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The Death of the 1031 Exchange

How 100% Bonus Depreciation Is Changing the Math for Family Business Owners Who Buy, Sell, and Reinvest in Real Estate

By Trevor Schuesler, CFA and Annie Clare

Here's a story I hear all the time.

A family built a successful business. Along the way they bought real estate. Maybe a warehouse. Maybe a strip center near the office. Maybe a small apartment building their parents purchased in the '90s. It appreciated nicely, the mortgage got paid down, and now the asset just sits there: fully valued, underleveraged, and a headache for the family to manage.

They know they should sell. But every time they run the numbers, capital gains tax takes 20% or more of the gain. So the property stays. The family stays concentrated. The capital stays trapped.

For decades the answer was a 1031 exchange. Sell the old property, buy a new one within 180 days, defer the tax. It works, but it comes with a 45-day identification window, rigid rules, and the nagging feeling you're choosing a property because the clock is ticking, not because it's the best deal available.

There is now a different answer. For many Family Business owners, it may actually be better.

What Changed

In 2025, the One Big Beautiful Bill Act permanently restored 100% bonus depreciation for qualifying property acquired and placed in service after January 19, 2025. When you buy a property and certain components inside it have a useful life of 20 years or less (parking lots, landscaping, cabinetry, specialty electrical, carpeting, fencing), you can deduct the entire cost of those components in year one. Not over decades. Year one.

The 2017 Tax Cuts and Jobs Act had introduced this benefit on a phase-down schedule heading toward zero. The new law reversed that and made it permanent. That permanence changes everything. When a tax benefit is expiring, you rush and make mistakes. When it is permanent, you plan and optimize.

Cost Segregation in 60 Seconds

The IRS normally depreciates an entire building over 27.5 years (residential) or 39 years (commercial). A cost segregation study is an engineering analysis that breaks the building into components and reassigns shorter-lived items to 5-, 7-, or 15-year categories. Those components qualify for 100% bonus depreciation: a full write-off in year one.

Everything in the first three rows qualifies for 100% bonus depreciation under current law. On a typical deal, 20% to 40% of a property's purchase price can take advantage of 100% bonus depreciation. The building shell and land do not qualify, but everything bolted onto or paved around it often does.

Depreciation Categories

Category	Recovery Period	Examples
Personal property	5–7 years	Carpet, cabinetry, appliances, decorative lighting, signage
Land improvements	15 years	Parking lots, sidewalks, landscaping, fencing, drainage
Qualified improvement property	15 years	Interior improvements to nonresidential buildings
Building structure	27.5 / 39 years	Roof, foundation, walls, core HVAC (not bonus-eligible)

The Key Insight: Passive Losses Offset Passive Gains

Here is why this matters so much for a Family Business owner selling real estate. The gain from selling a rental property is passive income. The depreciation loss from a new rental property is a passive loss. Under the tax code, passive losses offset passive gains directly. So when a family sells one property and redeploys into another passive real estate investment with bonus-eligible components, the year-one depreciation loss from the new property reduces, or even eliminates, the taxable gain from the sale.

