

Cohen & Co

What the Tax Cuts and Jobs Act Means for the Real Estate Industry

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Welcome & Introductions



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Overview

Tax Cuts and Jobs Act

- › Signed into law December 22, 2017
- › Sweeping tax changes, not exactly reform
- › In need of many clarifying regulations and technical corrections to address unintended consequences of the law
 - Cohen & Company is working with AICPA Major Firms Group to develop a list of items in need of review

Tax Cuts and Jobs Act

- › How did the Real Estate industry fare?

What You Need to Know

Section 1031 Like-Kind Exchanges

- › Preserved for real estate transactions
- › Like-kind exchange treatment does not apply to any exchange of real property held primarily for sale
- › Tax deferral for personal property exchanges eliminated (but personal property can be written off 100% in year of acquisition)
- › Effective for exchanges completed after 12/31/17 (transition rules apply if the first step of an exchange under old rules occurred prior to 1/1/18 and not completed as of 12/31/17)

Carried Interest

- › Now requires a 3-year holding period (prior period was 12 months)
 - Holds less than 3 years will be treated as short-term capital gain
 - 3-year hold appears to apply to sale of an applicable partnership interest in addition to the sale of underlying assets
 - The applicable partnership interest is one that is granted in connection to performing an applicable trade or business
- › An "applicable trade or business" is one whose regular business activity consists of (1) raising or returning capital, and (2) either investing in or disposing of specified assets or developing specified assets
 - "Specified assets" include real estate held for rental or investment; an interest in a partnership to the extent of the partnership's proportionate interest in these assets is also a specified asset
- › Effective for tax years beginning after 12/31/17

Technical Termination of a Partnership

- › Rule providing for technical terminations of partnerships repealed for partnership tax years beginning after 12/31/17
 - Prior law treated a partnership as terminating if 50% or more of its interests were transferred within a 12-month period
 - Upon a technical termination, a partnership was treated as newly formed and was required to make certain new elections and restart depreciation on its assets

Gain/Loss of Foreign Person From Sale of Partnership Interest

- › Gain or loss from the sale or exchange of a partnership interest is effectively connected with a U.S. trade or business to the extent that the transferor would have had effectively connected gain or loss had the partnership sold all of its assets at fair market value as of the disposition date
- › The transferee of a partnership interest must withhold 10% of the amount realized on the sale or exchange unless the transferor certifies that it is not a nonresident alien or foreign corporation
- › Effective for sales, exchanges and dispositions after 11/26/17 (to be treated as effectively connected with a U.S. trade or business)
 - Withholding requirements apply to sales, exchanges or dispositions after 12/31/17

Bonus Depreciation

- › Increased to 100% for qualified property placed in service after 9/27/17 and before 1/1/23
- › 100% allowance phased down by 20% per calendar year for property placed in service after 2022
- › Used property now qualifies for bonus depreciation if it is acquired from an unrelated party
- › Expect qualified improvement property placed in service after 12/31/17 to have a 15-year recovery period and therefore be subject to bonus depreciation
 - *Currently* the law does not provide for that, but we expect a technical correction to be made
 - Qualified improvement property = improvements made to an interior of nonresidential real property; does not include improvements for expenditures attributable to the enlargement of a building, any elevator or the internal structural framework of a building

Section 179 Expensing

- › Limits raised to \$1 million of expenses annually and \$2.5 million for the annual phase-down threshold based on investment
- › Qualified improvement property, roofs, HVAC, fire protection and alarm systems, and security systems now eligible for nonresidential property
 - Must be placed in service after the nonresidential real property was first placed in service
- › Effective for property placed in service in tax years beginning after 12/31/17

Deduction of Business Interest

- › Deduction allowed for any tax year cannot exceed the sum of:

Taxpayer's business interest income for the tax year

+

30% of the taxpayer's adjusted taxable income for the tax year
(=taxable income without regard to interest income & expense, net operating losses, and depreciation & amortization)

+

Taxpayer's floor plan financing interest for the tax year

Deduction of Business Interest (cont.)

- Any business interest that isn't deductible because of the limitation is treated as business interest paid or accrued in the following tax year and may be carried forward indefinitely
- In the case of a partnership, the net interest expense disallowance would be determined at the partnership (not the partner) level
- Effective for tax years beginning after 12/31/17
- Small taxpayer exception
 - Business interest limitation does not apply to taxpayers that meet the \$25 million gross receipts test (controlled group rules apply)
 - The small business exception doesn't apply to tax shelters
 - Syndicate is considered a tax shelter, which is a partnership if > 35% of losses are allocable to limited partners or limited entrepreneurs

Deduction of Business Interest (cont.)

