

The Property Line: The Big Beautiful Bill Unlocked: Turning Tax Law into Enhanced Real Estate Deal Flow

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Welcome to The Property Line, a commercial real estate podcast brought to you by Seyfarth Shaw's Real Estate department. The Property Line is a brief discussion of current market trends, bringing you insights from our acclaimed national team of real estate attorneys. Each episode focuses on a key takeaway for the busy real estate professional. Now, on to this week's discussion.

James O'Brien

Hello and welcome back to The Property Line. My name is James O'Brien, and I'm a partner in Seyfarth's Washington, DC office. My co host today is Eric Greenberg, a real estate partner in our Boston office. We're joined by Matt Peurach, a partner in our Atlanta office, whose practice focuses on the intersection of tax, commercial real estate, and private equity structures. Matt primarily works with clients to devise tax mitigation strategies and to structure and negotiate private equity investments in real estate. Welcome Matt. Thanks for joining us.

Matt Peurach

Thank you for having me.

James O'Brien

That's good. Now we've got somebody very smart on to break down the One Big Beautiful Bill Act, because taxes is not in my wheelhouse. So I know that there are implications for real estate transactions of the act, some of which the real estate community is excited about. But before we get into that and what's changed in the new Act, can you set the stage for us? What are the rules under the old law that real estate investors have been living with up till now?

Matt Peurach

Yeah, sure. And so I'm going to hit the high points of the new Act in terms of how it affects real estate and so really the three things that I'm focused on is bonus depreciation, mortgage interest deductions, and opportunity zones. So in the context of bonus depreciation, really what we're talking about here, for people that may not be familiar with what that means, are tax losses. So losses from a depreciating asset that gets flowed out through a partnership that investors can use to offset other income sources. And so under current law, each real estate property has a fixed schedule for depreciation. So if you're talking about, for example, a gas station that's not residential real estate, and that has a 39 year depreciation schedule. So basically, if you pay a million dollars for it, you get 1/39 of a million dollar tax deduction over 39 years, right? Of course, when you're talking about commercial real estate, there's a lot of different components within that real estate that have differing depreciation schedules. And so if you're talking about property that has under a 20 year useful life or 20 year depreciation schedule,

those components of the property could be eligible for bonus depreciation, which basically at what at one point meant you got to deduct 100% of the cost that was allocated to that component of the property, so that that was an element of the Tax Cuts and Jobs Act back in 2017 and so it started off at 100% deductibility, and then over the years, it's continued to phase down.

James O'Brien

This is 100% deductibility in the first year you're correct, right? Yeah, as opposed to over the 39 year schedule.

Matt Peurach

Right. So it started at 100% went down 80, down to 60. This year it was supposed to be 40, and then it was eventually going to get phased out completely. And so what the what OBBBA, the '25 Act, did was that it made permanent the 100% bonus depreciation. Okay, so that's one element of OBBBA.

James O'Brien

That sounds huge. That sounds like a lot of a lot of cost savings to be had, potentially.

Matt Peurach

Absolutely.

James O'Brien

And a boon for the consultants who do cost segregation analysis, I would guess.

Matt Peurach

Yep, that cottage industry has been booming for years, and it's about to get a lot more booming. So, so that's something that's very interesting to real estate owners and investors. The second big thing that we're talking about is the ability to take tax deductions for mortgage interest expense, and so under the old law, there's a threshold, there's a cap, you know, it's 30% of your adjusted taxable income was the max amount of mortgage interest deductions you could take for real estate. And it's a complicated calculation as to how you come up with the number that equals that 30% cap. But you know the upshot was, under the old law that 30% cap amount was smaller because there were certain add backs that you couldn't count towards the total ATI amount adjusted tax. So OBBBA has impacted that. And a piece of the puzzle as it relates to mortgage interest deduction, specific for commercial real estate folks, is that there was a special election called The Real Property Trader Business Election, where if you were over that 30% cap and you wanted to take interest deductions in excess of that, you could make this real property trade or business election, which freed up your ability to take tax deductions for the interest expense, even though you were over the 30% cap. But the trade off for that was that to the extent you had any eligibility to take bonus depreciation, that was the trade off. You couldn't have your cake and eat it too. So, you know, we'll get into it a little bit more. But OBBBA has changed the playing fields on that, which is also very interesting and beneficial to real estate folks. And then the third element of over that we're going to get into relates to opportunity zones, which has been a very, over the years since you know that that came to be in 2018, has been a very powerful tax mitigation strategy for certain types of real estate that are especially designated in opportunity zones. And so that entire

