Federal Tax Reform
Impact on Real Estate Businesses

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Tax Cuts and Jobs Act

Overview

- 20% Qualified Business Income Deduction
- Business Interest Deduction Limitation
- Bonus Depreciation/Section 179 Expensing
- Qualified Improvement Property
- Misc.

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Tax Cuts and Jobs Act

General

- Most provisions are effective for taxable years beginning after December 31, 2017.
- Many provisions are permanent, though some are temporary.

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Income Tax Rates

- C corporations: Taxed at flat 21% rate (down from 35% top rate).
  - Effective for years beginning after Dec. 31, 2017, with no expiration.
- Individuals: Taxed at 37% top rate (down from 39.6% top rate).
  - Effective for years beginning after Dec. 31, 2017. Expires for years beginning after Dec. 31, 2025.
  - 20% capital gains rate, employment tax rates and 3.8% net investment income rates remain unchanged.

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Deduction for State and Local Taxes

- C corporations:
  - No limit.
- Individuals:
  - Aggregate deduction for the following items limited to $10,000 ($5,000 for married filing separate) per year:
    - *All* state and local income taxes (apparently including an individual's share of state and local income taxes imposed directly on a flow-through entity); and
    - State and local real and personal property taxes, *other than* any such taxes that accrued in carrying on a trade or business or investment activity.
  - Effective for years beginning after Dec. 31, 2017. Expires for years beginning after Dec. 31, 2025.

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QBI Deduction: Section 199A

- Subject to certain limitations, taxpayers other than corporations may deduct 20% of *qualified business income* (the "QBI deduction") derived from a trade or business.
  - Effective for years beginning after Dec. 31, 2017. Expires for years beginning after Dec. 31, 2025.

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QBI Deduction: Section 199A

- "**Qualified Business Income**" generally is net income from the conduct of a trade or business in the US, other than the following investment items:
  - capital gain or loss, dividends, interest income, wages and guaranteed payments paid to the taxpayer by the business.

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QBI Deduction: Section 199A

Specified Services Limitation

•"**Specified Service Trade or Business**" means any trade or business:

- involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees, or
- which involves the performance of services that consist of investing and investment management, trading, or dealing in securities, partnership interests, or commodities.

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QBI Deduction: Section 199A

Specified Services Limitation

•For *specified service trades or businesses*, the QBI deduction is phased-out based upon the taxpayer's taxable income from all sources:

- Phase-out applies to taxpayers with taxable income in excess of $157,000 ($315,000 for joint returns), and
- QBI deduction is entirely phased-out for taxpayers with taxable income in excess of $207,500 ($415,000 for joint returns).

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QBI Deduction: Section 199A

W-2 Wage and Qualified Property Limitation

•For taxpayers with taxable income (from all sources) in excess of $157,000 ($315,000 for joint returns) the QBI deduction is subject to the *W-2 Wages and Qualified Property Limitation*.

- Limitation is phased-in for taxpayers with taxable income in excess of $157,000 ($315,000 for joint returns), and
- Is entirely phased-in for taxpayers with taxable income in excess of $207,500 ($415,000 for joint returns).

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QBI Deduction: Section 199A

W-2 Wage and Qualified Property Limitation

•Limitation amount is the greater of:

- 50% of W-2 wages with respect to the business, or
- 25% of W-2 wages with respect to the business, plus 2.5% of the unadjusted basis immediately after acquisition of all *qualified property* of the business.

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QBI Deduction: Section 199A

W-2 Wage and Qualified Property Limitation

•"**Qualified Property**" generally means:

- tangible, depreciable property,
- held by the business *at the close of the taxable year*,
- for which the depreciable period has not ended before the close of the taxable year (using a minimum 10-year depreciation period).

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QBI Deduction: Section 199A

S Corporations and Partnerships

•The QBI deduction is available at the shareholder/partner level.

- Shareholders/partners take into account their allocable share of the entity's:
  - qualified business income,
  - W-2 wages, and
  - unadjusted basis of qualified property.

