Hip Hip Hooray, Bonus Depreciation Lives to See Another Day

Aug 08, 2025

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Depreciation plays a crucial role in real estate investing, directly impacting how much income investors report and how much tax they pay. Under Section 168(a) of the Internal Revenue Code, the costs of certain business assets, such as equipment and buildings, must be depreciated over time based on the life of the asset, typically ranging from three to 40 years. Bonus depreciation, however, is a tax incentive that allows real estate investors to accelerate depreciation on qualified assets, thereby reducing taxable income in the early years of property ownership.

By allowing investors to write off a larger portion of an asset's cost in the year it is placed in service instead of spreading it over a longer recovery period, bonus depreciation can be a powerful tool for managing tax liabilities and optimizing financial performance. In this post, we explore how investors can use recent legislative changes to continue to enhance their portfolio performance.

Changes to Bonus Depreciation Under the OBBBA

Prior to the enactment of the One Big Beautiful Bill Act (OBBBA), bonus depreciation was set to phase down annually over several years, dropping to 20% in 2026 and 0% in 2027. This is because the deduction was originally meant to be a temporary tax break. It was part of a short-term plan, under the Tax Cuts and Jobs Act of 2017, to boost business investment. The OBBBA, however, permanently extends the 100% bonus depreciation under Section 168(k) of the Internal Revenue Code for most new and used tangible property, with a recovery period of 20 years or less. This includes a wide range of qualifying property, such as furniture, carpeting, appliances, office and technology equipment, agricultural machinery, and manufacturing assets.

Investors can benefit from this extended bonus depreciation for eligible property acquired or contracted on or after January 20, 2025. This change provides investors with greater certainty and a

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powerful incentive to invest in qualifying assets, helping to maximize tax savings and improve cash flow well into the future.

Qualified Production Property Tax Considerations

While bonus depreciation under OBBBA Section 168(k) applies broadly to many asset types, a new provision of OBBBA Section 168(n) introduces an additional, more targeted incentive designed to benefit capital-intensive industries, particularly those in manufacturing and production. This special depreciation deduction allows a full deduction in the year incurred for "qualified production property." This includes nonresidential real property that is "an integral part of a qualified production activity," meaning the property must be directly involved in the manufacturing, production, or refining of a product itself and the property must begin construction after January 19, 2025, and before January 1, 2029, and be placed in service before January 1, 2031.

The original use of the property must also begin with the taxpayer, such that lessors would not qualify for the deduction. Importantly, there are carveouts to this classification, including property used in a qualified production activity from January 1, 2021, to May 12, 2025, and property used for office functions, parking, administrative services, and non-production activities, which are not eligible for the deduction.

Understanding these specific qualifications and exclusions is essential for investors looking to leverage Section 168(n) effectively and maximize the tax benefits available within manufacturing-focused real estate investments. It is also important to note that Section 168(n) requires the taxpayer to recapture the benefit of expensing if the property ceases qualified production activity within 10 years of being placed into service. Taxpayers should closely consider whether they will use the property for a qualified use for the entire period to avoid recapture.

Key Takeaways for Real Estate Investors

The permanent extension of bonus depreciation under the OBBBA presents significant advantages for real estate investors looking to

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optimize their tax liabilities. Additionally, the introduction of Section 168(n) provides further tax incentives for manufacturing-heavy sectors, offering full deductions for qualified production property. Together, these measures enhance the attractiveness of real estate investing, making it a lucrative opportunity for those looking to leverage improved tax incentives. As a result, we may see increased market activity and competition as investors capitalize on these benefits, potentially driving higher demand for qualifying properties and stimulating growth in real estate and industrial sectors.

Please contact the authors or any attorney with Frost Brown Todd's Retail and Shopping Center Finance team if you have questions about whether particular assets qualify for bonus depreciation and how to leverage these potential tax savings in your next real estate project or investment.

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