

Why the currently challenging market requires nuanced tax solutions

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With the Fed raising interest rates to combat inflation, these persistent levels appear to have peaked and are balancing out. However, even with moderate rate cuts expected in 2024, the resulting increased debt costs will continue to put pressure on capitalization rates in the real estate industry across all asset classes.



In fact, upwards of \$3 trillion in debt is coming over the next few years, which means the tax implications will be significant for property owners across all property types. The office market is still in the early days of a generational reset, while investors are chomping at the bit to deploy capital in most other most asset classes as soon as the bid/ask delta narrows to an improved state of equilibrium.

To prepare for various tax implications and financial tension applied to 2023 business operations, we suggest that real estate owners and investors focus on the following three areas:

- Benefits of [cost segregation studies](#);
- Taking advantage of [bonus depreciation](#);
- Implications of debt modifications and foreclosures.

Perspective is a critical factor in decision-making. While the COVID-19 pandemic is behind us and businesses at large are to various degrees reconfiguring projections, investments and operations, the impact that the pandemic has had on the real estate industry is not. It is always important to find ways to maintain returns to owners and investors, such as being prepared for federal and state taxes.

In an almost Pavlovian manner, we tend to instinctively associate early spring as “tax time,” but the reality is that tax planning is a 12-month activity. With 2023 tax returns due in the coming month, now is a critical time to review tax strategies from the past and revise them for the future. Most of the recent tax proposals have been abandoned, and major tax changes from recent years remain in place.

Stability makes tax planning more predictable, with deferral of income more attractive for most taxpayers. With that, we reiterate the tremendous value in the following three real estate tax strategies:

Cost segregation: This study identifies and quantifies the various components of both purchased and constructed assets. This quantification enables businesses to depreciate building components using shorter lives. If the assets are eligible, businesses can take bonus depreciation on the segregated building components.

Debt modifications in a distressed market: Owners and lenders may consider loan term renegotiations to maximize their cash flow. However, this may bring unexpected tax consequences. Strategies to better manage cash flow include: extending the loan's maturity date, changing the interest rate, exercising conversion features, or changing fixed payment of principal to contingent amounts.

Bonus depreciation: This enables taxpayers to accelerate the depreciation of property purchased that has a recovery period of 20 years or less. If bonus depreciation is deemed more beneficial, care must be taken when drafting lease agreements. One consideration for nonresidential real estate owners (regarding the eligibility of utilizing bonus depreciation on qualified properties) is if the business takes the irrevocable election out of business interest expense limitation. Should they make this election, qualified properties will be ineligible for bonus depreciation.

The real estate market is still finding its way through pandemic-inflicted disruptions. Individually and collectively, these strategies—as applied to 2023 business operations—can wield meaningful savings and better position owners and investors for the year ahead.

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