Sell, Redeploy, and Keep More Capital Compounding

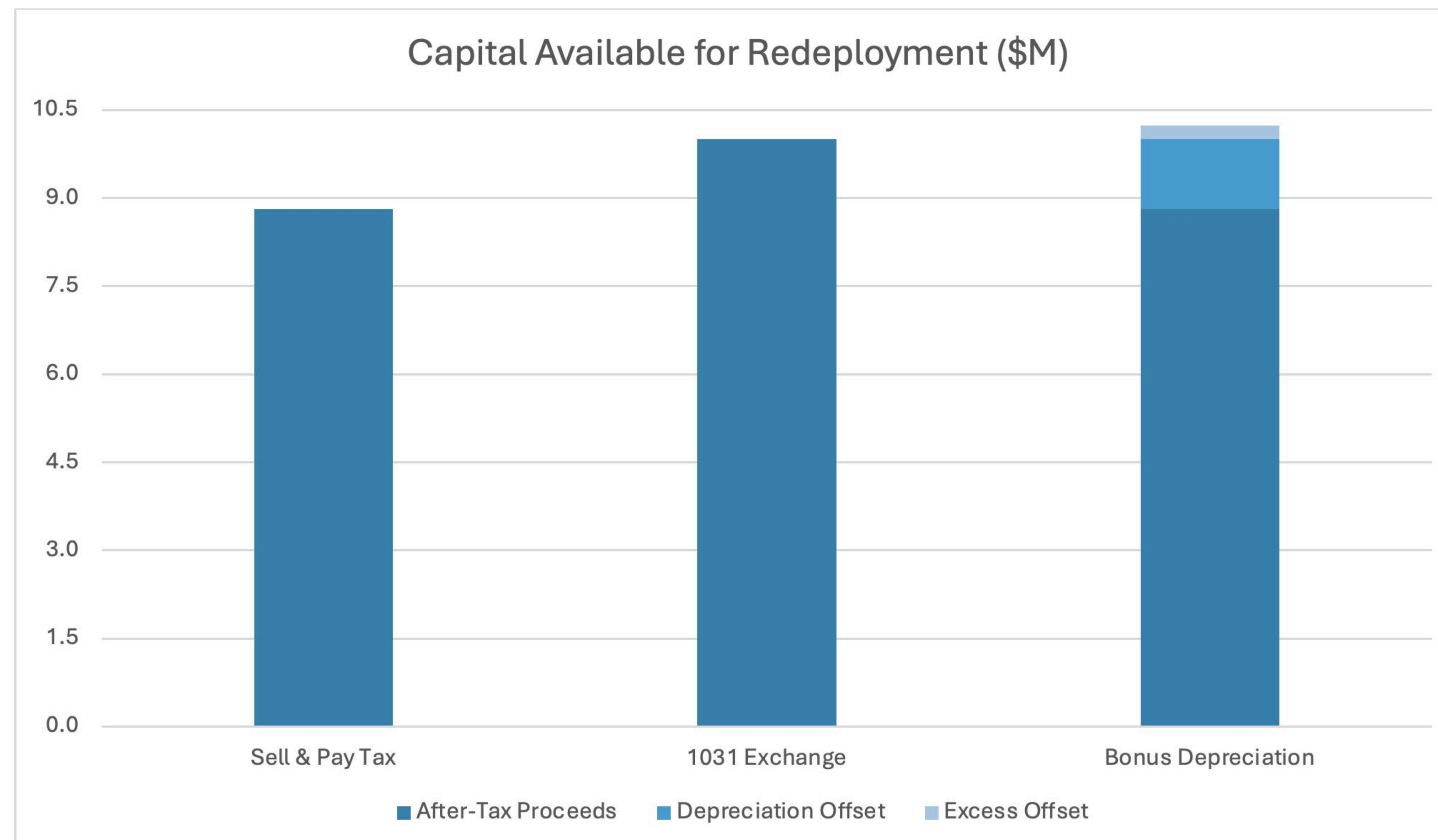
Let's walk through a complete cycle. A Family Business owner invests $5 million of equity into a $10 million commercial property (50% loan-to-value). Over time, the property appreciates to $15 million, delivering a 100% return on equity. The owner sells, pays off the $5 million mortgage, and walks away with $10 million in proceeds including a $5 million taxable gain.

Growth & Appreciation

Path 1: Sell & pay tax. The owner pays about $1.19 million in federal capital gains tax (at 23.8%, which includes the 20% long-term rate plus 3.8% net investment income tax). **Result: $8.81 million available to be redeployed.**

Path 2: 1031 exchange. Defer the full gain by finding and closing a replacement property within 45/180 days. To fully defer gain in a 1031 transaction, the replacement property needs to be of equal or greater value than the sold property. All $10 million stays deployed in one investment, but on someone else's timeline, with carryover basis that kicks the tax can down the road. **Result: $10 million redeployed.**

Path 3: Sell & redeploy with bonus depreciation. (1) The owner reinvests the full $10 million of equity into a $20 million property at 50% LTV. A cost segregation study identifies 30% of the property's basis as bonus-eligible, creating a $6 million passive loss in year one. That loss fully offsets the $5 million passive gain from the sale. If the excess passive loss is usable immediately against another passive gain taxed at 23.8%, it creates $238,000 of additional tax value. **Result: $10 million available to be redeployed, plus $238,000 of additional tax value.**



In Path 3, the family doubled their equity, sold the property, redeployed into a larger asset, and paid zero federal capital gains tax. All $10 million stays invested. That matches the 1031 exchange on capital deployed, but without any of the constraints. And relative to the 1031 option, the family creates $238,000 of additional tax value if the excess passive loss can be used to offset future passive income.

