



OAK STREET ASSETS · INVESTOR EDUCATION

THE DEPRECIATION GUIDE FOR PASSIVE INVESTORS

How accelerated depreciation works inside a real estate offering, what the deduction can actually offset, and why the answer is different for every investor who receives the same K-1.

Timothy Fergestad, PhD

Founder and Managing Partner

Oak Street Assets

Depreciation is one of the best reasons to own real estate. The tax code lets you deduct the cost of a building that is often rising in value, and in a well structured deal that deduction can shelter years of income and save real tax.

It also comes with rules that decide who gets that money, and when. Two investors can receive the same K-1, with the same deduction printed on it, and one saves tens of thousands this year while the other saves nothing at all. The difference is not the deal. It is what else is on the return.

That is why this guide starts with the rule rather than the benefit. If you are building a portfolio rather than making one investment, this is also where compounding begins, because the deductions one deal cannot use are absorbed by the next. That is the practical version of the case we make in **The Income Trap** for owning assets rather than simply earning more.

SECTION ONE

The distinction that decides everything

The tax code sorts your income into three buckets and builds a wall between them. Almost every misunderstanding about real estate depreciation comes from ignoring that wall.

ACTIVE / EARNED W-2 wages, guaranteed payments, and income from a business you materially participate in. Your salary, your practice, your operating company. HIGHEST RATES	PORTFOLIO Interest, dividends, royalties, and capital gains from securities. Income your capital produces without an underlying trade or business. PREFERENTIAL RATES ON SOME	PASSIVE Rental activities, and any trade or business you do not materially participate in. This includes a limited partner interest in a real estate offering. WHERE YOUR K-1 LANDS
--	--	--

Internal Revenue Code Section 469 governs the third bucket. The rule is short: **a passive loss may be deducted only against passive income.** Any excess is suspended, carried forward indefinitely, and tracked on Form 8582 until you have passive income to absorb it or you dispose of the activity.

This is why the most common promise in real estate marketing, that depreciation will shelter your W-2 income, is wrong for most of the people it is sold to. Absent real estate professional status or the short-term rental exception, both covered in Section Six, a passive loss does not touch your wages. It also does not generally offset portfolio income.

What this means in practice. A large first-year depreciation deduction from a syndication is real, and often very large. Its value to you this year depends almost entirely on one number that has nothing to do with the deal: how much passive income you already have.

SECTION TWO

Where the deduction comes from

When a partnership buys an apartment community, the purchase price splits between land, which is never depreciable, and improvements, which are. Under the default method the improvements are written off on a straight line over 27.5 years. On a ten million dollar building that is roughly three hundred sixty thousand dollars a year, in even slices.

Cost segregation changes the timing. An engineering study walks the property and reclassifies components that are not structural: appliances, cabinetry, carpet and floor coverings, dedicated electrical, and similar items into 5-year personal property, and site work such as paving, landscaping, fencing, and site lighting into 15-year land improvements. The remaining shell stays at 27.5 years. Nothing about the total deduction changes. Only the schedule does.

Bonus depreciation then compresses that schedule to a single year. The One Big Beautiful Bill Act, signed in July 2025, restored the bonus rate to 100 percent and made it permanent for qualified property acquired after January 19, 2025. Qualified property means tangible property with a class life of twenty years or less, which is exactly the 5-year and 15-year buckets a cost segregation study creates. The 27.5-year shell is not eligible and continues on its normal schedule.

Put those two together and a deal that would have generated a few hundred thousand dollars of deduction in year one can instead generate several million, concentrated entirely in the year the property is placed in service. That deduction flows through the partnership return and lands on your Schedule K-1 as a net rental real estate loss.

ONE DATE THAT MATTERS

The 100 percent rate applies to property **acquired after January 19, 2025**. Property under a written binding contract entered into before January 20, 2025 is treated as acquired on the contract date and falls under the older phase-down schedule instead. When you evaluate an offering, ask when the property was placed under contract, not just when it closed.

