Twitter Thread by Nick Huber

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A thread on how real estate investors, developers and operators can make millions a year and pay almost nothing in TAXES by using depreciation, bonus depreciation, and 1031 exchanges.

How it works:

Depreciation is the act of slowly, over time, deducting the initial expense of an asset against your taxable income. Generally over a 27.5 (residential) or 39 (commercial) yr time frame. So each year you can write off 2-3.6% of the purchase price against your income.

Thats a big deal. We're buying a new property, a $3MM self storage facility. Thats a $60k a year write off against about $260k in NOI and 200k in cashflow on a $3MM deal.

It makes 30% of our cashflow tax free.

Very powerful but there is much more to it...

Different parts of the asset can be depreciated on different schedules.

We'll have a cost segregation study done to split up the depreciable lifespan of different parts of the building. The raw land can't be depreciated so you have to give that a value.

But other items can be depreciated on a quicker timeline. A roof, road, sidewalk, fencing, walls, gates, doors, latches, flooring, air conditioners, pavers, curbing, landscaping, etc.

The IRS has a depreciation schedule for each type. Some parts are 5 yrs. Others 15 years...

So you can depreciate a portion of the asset costs faster. Get the study done, get dollar amounts assigned to different parts and different schedules to front-load depreciation.

Now you can get 5 or 6% of the value as a deduction in the early years...

But wait... theres more.

Bonus depreciation allows you to deduct a certain percentage of cost in the first year an asset is put into service. Anything that is on a schedule of 15 years or less...

So the doors, sidewalks, HVAC, walls, latches, curbs, security, gates, etc.

A % of this stuff goes in Yr 1

For years 2015 through 2017, first-year bonus depreciation for these items was set at 50%. It was scheduled to go down to 40% in 2018 and 30% in 2019, 0% in 2020

But then Trump got elected and he enacted the Tax Cuts and Jobs act. Moving this percentage to 100% from 2017 to 2023

Its not uncommon to allocate 30% of an asset cost to items that can be depreciated on a 15 year or faster time frame.

So now 30% of your asset cost can be DEPRECIATED IN THE FIRST YEAR.

So back to our $3MM self storage facility we're buying in a few weeks.

The cost segregation study came back. 30% of the asset cost can be depreciated on a 15 yr or faster timeframe. This is 100% deductible THIS YEAR...

Take a quick break to remind you that I send out a newsletter with stuff just like this all the time. Signup here:

https://t.co/FEt1sBoSWS

30% of $3MM is $900k.

A $900k tax deduction. In year 1.

The facility will produce about $260k in NOI and $200k in free cashflow after interest expense.

So while $200k goes into the bank account the tax LOSS is $700k.

But wait there is more...

The Cares act made it so you can carry those losses back 5 years to income made from 2015 onward. You can also use the new depreciation guidelines to CATCH UP assets purchased in the last 3 years.

You can also carry these losses forward into eternity.

The passive losses can't offset active income (W2 income, etc) but they can offset gains from other real estate properties or passive income.

On these new properties we won't have a tax liability for 4+ years because of Bonus Depreciation...

We'll also get a huge tax shield on cash we are now making from the facility we built in 2017.

INSANITY.

This is how real estate owners, operators, developers make millions a year and pay 0 taxes.

There is a downside. If you sell your asset you have something called recapture. Your basis decreases in the asset as you depreciate it so you have more profits when you sell and thus a higher tax rate.

But if you've owned it longer than 12 months its taxed at capital gains...

Which is 15% vs 30-40% for standard income in higher brackets.

And you can do whats called a "like-kind exchange" (1031 exchange) which allows you to use the proceeds to buy a new asset and shield the taxes and push them further down the line.

Me? I'll never sell this $3MM facility so I won't have recapture. Yes depreciation will run out over time but we'll use the proceeds to buy more facilities and thus getting more bonus depreciation and shielding more taxes.

Powerful stuff.

A disclaimer - I'm not a CPA, this isn't advice, and I'm not a master at this stuff. I look forward to getting corrected wherever possible!

To get a quote on a cost seg study reach out to @1245consulting! He did all the cost segs on the 9 buildings we purchased over the past 2 yrs.

You can even cost seg your vacation homes or small rental properties and its often very cost-effective.

Thanks for following along!

Sorry this is a repeat thread. I’ve been releasing a lot of them so I’m going to re-post them from time to time so folks can get reminders or see them if they missed them!

Thoughts?