BOOTS ON THE GROUND

Impact of the 2018 Tax Laws

This month's newsletter takes a broad view of a few sections of the confusing and cumbersome new tax laws, formally referred to as "The Tax Cuts and Jobs Act", as it impacts both residential property owners as well as investment property owners. In an effort to keep your attention and save paper, we focused mainly on the real estate-related tax law changes.

Primary Residence Homeowners

STANDARD DEDUCTION INCREASE

- Standard deduction to $12,000 for single filers and $24,000 for married filing jointly
- 38 million Americans who would otherwise itemize may instead choose the higher standard deduction under the new tax plan
- A likely unintended outcome will be fewer Americans choosing to become homeowners versus renting a residence solely for the tax advantages.

HOME MORTGAGE INTEREST DEDUCTION LIMIT

- Any home mortgage interest debt incurred before December 15, 2017, will continue to be eligible for the home mortgage interest deduction up to $1,000,000, if used to acquire or improve the property.
- Any home mortgage interest debt incurred after this date will be limited to no more than $750,000 qualifying for the home mortgage interest deduction , if used to acquire or improve the property.
- Beginning 2018, the deduction for interest paid on a home equity line of credit

We have several clients in various stages of their 1031 Exchanges. If you have been considering a sale or have an off-market opportunity, please contact us to discuss further.

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("HELOC") may only be taken if it is used to acquire or improve the home if under $1,000,000.

- However, the new tax law preserves the deduction of mortgage debt used to acquire a second home. This should have a positive impact on supporting property values in resort and vacation destinations.

STATE AND LOCAL TAX DEDUCTION LIMIT

- State and local taxes (referred to collectively as "SALT") can be deducted, but will no longer be unlimited as under previous tax law. The 2018 tax law will allow homeowners to deduct property taxes and either income or sales taxes with a combined limit on these deductions being limited to no more than $10,000.
- There is the potential for home values in high state tax areas on both the West Coast and East Coast to see a reduction in property values partially due to the new capped SALT deduction at $10,000 and partially due to the new maximum $750,000 home mortgage deduction

Investment Property Owners

NO CHANGE IN 1031 EXCHANGE FOR INVESTMENT PROPERTIES

- Investment property owners will continue to be able to defer capital gains taxes using 1031 tax-deferred exchanges that have been in the tax code since 1921.
- The new tax law repeals 1031 exchanges for all other types of property that are not real property. This means 1031 exchanges of personal property, collectibles, aircraft, franchise rights, rental cars, trucks, heavy equipment and machinery, etc. will no longer be permitted beginning in 2018.
- There were no changes made to the capital gain tax rates. An investment property owner selling an investment property can potentially owe up to four different taxes: (1) Deprecation recapture at a rate of 25%, (2) federal capital gain taxed at either 20% or 15% depending on taxable income, (3) 3.8% net investment income tax ("NIIT") when applicable, and (4) the applicable state tax rate (as high as an additional 13.3% in California.)

DEPRECIATION OF QUALIFIED IMPROVEMENT PROPERTY

- The new law provides that qualified improvement property is depreciable using a 15-year recovery period and the straight-line method.
- Qualified improvement property is any improvement to an interior portion of a building that is nonresidential real property placed in service after the building was placed in service.

Corporations, Pass Thru Entities, Businesses

CORPORATE TAX RATES REDUCED

- One of the more significant new law provisions cuts the corporate tax rate to a flat 21%.
- Before the new law, rates were graduated, starting at 15% for taxable income up to $50,000, with rates at 25% for income between 50,001 and $75,000, 34% for income between $75,001 and $10 million, and 35% for income above $10 million.

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NEW DEDUCTION FOR PASS-THROUGH ENTITIES

- The tax law creates a new tax deduction of 20% for pass-through businesses. For taxpayers with incomes above certain thresholds, the 20% deduction is limited to the greater of: 50% of the W-2 wages paid by the business or 25% of the W-2 wages paid by the business plus 2.5% of the unadjusted basis, immediately after acquisition, of depreciable property (which includes structures, but not land).
- Estates and trusts are eligible for the pass-through benefit. The 20% pass-through deduction begins to phase out beginning at $315,000 for married couples filing jointly.
- Service companies are phased out above $415,000.