THE CHAIN, START TO FINISH

- 1 **Purchase price is allocated.** A portion to land, which is not depreciable, and the balance to depreciable basis. The land allocation is a judgment call that should be supportable.
- 2 **A cost segregation study runs.** An engineering firm reclassifies a share of the depreciable basis into 5-year and 15-year lives. On 1980s-era garden-style multifamily, that share commonly lands in the high twenties to mid thirties as a percentage of basis.
- 3 **Bonus depreciation is claimed.** The reclassified 5-year and 15-year property is deducted in full in year one. The 27.5-year shell is deducted normally, prorated from the placed-in-service month.
- 4 **The loss passes through.** The partnership allocates the deduction among partners. You receive a K-1 showing your share as a passive loss.
- 5 **Section 469 decides what it is worth to you.** Passive income you hold absorbs it. Everything above that suspends and waits.

A word on the word “savings.” Cost segregation proposals routinely label the first-year deduction as first-year savings. It is not. A deduction reduces taxable income; it does not reduce your tax bill dollar for dollar. A three million dollar deduction is worth roughly one million dollars of deferred federal tax to someone in the top bracket with three million dollars of passive income to absorb it, and it is worth nothing at all this year to someone with none. Read every proposal with that translation in mind.

TWO CONSTRAINTS THAT SIT AHEAD OF SECTION 469

- **Basis.** You cannot deduct a loss larger than your adjusted basis in the partnership interest. For most equity investors in a syndication the first-year loss stays well inside their capital contribution, but partnership debt allocations affect this and the arithmetic belongs with your CPA.
- **At-risk rules, Section 465.** Losses are limited to amounts you are economically at risk for. Nonrecourse debt that is qualified nonrecourse financing generally counts; other nonrecourse debt generally does not.

Both of these are usually satisfied in a straightforward equity investment. They are listed here because a guide that skips them is not a complete one.

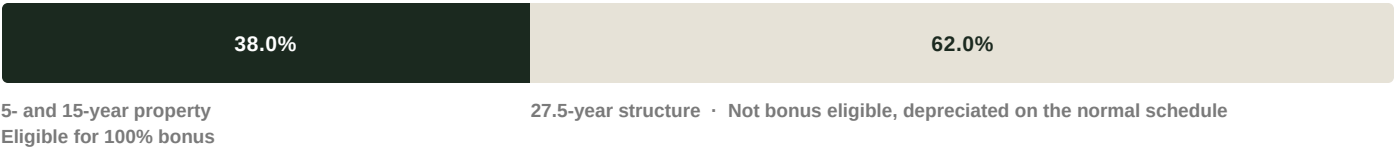
SECTION THREE

A real deal: Winston Apartments, San Antonio

Rather than illustrate this with a round hypothetical, here are the actual figures from an Oak Street Assets offering, taken from the cost segregation estimate prepared for the property.

PROPERTY	DETAIL
Asset	112-unit apartment community, built 1981
Location	11246 Sir Winston St, San Antonio, TX
Purchase price	\$11,250,000
Land allocation	8.0%
Depreciable basis	\$10,350,000
Placed in service	November 19, 2025
Limited partner equity raised	\$4,550,000

HOW THE BASIS RECLASSIFIED



Because the property was acquired in November 2025, after the January 19, 2025 cutoff, the reclassified 5-year and 15-year property qualified for the full 100 percent bonus rate. The effect on the first year is the entire point of the exercise.

PROPERTY-LEVEL DEPRECIATION, FIRST YEAR AND FIRST SIX YEARS

METHOD	YEAR ONE	YEARS ONE TO SIX
Straight line, no cost segregation	\$43,319	\$1,925,137
Cost segregation with 100% bonus	\$3,959,858	\$5,126,585

Figures are depreciation deductions, not tax savings, and not cash. Year-one straight-line is small because the property was placed in service in November, leaving roughly six weeks of the tax year. The structural component is prorated in the model by days; MACRS applies a mid-month convention to 27.5-year property, a difference immaterial at the investor level. Source: cost segregation model for the property prepared by Madison SPECS, LLC, as presented by Brian Bigham, VP, Madison SPECS, in a recorded interview on September 22, 2026.

