

Top 5 Advantages of Owning Your Dental Office Building

Highlights

1. Favorable tax treatment at sale
2. Depreciation deduction
3. Deductibility of renovation and maintenance expenses
4. Interest expense deduction
5. Potential step up in basis for inheritors/beneficiaries

1. Favorable Tax Treatment at Sale

Selling your dental practice's building should result in capital gains tax liability rather than ordinary income tax liability. For almost all dentists, the capital gains tax rate will be lower than their ordinary income rate. Consider a hypothetical dentist with a 401k worth \$500,000 and a dental practice building also worth \$500,000¹. Assuming that the dentist is married filing jointly and in the second highest 2020 income bracket, she would pay 42% (35% federal, 7% South Carolina state) in taxes on the entirety of distributions from the 401k, but 15% on only the capital gains portion of the sale price of the building. It is important to note that owning your practice's building is not a substitute for saving in a qualified retirement plan such as a 401k. Rather, it serves as an additional vehicle for tax efficiency when you have already reached the limits for savings in your qualified plan(s).

2. Depreciation Deduction

The IRS permits deduction of depreciation value on many types of commercial property, most often on a 39-year straight line. If you are leasing the building for your practice, there is a good chance your landlord is claiming this deduction. In contrast, if you own the building, you can claim it. For example, if your dental building has a fair market value of \$500,000, you may be able to deduct \$12,820.51 per year ($\$500,000/39$ years).

3. Step-up in Basis

If you decide not to sell your dental building but leave it to your heirs, they should avoid or greatly reduce capital gains taxes and depreciation recapture (which would be implicated if you annually claim a depreciation deduction on your dental building). For example, assume you purchased a dental office building for \$400,000 ten years ago, and the fair market value is now \$500,000. If you sell the building, you will have to pay capital gains tax on the increase in value of \$100,000. In contrast, if you leave the building to your heirs and they sell it at your death, your heirs can claim a step-up in basis and pay no capital gains or depreciation recapture taxes.

4. Deductibility of Renovation and Maintenance Expenses

If you own your dental building, you can claim tax deductions for the inevitable costs of renovations and maintenance which would not be available to a lessee. Of course, if you do not own your building, you should not be responsible for any of the renovation costs, but you will have no control over when and how those renovations and maintenance are performed. In

¹ Assume that the hypothetical dentist bought the real estate 6 years ago for \$400,000.

contrast, owning your building gives you greater control, and the ability to deduct those expenses helps lower the overall cost of growing equity in your building.

5. Deduction of Interest Expense

If you take out a loan to purchase your dental building, you can deduct the commercial mortgage interest from your taxes. For example, if your monthly mortgage payment is \$5,000, and \$2,000 of that amount is interest, you can take an annual deduction of \$24,000.