Furthermore, Path 3 provides greater flexibility, allowing the family to diversify across multiple properties or real estate partnerships. Bonus depreciation and the resulting passive losses are not required to come from a single investment.

1) Hypothetical example for illustrative purposes only. This example only takes into account federal taxes. Actual results could be materially different depending on the findings of the cost segregation study and the investor's individual tax circumstances. Consult your tax and legal advisors.

Why 1031 Exchanges Just Lost Their Monopoly

A 1031 is still a useful tool. Nobody is throwing it away. But it used to be the only serious option for managing gain on a sale. You either exchanged or you wrote a massive check to the IRS.

Now there is a third lane. And it eliminates every constraint that makes a 1031 painful:

- No 45-day identification scramble.
- No 180-day closing deadline.
- No three-property rule limiting your options.
- No carryover basis pushing today's tax into tomorrow's problem.
- No pressure to overpay for a replacement just to beat the clock.

In the example on the previous page, the bonus depreciation path matches the 1031 on capital deployed ($10 million), eliminates the tax entirely, and creates $238,000 of additional tax value. The question is no longer 'must we exchange?' It is 'why would we?'

Real Estate as a Tax Management Tool

Most families built wealth by reinvesting in the operating business. That discipline is what got them here. But over time, concentration risk builds. Real estate, paired with cost segregation and bonus depreciation, becomes more than diversification. It becomes a balance sheet tool: generating passive losses that offset passive gains across the family's portfolio, smoothing cash flow, and keeping more capital compounding inside the family enterprise.

Every dollar of tax you do not pay today is a dollar that compounds for the next generation. Over a 20 or 30 year horizon, the kind families actually plan on, that effect is enormous.

The Fine Print of Bonus Depreciation

- **Not all basis qualifies.** The building shell and land do not benefit. The opportunity is in shorter-lived components.
- **Passive activity rules apply.** The depreciation loss offsets passive income (such as gains from selling rental property), not W-2 or active business income, unless the taxpayer qualifies as a real estate professional.
- **State rules differ.** Not all states conform to federal bonus depreciation, which can reduce the net benefit.
- **Recapture is real.** Accelerating depreciation increases recapture risk at exit. Plan for it upfront.
- **1031 still has a role.** For very large gains with a ready replacement, an exchange may still win.
- **This is not tax advice.** Every situation is different. Work with your CPA and tax attorney.

The Bottom Line

For years, Family Business owners had two choices after selling real estate: exchange or pay. Permanent 100% bonus depreciation has opened a third lane. One that offers flexibility, complete tax elimination in many cases, and the freedom to invest on your terms.

You are no longer hostage to a 45-day clock. You are no longer forced to choose between a massive tax bill and a mediocre replacement property. The capital is yours. The tax code, for once, is working in your favor. The only question is what you want to build next.

About Buchanan Street Partners, LP

Buchanan Street Partners is a Newport Beach, CA based real estate investment management firm specializing in core-plus, value-add, and debt investments across multifamily, commercial, and self-storage properties in the Western and Southwestern United States. The company serves a broad range of clients including high-net-worth individuals, family offices and the advisors that serve them.

Buchanan's foundation of success is backed by a track record of results, having invested in over $8 billion of real estate assets since its founding in 1999. The company's experienced and cohesive team has navigated multiple real estate cycles together. Buchanan balances the pursuit of risk-adjusted returns with preservation of capital to deliver both performance and peace of mind to its investors.

This paper is for educational purposes only and does not constitute tax, legal, or investment advice. All examples are illustrative and exclude state taxes, depreciation recapture, transaction costs, and other factors that may materially affect outcomes. Consult your tax and legal advisors before making any investment or tax planning decisions.

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