The bonus column is more than ninety times the straight-line column in year one. Over six years the gap narrows to about two and a half times, and by year seven the cost segregation schedule produces less annual depreciation than the straight-line schedule would have. That is the trade being made: the same total deduction, pulled forward.

WHAT IT LOOKED LIKE FOR A ONE HUNDRED THOUSAND DOLLAR INVESTOR

A \$100,000 commitment represented 2.20 percent of the \$4,550,000 raised. Applying that share to the property-level schedule produces the following allocation.

\$87,030

YEAR ONE PASSIVE LOSS
ON \$100,000 INVESTED

87.0%

YEAR ONE DEDUCTION AS A
SHARE OF CAPITAL INVESTED

\$112,672

CUMULATIVE DEDUCTION
OVER SIX YEARS · 112.7%

Investor allocation from the Madison SPECS cost segregation model for this property. An illustrative model prepared before the property's first tax filing, not a projection of returns and not a result. Actual allocations depend on the final land allocation, the completed study, partnership agreement terms, and the timing of each investor's admission.

Those are genuinely striking numbers, and they are the numbers that get repeated on stage. Here is the part that usually does not get repeated.

Three investors, one K-1, three different outcomes. Each invested \$100,000 in the same deal and each received the same \$87,030 passive loss. What happened next depended entirely on what else was on their return.

INVESTOR	OTHER PASSIVE INCOME	LOSS USED THIS YEAR	CARRIED FORWARD
A · Seasoned LP with a portfolio of other deals	\$90,000	\$87,030	\$0
B · One prior rental, modest passive income	\$25,000	\$25,000	\$62,030
C · High W-2 earner, first passive investment	\$0	\$0	\$87,030

Investor A deferred roughly \$32,200 of federal tax in year one, assuming a 37 percent marginal rate. Investor B deferred roughly \$9,250. Investor C deferred nothing at all in year one, despite holding a deduction worth eighty seven percent of the capital committed.

WHY THIS NUMBER IS SO LARGE, AND WHY IT IS NOT A PROMISE

Eighty seven percent is a function of leverage and allocation, not a law of the asset class. \$11,250,000 of building sits on \$4,550,000 of limited partner equity, so each equity dollar carries roughly two and a half dollars of property. Change the land allocation, the debt, or add preferred equity that takes no depreciation, and the number moves. **Treat it as one model on one deal, not a rate of return to expect.**

Investor C did not lose anything. The deduction is not forfeited, it is queued, and Section Four explains what releases it. But an investor who bought the deal expecting a year-one refund against a physician's salary bought it on a premise the tax code does not support, and that is a conversation worth having before the wire goes out rather than the following April.

THE QUESTION TO ASK YOURSELF FIRST

Before evaluating any offering on its tax profile, total your expected passive income for the year: net income from rentals, distributions of operating income from other syndications and partnerships where you are not active, and any suspended losses already in the queue ahead of this one. **That number, not the deal's depreciation schedule, sets the ceiling on what a first-year deduction is worth to you.**

SECTION FOUR

What happens to the losses you cannot use

A suspended passive loss does not expire. It attaches to the activity that produced it, carries forward indefinitely, and is reported each year on Form 8582. Three things bring it back.

- **The deal's own income absorbs it.** A property that produced a large loss in year one often turns taxable by year three or four, as depreciation drops off and net operating income climbs. Suspended losses from that activity absorb that income first, which is why many investors receive distributions for years without a matching tax bill.
- **Other passive income absorbs it.** Add a second or third passive investment that throws off taxable income and the queued loss meets it. This is why a passive portfolio tends to become more tax efficient as it grows, rather than less.
- **Disposition releases it entirely.** Under Section 469(g), a fully taxable disposition of your entire interest to an unrelated party frees every suspended loss from that activity. The released loss is no longer confined to the passive bucket and can offset income of any character, including wages.