QBI Deduction: Section 199A

- Trusts and estates are eligible for the QBI deduction.
- The QBI deduction impacts income tax liability only.
  - It does not reduce income for purposes of employment tax or 3.8% tax on net investment income.
- Under current OH law, the federal QBI deduction does not impact OH income tax liability.

Business Interest Deduction Limitation

General

•The deduction of *business interest* is limited to the sum of (i) 30% of a taxpayer's *adjusted taxable income*, plus (ii) the taxpayer's interest income (if any) from a trade or business.

- This limitation is permanent, effective for years beginning after Dec. 31, 2017.

Business Interest Deduction Limitation

Adjusted Taxable Income: Phase-In

•The computation of "adjusted taxable income":

- For taxable years beginning on or before Dec. 31, 2021, *does not* take into account depreciation, amortization or depletion (EBITDA).
- For taxable years beginning after Dec. 31, 2021, *does* take into account depreciation, amortization and depletion (EBIT).
- Does not take into account any available QBI deduction.

Business Interest Deduction Limitation

Carryforwards

•Disallowed interest is treated as business interest paid or accrued in the succeeding taxable year, and generally may be carried forward indefinitely.

Business Interest Deduction Limitation

S Corporations and Partnerships

•The business interest deduction limitation is applied at the S corporation/partnership level.

- Complicated rules apply to excess business interest expense or adjusted taxable income of S corporation/partnership.

Business Interest Deduction Limitation

Small Business Exception

•A business is exempt from the interest deduction limitation if its average annual items of gross receipts for the immediately-preceding three-year period is not greater than $25,000,000 (applying attribution rules).

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Business Interest Deduction Limitation

Election-Out for Real Estate Businesses

•Generally, real estate businesses may make an irrevocable election to avoid any business interest deduction limitation.

- Businesses qualifying for this election include:
  - any "real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business."

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Business Interest Deduction Limitation

Election-Out for Real Estate Businesses

•A business that makes this election *must* use the alternative depreciation system (ADS) for nonresidential real property, residential rental property, and *qualified improvement property*.

- Property subject to ADS is not eligible for bonus depreciation, but is eligible for Section 179 expensing.

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Qualified Improvement Property

Useful Life

Property placed in service *on or before* Dec. 31, 2017:

	MACRS	ADS
Qualified leasehold improvement property	15	39
Qualified restaurant property	15	39
Qualified retail improvement property	15	39

Property placed in service *after* Dec. 31, 2017:

	MACRS	ADS
Qualified improvement property	[15?][39?]	[20?][40?]

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Qualified Improvement Property

- "**Qualified Improvement Property**" generally means an improvement to an interior portion of a nonresidential building previously placed in service, *excluding:*
  - any enlargement of the building,
  - any elevator or escalator, and
  - the internal structural framework of the building.

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Bonus Depreciation

- Temporarily, 100% (up from 50%) of the cost of *qualified property* may be immediately expensed.
  - "**Qualified property**" generally means:
    - tangible depreciable property with a recovery period of 20 years or less (including qualified improvement property?), and
    - off-the-shelf computer software.

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Bonus Depreciation

Phase-Out

•Bonus depreciation is available for qualified property acquired and placed in service after Sept. 27, 2017 and before Jan. 1, 2027.

- ➢ Beginning in 2023, the bonus depreciation rate is reduced 20% per year, with bonus depreciation eliminated after Jan. 1, 2027.

Bonus Depreciation

- Now bonus depreciation is available for used property, if the property:
  - ➢ was not used by the taxpayer at any time before the acquisition, and
  - ➢ was not acquired by inheritance, gift or from a related person.
- Bonus depreciation may not be claimed for ADS property.

Section 179 Expensing Election

- Taxpayers may elect to immediately expense up to $1,000,000 (up from $500,000) of *Section 179 property* placed in service during a taxable year.
  - — The maximum $1,000,000 amount is subject to reduction if taxpayer places in service more than $2,500,000 (up from $2,000,000) of Section 179 property during the taxable year.

