NAR Issue Brief

Depreciation – Real Estate Buildings

What is the issue and how is it treated under current law?
Depreciation is the loss in value of an asset / building over time due to wear and tear, physical deterioration and age. The cost of reproducing an income property can be recovered over the useful life of the asset which is determined by law. Depreciation is treated as an expense and is a line item on an income statement. Residential income property must be depreciated over a 27.5 year period using straight line depreciation. Commercial income property must be depreciated over 39 years using straight line depreciation. Straight line depreciation stipulates that an asset must be depreciated by equal amounts each year over its useful life.
The current law depreciation rules are out of date and do not reflect the economic life of structures. The 27.5- and 39-year cost recovery periods for real property should be shortened.

What would be the impact of changing this provision?
Studies by Treasury, Congress, and the real estate industry have repeatedly concluded that the current tax depreciation lives for non-residential structures (39 years) and residential structures (27.5 years) are too long – exceeding the useful lives of such properties (physical wear and tear as well as technological obsolescence).

A more realistic rate of return on depreciable assets would make real estate a more attractive investment. Policymakers should reduce the period over which non-residential and residential structures are depreciated to between 22 - 24 years, which would enhance economic growth.