INCREASED CODE SEC.179 EXPENSING

- The new law increases the maximum amount that may be expensed under Code Sec. 179 to $1 million. If more than $2.5 million of property is placed in service during the year, the $1 million limitation is reduced by the excess over $2.5 million. Both the $1 million and the $2.5 million amounts are indexed for inflation after 2018.
- The expense election has also been expanded to cover (1) certain depreciable tangible personal property used mostly to furnish lodging or in connection with furnishing lodging, and (2) the following improvements to nonresidential real property made after it was first placed in service: roofs; heating, ventilation, and air-conditioning property; fire protection and alarm systems; security systems; and any other building improvements that aren't elevators or escalators, don't enlarge the building, and aren't attributable to internal structural framework.

BONUS DEPRECIATION INCREASE

- Under the new law, a 100% first-year deduction is allowed for qualified new and used property acquired and placed in service after September 27, 2017 and before 2023. Pre-Act law provided for a 50% allowance, to be phased down for property placed in service after 2017. Under the new law, the 100% allowance is phased down starting after 2023.

NET OPERATING LOSS MODIFIED

- Under the new law, generally, NOLs arising in tax years ending after 2017 can only be carried forward, not back. The general two-year carryback rule, and other special carryback provisions, have been repealed.
- These NOLs can be carried forward indefinitely, rather than expiring after 20 years. Additionally, under the new law, for losses arising in tax years beginning after 2017, the NOL deduction is limited to 80% of taxable income, determined without regard to the deduction. Carryovers to other years are adjusted to take account of the 80% limitation.

COMPUTERS AND PERIPHERAL EQUIPMENT

- The new law removes computers and peripheral equipment from the definition of listed property. Thus, the heightened substantiation requirements and possibly slower cost recovery for listed property no longer apply.

FAMILY AND MEDICAL LEAVE CREDIT

- A new general business credit is available for tax years beginning in 2018 and 2019 for eligible employers equal to 12.5% of wages they pay to qualifying employees on family and medical leave if the rate of payment is 50% of wages normally paid to the employee.
- The credit increases by 0.25% (up to a maximum of 25%) for each percent by which the payment rate exceeds 50% of normal wages. For this purpose, the maximum leave that may be taken into account for any employee for any year is 12 weeks.

- Eligible employers are those with a written policy in place allowing qualifying full-time employees at least two weeks of paid family and medical leave a year, and less than full-time employees a pro-rated amount of leave.
- A qualifying employee is one who has been employed by the employer for one year or more, and who, in the preceding year, had compensation not above 60% of the compensation threshold for highly compensated employees. Paid leave provided as vacation leave, personal leave, or other medical or sick leave is not considered family and medical leave.

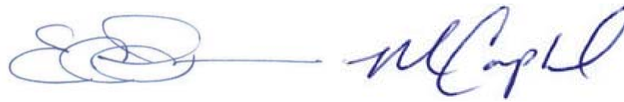
LUXURY AUTO DEPRECIATION LIMITS

- Under the new law, for a passenger automobile for which bonus depreciation (see above) is not claimed, the maximum depreciation allowance is increased to $10,000 for the year it's placed in service, $16,000 for the second year, $9,000 for the third year, and $5,760 for the fourth and later years in the recovery period.
- These amounts are indexed for inflation after 2018. For passenger autos eligible for bonus first year depreciation, the maximum additional first year depreciation allowance remains at $8,000 as under pre-Act law.

This newsletter is solely intended to provide a broad overview and touch on some important new changes to the evolving tax law, especially for the commercial real estate industry. We recommend sitting down with your CPA to discuss these and other changes that may have a significant impact in 2018.

We look forward to a prosperous 2018, please don't hesitate to reach out if we can assist you in any way with your net lease goals.

Sincerely,



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Sources:

1. *Article written by Greg Lehrmann, Attorney, Board Certified in Commercial and Residential Real Estate law*
2. *Christopher Tutor, Certified Public Accountant in the Real Estate Department of Considine and Considine, a San Diego based CPA firm*