Section 179 Expensing Election

- "**Section 179 property**" means new or used property acquired by purchase for use in a trade or business from an unrelated person, and which property is:
  - — tangible personal property used in a trade or business,
  - — off-the-shelf computer software, or
  - — at the taxpayer's election:
    - ➢ qualified improvement property, or
    - ➢ the following improvements made to nonresidential buildings previously placed in service: roofs, HVAC, fire protection and alarm systems, and security systems (interior *and exterior*).

Section 179 Expensing Election

- No exclusion for ADS property.
- The $1,000,000/$2,500,00 thresholds are
  - — subject to inflation, and
  - — applied at both the partnership and partner level.

New Carried Interest Provision

- Where a taxpayer (other than a corporation) receives an interest in a real estate partnership in exchange for management services (a "carried interest"), long-term capital gain resulting from the interest now requires a 3-year holding period.
  - — Effective for years beginning after Dec. 31, 2017, with no expiration.

Limitation on Excess Business Losses

- For taxpayers other than corporations, the amount of net loss from trades or businesses that may be used to offset the taxpayer's non-trade or business income is limited to $250,000 per year ($500,000 for married filing jointly).
  - For S corporations and partnerships, this limitation is applied at the shareholder/partner level.
  - Any excess loss is treated as an NOL carryover to following year.
  - Effective for years beginning after Dec. 31, 2017. Expires for years beginning after Dec. 31, 2025.

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Repeal of Partnership Technical Terminations

- For taxable years beginning after Dec. 31, 2017, a transfer of interests in a partnership will not result in a "technical termination" of the partnership.
  - Under prior law, a "technical termination" of a partnership required the partnership to restart the depreciation period for depreciable assets, remake tax elections, etc.

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Like-Kind Exchanges

- Under prior law, tax-free like-kind exchange treatment was permitted for exchanges of both real and personal property.
- Under current law, only real property may be exchanged in a like-kind exchange.
  - Generally effective for exchanges completed after Dec. 31, 2017 (with limited transition relief where 180-day exchange period started in 2017).

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Net Operating Loss Deduction

- Net operating losses (NOLs) generated by a business generally may no longer be carried back, but may be carried forward indefinitely.
  - Applies to losses in taxable years ending [?] after Dec. 31, 2017.
- The available deduction for NOLs in any year is now limited to 80% of taxable income in such year.
  - Applies to losses in taxable years beginning after Dec. 31, 2017.

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Non-Shareholder Capital Contributions

- Corporations now are subject to federal income tax on contributions of cash or property received by the corporation from a governmental entity or civic group.
  - Under prior law, such contributions were not taxable.
- Generally applies to contributions made after Dec. 22, 2017.

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Tax Credits

- **Low Income Housing Tax Credits**: unchanged.
- **New Market Tax Credits**: unchanged.
- **Historic Tax Credits**:
  - 10% credit is eliminated, and
  - 20% credit must be claimed over a 5-year period (rather than being entirely claimed in the year a property is placed in service).

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New Qualified Opportunity Zones

- Taxpayers may defer gain on the sale of any property (including securities) by investing proceeds in any "qualified opportunity zone fund" within 180 days.
  – The qualified opportunity zone fund must use the proceeds to make qualifying investments in low-income census tracts designated as qualified opportunity zones.
- After the interest in the fund has been held for:
  – at least 5 years, 10% of the deferred gain is eliminated;
  – at least 7 years, additional 5% of the deferred gain is eliminated;
  – at least 10 years, upon the sale of the interest in the fund, any appreciation in the value of the interest in the fund since the date of the taxpayer's acquisition of that interest is eliminated.

New Qualified Opportunity Zones

- States must submit a list of qualifying census tracts to the Treasury Department for potential certification as Qualified Opportunity Zones by March 21, 2018 (with a possible 30-day extension).
- Ohio is accepting online recommendations from the public for census tracts to be included in Ohio's submission: http://odsa.force.com/ozf

Questions?

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