

Special Report

Tax Reform FAQs

March 2018

Q: Was the 1031 Tax Deferred Exchange retained?

A: Tax deferred exchanges for real estate were retained. Tax deferred exchanges can no longer be used for personal property

Q: How will the elimination of allocated value to personal property from Section 1031 impact cost segregation value of real estate properties?

A: Cost segregation can still be done. The personal property – depending on how the Treasury defines that – will not qualify for exchange treatment.

Q: Is the interest on a loan used to purchase investment real estate still tax deductible?

A: Interest on loans used to finance investment real estate is still deductible, but using this deduction will extend the depreciation timeline for the asset.

Q: Can investment real estate still be depreciated?

A: Investment real estate can still be depreciated. If the mortgage interest deduction is used, then the depreciation timeline for residential real estate is extended from 27.5 years to 30 years, and for commercial real estate the timeline is extended from 39 years to 40 years.

Q: Will carried interest for the Sponsor/GP on investment real estate be considered Long-Term gains after one or three years under the new tax law?

A: To be taxed at the capital gains rate, carried interest requires that the asset be held for three years instead of one year.

Q: What is the effective date on the new tax rules?

A: January 1, 2018 for most tax rules, but several bonus depreciation rules have an effective start date of September 2017.

Q: Is the tax law that was signed on December 22, 2017 the final version, or are additional changes to the tax law anticipated?

A: There have already been changes to the tax law. When the Bipartisan Budget Act of 2018 was signed on February 9, 2018 it included several modifications to the tax law. Many ambiguities in the new tax law will need to be addressed. Some will be handled by Treasury Department and IRS interpretation, but several will require technical corrections and modification by Congress.

Q: How long until the Treasury Department and IRS come out with additional guidance? Will it come all at once or piecemeal?

A: Guidelines on income tax withholding were released in February. Guidance on other tax ruling will likely be released in pieces. The IRS has announced that additional guidance will be out this summer.

Q: Are there any property types that are specifically negatively affected by the new tax laws?

A: Although the new tax law does not have a particularly negative effect on specific types of property, provisions could influence investor behavior and areas of focus. Investors may prefer investments that produce current year income over investments that produce capital gains that may be realized in the future because of the relatively low Federal income taxes currently in place. There may be a shift in investments in income producing properties. Properties that include a significant amount of Sec. 1245 personal property may also be less favored because absent guidance, these properties may present challenges in a 1031 exchange.

Q: For the 20% Pass-Through Deduction, what is a pass-through entity? Would it include an individual private owner that owns an investment property under his/her personal name, or does it require an LLC?

A: The deduction is available to every taxpayer who is not a corporation. This can include entities taxed as partnerships, S corporations, trusts, and even sole proprietors.

Q: The pass through seems complicated. There is a phase out of the 20% pass-through above \$315,000 for married couples (\$157,500 for individuals). If I make more than that, do I use an alternative means to calculate the pass-through deduction?

A: Investors are still eligible for the 20% pass-through deduction if their income is above \$315,000. However, above \$315,000 there are limitations placed on the size of the deduction and there are restrictions that limit who can take the deduction. Below \$315,000 there is no limitation. The limitation, if applicable, limits the deduction to the larger of: (50% of W-2 wages); OR (25% of W-2 wages plus 2.5% of the unadjusted basis of qualified property). The limitation is phased in over \$100,000 of income. So, if an investor makes between \$315,000 and \$415,000, they would be subject only to a fraction of the limitation. That fraction is based on the extent to which your income exceeds \$315,000. (IMPORTANT NOTE: The pass-through deduction has not been well defined and additional guidance from the IRS will be needed to determine exactly how the rules will be applied.)

Q: With respect to the 2.5% unadjusted basis of qualified property for pass-through deduction, how does one determine what the "unadjusted basis" is for property acquired via exchange(s)?

A: The rules do not answer this question and additional guidance will be required. A literal reading of the new law suggests that it would be the exchanged basis.

Q: For purposes of the 20% Qualified Business Income (QBI) deduction on commercial investment properties, does 'QBI' refer to a property's revenue or more to NOI, which of course includes expenses?

A: It is closer to NOI. Qualified business income means the net-net-number of qualified items of income, gain, deduction, and loss with respect to the qualified trade or business of the taxpayer. It does not include wages earned as an employee or certain investment income: short-term capital gain or loss; long-term capital gain or loss; dividend income; or interest income.

Q: It was mentioned that acquisitions of new or used personal property can now qualify for bonus depreciation. Is this limited to \$1,000,000 per property and \$2.5 million in aggregate?

A: The \$1m/\$2.5m limitation applies to Section 179 expensing, not bonus depreciation. There are no dollar limitations for bonus depreciation. Section 1250 property is not explicitly excluded from bonus depreciation, but, generally speaking, bonus depreciation can only be used for property that has a recovery period of 20 years or less.

Q: What is the status of EPAct 179D the deduction for energy efficient lights, HVAC, and Roofs for commercial buildings?

A: On February 9, 2018, it was extended to retroactively cover the 2017 filing period. It was a part of a package of 30+ extenders that were included in the Bipartisan Budget Act of 2018. The extension only covers the 2017 filing period. In 2018, Congress will again reevaluate whether to further extend the deduction.

Deduction Eligibility:

Any Commercial Property or 4+ Story Multi-Family Property Newly Constructed prior to December 31, 2017 OR retrofits to Lighting, HVAC, or Envelope components resulting in reduced energy consumption

Eligible New Properties Qualify for up to \$1.80 per square foot, Eligible retrofits qualify for up to \$0.60 for lighting, \$0.60 for HVAC, \$0.60 for Envelope

Q: What is the status of 45L Energy Tax Credit for residential properties?

A: On February 9, 2018, it was extended to retroactively cover the 2017 filing period. It was a part of a package of 30+ extenders that were included in the Bipartisan Budget Act of 2018. The extension only covers the 2017 filing period. In 2018, Congress will again reevaluate whether to further extend the deduction.

Credit Eligibility

Single-Family or Multi-Family Less than 3 Stories

New Construction or Major Renovation

\$2,000 tax credit per unit

Q: If a property owner gave TI money towards the buildout of leased space, would that qualify as a Qualified Lease Hold Improvements (QLHI) property?

A: There is no QLHI anymore. There is just QIP (Qualified Improvement Property). A technical correction will need to be approved by Congress to ensure that QIP qualifies for bonus. It should also be noted that there is always a question of who owns the TI and is eligible for depreciation.

Q: Do the new Bonus Depreciation rules exclude residential properties?

A: The law does not distinguish between residential and nonresidential. Instead, it looks to the class life of the unit of property. With real estate, the unit of property can include subcomponents, many of which may qualify for bonus. This may include 5 year and 15 year personal property, land improvements and QIP, for example that a cost segregation study would help identify.

Q: What should real estate investors do to capitalize on the new tax law?

A: Although the new tax law provides a framework that investors can use to make some investment decisions, many specifics will require additional guidance or a technical correction before true clarity emerges. Maintaining proactive communication and planning with a qualified tax professional, particularly one that specializes in commercial real estate investments, can help.



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