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Five tax advantages of buying a commercial property

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Whether you buy a small apartment or a sizable commercial building, an investment in commercial property typically provides multiple tax breaks for a small company. Your financial or tax advisor can determine exactly how an investment would play out for your business, but many pursue this investment as both a place to run a company and a tax-benefit-rich asset. Read below to learn about typical tax savings.

1. Interest expense
The interest you pay on the mortgage for your commercial purchase is deductible. This means that the interest payments you make over the course of a year as part of paying your mortgage can be deducted from the tax your business owes. For example, if roughly $3,000 of your monthly $8,000 mortgage payment is interest, you will accrue $36,000 of tax-deductible interest over the course of the year—enough to approximately offset the taxes you'd owe on $100,000 of profit.

2. Depreciation expense
An apartment, building or other structure begins to depreciate when you buy it. This depreciation builds up like a running meter and can typically offset a company's tax liability. For example, the IRS allows depreciation of a residential rental building over 27.5 years, and commercial buildings over 39 years. So, if you buy a residential building for $2 million, the annual $72,000 depreciation would roughly offset the tax you owe on $200,000 in profit.

3. Post-sales tax savings
If you leave the property to beneficiaries and they decide to sell, they will pay tax only on the property's increased value from the time of your death. For example, say you purchase a property for $2 million and it appreciates to $5 million by the time you die. If it is worth $6 million when your beneficiaries sell, they would only owe tax on $1 million.

4. Non-mortgage-related expenses
The renovations, maintenance, ongoing upgrades and other expenses related to owning a commercial property are also potential deductions. These are out-of-pocket expenses, but many of these expenditures improve the value of your building and you might be paying some of these costs on a leased property anyway. Condo fees associated with an apartment purchase can also be deducted, assuming you use the property for work. If you also live there, a portion of these fees, proportionate to your use, would be eligible.

5. Capital gains
Some business owners invest in commercial real estate as a way to create an asset for use at retirement time. A lower capital gains tax rate is one potential benefit a commercial property has compared with other retirement investments such as an IRA. Said another way, when you access most IRA funds, you will be billed at your personal tax rate on those funds. The sale of a commercial property also has tax implications, but the capital gains tax rate associated with a commercial building sale will typically be lower than the personal tax rate associated with your IRA. Roth IRAs—in which you pay tax when you invest the money—are one of the exceptions.

Beyond taxes, a real estate purchase of a commercial building or an apartment sometimes serves as a de facto succession plan. Since many businesses do not have solid succession plans in place, the investment in a commercial property can mean a company has a guaranteed asset at the end of its life, even if there isn't someone who wants to carry on running the business.

About the author
John Manos has been the President of Commercial Real Estate Lending Division at BankFinancial, NA since April 2014 and served as its President of Southern Region from 2006 to 2014. He has been with the company since 1999. Prior to joining BankFinancial, Manos was the Manager of Commercial Lending for Preferred Mortgage Associates.