program was set to expire at the end of next year, and OBBBA has changed that made it permanent. And we'll get into the specifics as to what that that means in a little bit.

James O'Brien

Gotcha. Gotcha. Well, it sounds like the biggest benefit of OBBBA is this bonus depreciation being, you know, now, at 100% and why is it that investors should, should really care about that?

Matt Peurach

Yeah, so, as I was just saying, you know, so, but for OBBBA, if you just use an example, it's probably easiest to illustrate. Let's say you've got a gas station property that you purchase for 20 million bucks. Okay, assuming that there was no bonus depreciation, you get to deduct 1/39 of 20 million over a 39 year period. Now that bonus depreciation is back to being a thing. What you could do when you purchase that gas station for \$20 million is you could get what's called a cost segregation study, which allocates a portion of that purchase price over the various components within the gas station. So you could allocate a piece to the shell building of the sea store that services the gas station. You could allocate a piece to the underlying dirt. Allocate a piece to all the fuel stations at the gas station, and let's just say that when you do that cost segregation study, \$10 million of the \$20 million purchase price is allocated to components of the property that have a 20 year or under depreciation schedule, and therefore are all eligible for 100% bonus depreciation. What that means is that in year one, you immediately get a \$10 million tax deduction, rather than having to spread that out over a number of years. So that's strategy.

James O'Brien

Yeah, it sounds super valuable. I mean, one query, if you're not making enough money, can you carry those losses forward at all, or do they have to use them or lose them against income?

Matt Peurach

That's a good question. And yes, those losses, to the extent that you don't have income to offset against, can be carried forward indefinitely. And there's a lot of complicated partnership tax rules, like the passive activity loss limitation rules and at risk rules that could preclude your ability from using all of the losses in year one. So that's something to always pay attention to. But to the extent you don't get to use the losses in year one, they carry forward, um, into future years, and ultimately, to the extent you haven't been able to fully use them when the asset is sold, at that point, you get to use them.

James O'Brien

Okay, interesting.

Eric Greenberg

What about mortgage interest deductions? You had mentioned that before. As we know, it's been a headache. How's OBBBA the change that exactly?

Matt Peurach

Yeah. So this is a, I mean, it's a headache, just because the math that goes into calculating the base on which you're limited to take mortgage interest deductions, is a really complicated formula. But, you

know, the upshot is that under the old law, the base on which that 30% limitation is calculated was smaller. And so, under OBBBA, there are some more add backs, you know, to add back depreciation, amortization, and depletion that has the overall effect of increasing the base on which that 30% limitation is structured. So I think that the key takeaway here is that to the extent under the old law, you may have been precluded from fully utilizing your mortgage interest deductions, the math has changed, and it's freed up the ability to get more of that to the point where you may not need to make the real property trade or business election to fully utilize your mortgage interest deductions, which, as I said before, to the extent you make that election, has the tangential effect of precluding your ability to take the bonus depreciation losses. So you know, the big takeaway here is sponsorship rerun their models to make sure that they can fully utilize the mortgage interest deductions without having to make that special real property trader business election such that they get to have their cake and eat it too, where they get to fully utilize the interest deductions and get the bonus depreciation as well.

Eric Greenberg

Sounds like another optimal outcome. As you mentioned, you mentioned, also opportunity zone. We all thought it was going to sunset, 2026 is going to be the end of the road. So what can you do with opportunity zones?

