvements are typically 15-year assets, which include improvements like sidewalks, roads, sewers, fences, landscaping, etc.

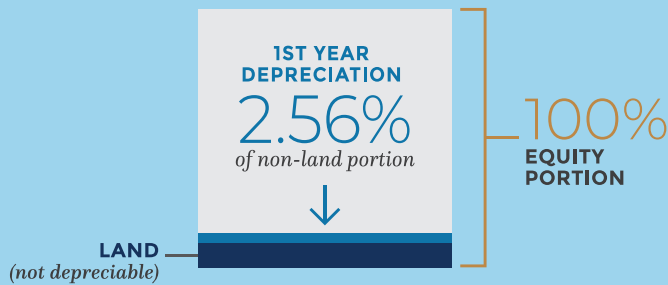
A relatively small percentage of real estate has been granted a depreciation schedule shorter than 20 years and is therefore able to utilize bonus depreciation. Retail Motor Fuel Outlets (gas stations) are one such property class that qualifies for bonus depreciation and does not need further engineering studies or analysis, as provided for in Internal Revenue Code (IRC) Section 168(e)(3)(E)(iii).¹

BRINGING EVERYTHING TOGETHER

A sophisticated investor can acquire gas station properties and strategically use leverage to amplify depreciation benefits. With 100% bonus depreciation reinstated for 2025, investors can fully depreciate the eligible portion of the purchase price (excluding land) in the year of acquisition, significantly maximizing their tax deductions and overall tax efficiency.

Comparing Depreciation Scenarios² More Money and More Property allows for More Tax Losses

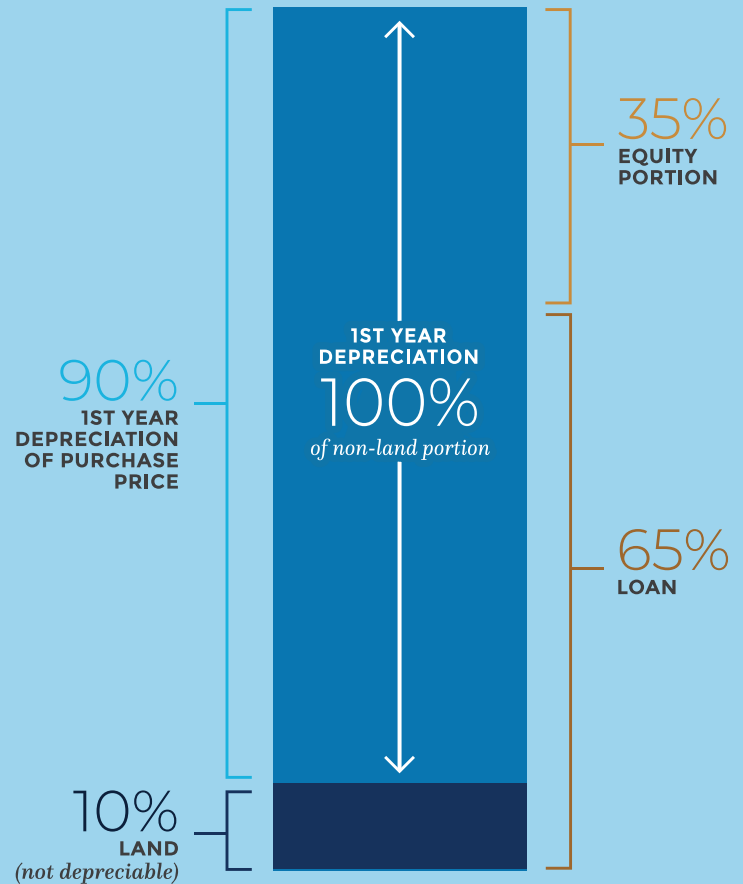
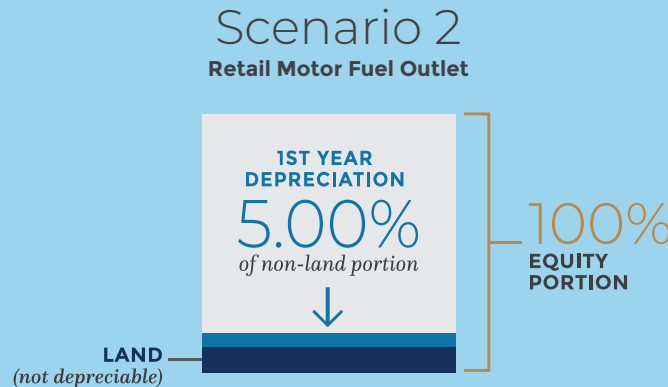
Scenario 1 Commercial Property



	Scenario 1	Scenario 2	Scenario 3	Scenario 4
Purchase Price	\$ 100.00	\$ 100.00	\$ 100.00	\$ 250.00
Invested Equity	\$ 100.00	\$ 100.00	\$ 100.00	\$ 87.50
Land Value	\$ 10.00	\$ 10.00	\$ 10.00	\$ 25.00
1st Year Depreciation	\$ 2.31	\$ 4.50	\$ 90.00	\$ 225.00

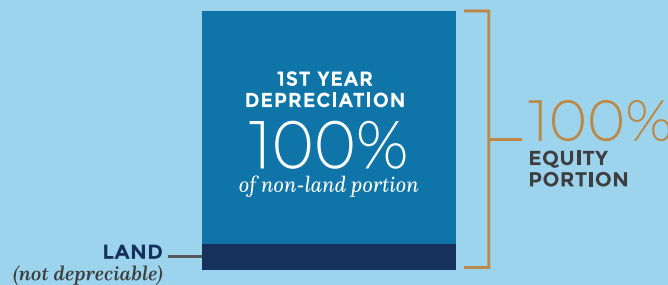
Scenario 4³

Applying Leverage to a Retail Motor Fuel Outlet
electing Bonus Depreciation



Scenario 3

Retail Motor Fuel Outlet electing Bonus Depreciation



² The figures include a 10% adjustment for land values. A higher land value will result in lower depreciation expense.