TWO THINGS THAT DO NOT RELEASE SUSPENDED LOSSES

A **1031 exchange** is not a taxable disposition, so it defers the gain and keeps the suspended losses suspended. At **death**, suspended losses are allowed on the final return only to the extent they exceed the step-up in basis, so most are often lost. Neither is a reason to avoid the structure. Both are reasons to know the plan before the exit.

SECTION FIVE

The exit: deferral, not forgiveness

Accelerated depreciation reduces the property's adjusted basis, and a lower basis means a larger gain at sale. The year-one deduction is borrowed from the exit.

At sale, the depreciation you took is added back and taxed. How much depends on what was depreciated, your bracket in the year you sell, and your state. Your CPA will model it when the time comes. What matters for the decision today is simpler: this is a timing difference, not a deduction that disappears.

WHY THE TRADE IS STILL WORTH MAKING

Tax you do not pay in 2026 stays invested and compounds until the exit, usually five to seven years later. You are putting money to work that would otherwise have gone to the IRS, and you often settle up in a year when your income looks different than it does now. That is the whole case, and it is the phrase the specialists use for it: **the time value of money**. It is a good case. It is not the same as never paying.

Stated plainly: **this is a timing strategy, not an erasure**. It is a good one. It is not the one being sold when someone promises tax-free returns.

SECTION SIX

The three exceptions, and whether they apply to you

There are three recognized routes around the passive wall. Each is legitimate. Each is narrower than the marketing suggests, and none of the three is available to a limited partner in an apartment syndication.

1. THE \$25,000 SPECIAL ALLOWANCE, SECTION 469(I)

An individual who *actively participates* in rental real estate may deduct up to \$25,000 of rental losses against non-passive income. Two things narrow it to almost nothing for this audience. The allowance phases out between \$100,000 and \$150,000 of modified adjusted gross income and disappears entirely above that. And the statute specifically provides that **an interest held as a limited partner never qualifies as active participation**. For an LP in an offering, this exception is unavailable regardless of income.

2. REAL ESTATE PROFESSIONAL STATUS, SECTION 469(C)(7)

A taxpayer who meets two tests in the same year is not subject to the automatic passive classification for rental activities. Both must be met:

- **More than half** of all personal services performed in all trades or businesses during the year must be in real property trades or businesses in which the taxpayer materially participates, and
- more than **750 hours** of service must be performed in those real property trades or businesses.

A physician, dentist, attorney, or executive working a full clinical or professional schedule cannot satisfy the first test on their own hours, because real estate cannot be more than half of their services when their profession already is. On a joint return the tests are applied to each spouse separately, so a spouse who does not work full time outside real estate may qualify where the earning spouse cannot. That is a real and frequently used planning path, and it deserves a serious conversation with a CPA rather than a seminar slide.

Note also that qualifying as a real estate professional removes only the automatic passive label. **Material participation in the specific activity is still required**, and materially participating in a syndication that a third-party sponsor operates is, in practice, close to impossible.

3. THE SHORT-TERM RENTAL EXCEPTION

If the average period of customer use is **seven days or less**, the activity is not a rental activity under the regulations at all. It is a trade or business. With material participation, the loss is non-passive and can offset wages. No real estate professional status is required, which is why this route has become popular.

It applies to short-term rentals you own and operate yourself, with contemporaneous hour logs to support material participation. It does not apply to a limited partner interest in a 112-unit apartment community with annual leases, and no structuring of that interest makes it apply.

The honest summary. If you are investing passively in multifamily, assume your depreciation offsets passive income and nothing else. Build your expectations on that. If one of the three exceptions genuinely fits your household, your CPA will tell you, and the analysis belongs on your return rather than in an offering's marketing material.