Matt Peurach

Yeah, so what OBBBA did, and everybody's referring to it as OZ 2.0 okay, so you had OZ1.0 now you've got OZ 2.0 right? Just to maybe set the stage a little bit under OZ 1.0 and OZ 2.0 basically, what we're talking about is tax, tax mitigation strategy, where if you have a capital gain event, so let's say, you know, I bought stock for a million dollars. It's currently worth \$2 million if I sell it right? So I triggered a million dollar capital gain. I have two options. I can either pay my tax on that million dollar gain, or I could pursue an Opportunity Zone deal where I invest that million dollar capital gain into an Opportunity Zone fund. Okay, and the tax benefits? There's really two tax benefits that we're talking about. One is deferral. So under OZ 1.0 I was able to defer that million dollar tax liability until the end of 2026, which is when the OZ program was set to expire. And then the second big tax benefit by investing my million dollar gain into an OZ fund is, if I hold my investment for 10 years, whatever let's say that the OZ fund, you know, bought a piece of property in an Opportunity Zone, and built a multi family building on it, okay? And after 10 years, that property is sold, and the new game that I have on that sale is \$5 million if I hit that \$10 million hold, I don't pay any tax on that \$5 million new game. So it's a powerful benefit, but OZ 1.0 like I said, was set to expire at the end of next year. And so what OBBBA did is it created OZ 2.0 which comes into effect January 1 of 2027 and, number one in terms of the deferral tax benefit, there's now a rolling five year period to fully optimize the deferral under OZ 1.0 there was a set date that the deferral period ended, and that was December 31, 2026, so under OZ 1.0 the longer I waited or the closer I got to December 31, 2026, the shorter deferral period I had.

James O'Brien

Right, probably just incentivize people from using it.

Matt Peurach

Correct. So under OZ 2.0 there's no fixed date. It doesn't really matter the date on which I put money or capital gains into an Opportunity Zone Fund. I can always get to the extent I want to, I can always get

that five year deferral period, top of that tax free 10 year exit, so that that is very positive for Opportunity Zone investments and the whole Opportunity Zone investment industry. And what else is really interesting about Opportunity Zone 2.0 is that we're getting an entirely new map of designated Opportunity Zones. So that's going to go into effect. We're told, July of 2026, they're going to release the new map that tells us where these new Opportunity Zones are. And on top of that, there's this extra incentive that's been created by Opportunity Zone 2.0 to invest in designated rural Opportunity Zones. Okay? So if you were to have a project that happened to be in a designated rural Opportunity Zone, the tax benefits that I was talking about previously are heightened. So if you invest in a rural Opportunity Zone, it's not just a 10% discount that you get after holding for five years, you get a 30% discount on the tax liability. And there are some other enhanced strategies for rural Opportunity Zones, but for sake of time, we won't get into those.

James O'Brien

Great, well. I mean, it does sound like some excellent benefits for real estate investors in the Act. If you had to boil it all down, what would you say are a couple of key takeaways that every real estate sponsor should walk away with when they're thinking about the benefits from OBBBA.

Matt Peurach

Yeah. So I think taking another look at your deals, you know, maybe you've had some deals in the pipeline that didn't look so attractive. Now, with some of these enhanced tax enhancements, I think that the math could change. So it's important for everybody to re underwrite their deals, taking into account this 100% bonus depreciation and hence flexibility to take mortgage interest deductions. And then, you know, I think the other key takeaway, really, is just focus on Opportunity Zones. You know, we see it all the time where somebody's doing a deal anyway, and then they find out, oh, this happens to be in an Opportunity Zone, right? So I think it's going to be really interesting to keep an eye out for that map. Yeah. For the new zones and compare it with where you're looking to do deals.

James O'Brien

Yeah, sounds like everybody should have that map on the wall.

Matt Peurach

Absolutely.

James O'Brien

Well, thank you, Matt. We're at the end of our time, so we'll go ahead and wrap it up, but obviously people can find you on our website if they've got more questions for you. Thanks for joining us today and for sharing your insights. And special thanks to our listeners for tuning in. Please keep an eye out for future episodes and until then, be well.

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