³ The figures represented require some assumptions about land values and loan amounts. In the scenario shown, we assume a 10% Land Value and a 65% Loan to Value loan.

APPLICATIONS ⁴

Since the depreciation in this case is likely to be greater than the cash flow a property will reasonably be expected to generate over a typical investment horizon of 5-10 years, the investor would ideally be able to use these dramatic depreciation expenses to offset income from other sources. The question then becomes, what income can investor offset?

Buckets of income used for determining federal income tax liability include the following:

1. Portfolio
2. Passive
3. Active

Real Estate Investors

Income or loss from rental real estate is, for most investors, a passive activity. Investors with portfolios of rental real estate, particularly real estate that has been owned for a long time and has experienced significant gains, likely have significant passive income that is currently being taxed as ordinary income.

Investors should be encouraged to review Form 8582, which will report the Passive Activity Income or Loss from their tax return. If Line 3 is positive, the investor has passive income that should be investigated further.

Form 8582 Department of the Treasury Internal Revenue Service Name(s) shown on return	Passive Activity Loss Limitations See separate instructions. Attach to Form 1040, 1040-SR, or 1041. Go to www.irs.gov/Form8582 for instructions and the latest information.	OMB No. 1545-1008 2024 Attachment Sequence No. 858
		Identifying number
Part I 2024 Passive Activity Loss Caution: Complete Parts IV and V before completing Part I.		
Rental Real Estate Activities With Active Participation (For the definition of active participation, see <i>Special Allowance for Rental Real Estate Activities</i> in the instructions.)		
1a Activities with net income (enter the amount from Part IV, column (a)) b Activities with net loss (enter the amount from Part IV, column (b)) c Prior years' unallowed losses (enter the amount from Part IV, column (c)) d Combine lines 1a, 1b, and 1c	1a 1b () 1c ()	1d
All Other Passive Activities		
2a Activities with net income (enter the amount from Part V, column (a)) b Activities with net loss (enter the amount from Part V, column (b)) c Prior years' unallowed losses (enter the amount from Part V, column (c)) d Combine lines 2a, 2b, and 2c	2a 2b () 2c ()	2d
3 Combine lines 1d and 2d and subtract any prior year unallowed CRD. See instructions. If this line is zero or more, stop here and include this form with your return; all losses are allowed, including any prior year unallowed losses entered on line 1c or 2c. Report the losses on the forms and schedules normally used		3

⁴ We can't provide tax advice as we are neither tax professionals, nor familiar with any investor's particular set of facts and circumstances. Every investor should have their own, independent, competent tax representation.

Failed 1031 Exchange

An investor who is unable to complete an orderly 1031 exchange would, in many cases, have passive income that is either section 1231 (capital gains) or section 1250 (recapture) – both of which can often be offset by depreciation expenses. An investor with a failed 1031 exchange should consult with their tax preparer to determine how the gains from sale will be characterized and if this strategy may be applicable.

Passive Business Owners

Some investors may own businesses in which they are no longer active and the income derived from those businesses may be considered passive income. As indicated above, this determination must be made with careful consideration and consultation with competent tax representation.

Real Estate Professionals

Some investors may be real estate professionals, as defined in the Internal Revenue Code. In which case, it may be possible for them to either invest as active participants in real estate, which would otherwise be considered passive activity, or aggregate all their real estate activities to claim active status. This can be particularly powerful for some investors but requires careful consideration and consultation with competent tax representation.

CONCLUSION

Sophisticated investors understand that positive returns are just the beginning of an effective investment strategy. Tax efficiency is key to protecting gains, maximizing returns, and building generational wealth. Investing in necessity-based asset classes that offer stable income and risk-adjusted returns provides a strong foundation for any portfolio. Strategic use of debt can further enhance investment capacity. Finally, allocating capital to leveraged, necessity-based real assets that qualify for bonus depreciation, such as retail motor fuel properties, can significantly enhance a portfolio's tax efficiency.

Footnotes:

1 IRC Sec. 168(e)(3)(E)(iii) provides that a retail motor fuels outlet is 15-year property even though food or other convenience items are sold at the outlet. Depreciable real property qualifies as a retail motor fuels outlet if (1) 50% or more of the gross revenue from the property is from petroleum sales or (2) 50% or more of the property's floor is devoted to petroleum marketing sales. A facility that is no more than 1,400 square feet in size is exempted from the 50% tests. Under IRC Sec. 168(g)(3)(B), the recovery period is 20 years under the alternative depreciation system of IRC Sec. 168(g). Rev. Rul. 97-29 held that a retail motor fuels outlet qualifies as 15-year property whether or not the taxpayer-owner is also the operator.

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Contact

www.incommercialre.com
info@incommercialre.com
(312) 243-0100

117 N Jefferson Street
Suite 303
Chicago, IL 60661