SECTION SEVEN

Nine questions to ask before you invest

- 1 **How much passive income will I actually have this year?** Ask this before you ask anything about the deal.
 - 2 **Is a cost segregation study planned, and who is performing it?** A projection without a commissioned study is an estimate of an estimate.
 - 3 **What percentage of depreciable basis is expected to reclassify** into 5-year and 15-year property, and what comparable properties support that figure?
 - 4 **When was the property placed under contract?** A binding contract dated before January 20, 2025 changes the bonus rate available.
 - 5 **What land allocation is being used, and what supports it?** A thin land allocation inflates depreciable basis and invites scrutiny.
 - 6 **What is my projected year-one loss as a percentage of capital invested?** Ask for it that way. It is the only form that lets you compare offerings.
 - 7 **Does my state conform to federal bonus depreciation?** Several states decouple, so the state benefit can be far smaller than the federal one.
 - 8 **When will K-1s be delivered?** Late K-1s mean extensions. Plan for them rather than being surprised.
 - 9 **What is the exit plan, and what does recapture look like under it?** A sale, a refinance, and a 1031 exchange produce three different tax outcomes for you.
-

Where this fits

Oak Street Assets is built on a single thesis: freedom comes from owning assets, not from earning income. Depreciation is one of the clearest expressions of why that is true. A dollar of salary is taxed the year it is earned, at the highest rates the code applies. A dollar deployed into a well-underwritten asset can produce cash flow, appreciation, amortization of debt by someone else's rent, and a deduction that shelters other passive income, all at once.

That is a structural advantage, and it is worth understanding precisely. It is not, on its own, a reason to invest. A deal that does not underwrite does not become a good deal because of its tax profile, and an investor who chooses an offering for the depreciation and ignores the business plan has simply found a more expensive way to lose money. **Underwrite first. Let the tax treatment be the second reason, never the first.**

Freedom through assets, not income.

SOURCES, AUTHORITIES AND DISCLOSURES

AUTHORITIES REFERENCED

- Internal Revenue Code Sections 168(k), 465, 469, 1245 and 1250
- Treasury Regulation 1.469-1T(e)(3)(ii)(A), defining rental activity and the seven-day exception
- One Big Beautiful Bill Act, enacted July 2025, and subsequent Treasury and IRS guidance on the additional first-year depreciation deduction
- Cost segregation study and investor allocation model for 11246 Sir Winston St, San Antonio, TX, prepared by Madison SPECS, LLC
- Recorded interview with Brian Bigham, VP, Madison SPECS, LLC, September 22, 2026, in which the property figures above were presented and discussed

How to use this guide. Bring it to your CPA. The nine questions in Section Seven are written to be asked out loud, and the passive income figure in Section Three is the one worth calculating before you evaluate any offering on its tax profile.

IMPORTANT DISCLOSURES

This guide is provided for educational purposes only. It is not tax, legal, accounting or investment advice, and it does not take into account the objectives, financial situation or circumstances of any individual. Tax law changes, and its application depends entirely on your specific facts. Consult a qualified tax advisor before acting on anything described here.

The Winston Apartments figures come from the Madison SPECS cost segregation model for that property, prepared before its first tax filing. They are an illustrative model, not filed results, and not a representation of what any investor realized. Individual allocations vary with the final study, the land allocation ultimately supported, partnership terms and the timing of each investor's admission. The investor scenarios in Section Three assume a 37 percent federal marginal rate and exclude state tax, net investment income tax, and basis and at-risk limitations.

Nothing in this document is an offer to sell or a solicitation of an offer to buy any security. Any such offer is made only through definitive offering documents to qualified investors. Past performance and projected performance do not guarantee future results. All investments involve risk, including the possible loss of principal.

Where to go next. New to passive real estate? Our free Real Estate 101 training walks through the whole landscape, start to finish, at OakStreet101.com. Already investing and want to see what we are buying? Join the Oak Street Assets Investor Club at OakStreetAssets.com.



Oak Street Assets
info@oakstreetassets.com | 480-225-9388
www.OakStreetAssets.com