- Business interest limitation exception for an electing real property trade or business
 - Real property trade or business is defined broadly as “real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business”
 - If election is made by real property trade or business, requires the real property trade or business to use the alternative depreciation system (ADS) to depreciate any of its real property
 - Residential rental property ADS life = 30 years (vs 27.5)
 - Nonresidential rental property ADS life = 40 years (vs 39)
 - Qualified improvement property ADS life = 20 years (vs 15), if technical correction is made to qualified improvement property rules (as noted under bonus depreciation section)
 - Provision applies to tax years beginning after 12/31/17 and not to property placed in service in tax years beginning after 12/31/17 (awaiting guidance or another technical correction)
 - One time irrevocable election

Entertainment Expenses

- › Business deduction no longer allowed for entertainment expenses, including:
 - An activity generally considered to be entertainment, amusement or recreation;
 - Membership dues for any club organized for business, pleasure, recreation or other social purposes; or
 - A facility used in connection with any of the above items
- › The following exceptions apply:
 - Expenses are treated as compensation to an employee as wages
 - Expenses in connection with the performance of services for another person are under a reimbursement plan
 - Expenses for recreational, social or similar activities are primarily for the benefit of the taxpayer's employees, other than highly compensated employees
- › Effective for amounts incurred or paid after 12/31/17

Non-Shareholder Contributions to Capital

- › Contributions to capital by a governmental entity, civic group, customer or potential customer that are not made by a shareholder are now taxable
- › Property contributed to a corporation by a governmental unit or civic group for the purpose of inducing the corporation to locate its business in a particular community, or to enable the corporation to expand its facilities, are now taxable to the corporation
- › Effective for contributions made after 12/22/17

Historic Tax Credit

- › 20% credit for qualified rehabilitation expenditures for certified historic structures now claimed ratably over a 5-year period
- › 10% credit for qualified rehabilitation expenditures for non-historic structures first placed in service before 1936 is eliminated
- › Effective for amounts paid or incurred after 12/31/17

Qualified Opportunity Fund

- › Defer capital gains on the sale of property if those gains are timely invested in Qualified Opportunity (QO) Funds
- › A QO Fund is any investment vehicle that is organized as a corporation or a partnership that invests at least 90% of its assets in Opportunity Zone businesses
 - Certification process likely similar to New Markets Tax Credit program
- › Partial forgiveness of deferred capital gains and gains from future appreciation is possible for QO investments held for 5, 7 and 10 years
 - Effective 12/22/17

Unrelated Business Income Tax

- › Tax-exempt organizations now required to calculate taxable income separately for each unrelated trade or business
- › Ability to shelter income from one activity with losses from another eliminated
- › Effects on real estate funds?
- › Effective for tax years beginning after 12/31/17

Overall Tax Rates

› Corporate

- C Corporations will enjoy a flat, permanent rate of 21%
- Effective for tax years beginning after 12/31/17

› Individual

- Individual rates were lowered across the board (max rate reduced from 39.6% to 37%) ONLY for tax years 2018 through 2025
- Effective for tax years beginning after 12/31/17

Qualified Business Income Deduction

- › Non-corporate taxpayers may deduct up to 20% of domestic qualified business income from a partnership, S Corporation or sole proprietorship
 - Deduction is limited to taxable income
 - 20% of REIT dividends eligible for this deduction in addition to the qualified business income deduction (results in an effective maximum income tax rate of 29.6% on REIT dividends)
 - Losses from qualified businesses are carried over against qualified business income in later years

Qualified Business Income Deduction (cont.)

- A limitation based on wages paid, or on wages paid plus a capital element, is phased in for taxpayers with taxable income above a threshold amount (\$415,000 for MFJ). Limitation is lesser of:
 - 20% of the taxpayer's qualified business income from the trade or business; or
 - A W-2 wages/qualified property limit, which is the greater of:
 - 50% of the W-2 wages of the trade or business; or
 - The sum of 25% of the W-2 wages of the trade or business, plus 2.5% of the unadjusted basis immediately after acquisition of all qualified property of the trade or business
- Deduction is not applicable to service businesses such as health, law, accounting, brokerage and investment management services if income is above certain threshold
- Additional reporting will be required on 2018 partnership and S Corporation returns
- Deduction applies to tax years 2018 through 2025

Alternative Minimum Tax (AMT)

› Individuals

- Exemption amounts are temporarily increased for individuals after 2017 and before 2026
- Beginning in 2018, the exemption amounts are:
 - \$109,400 for MFJ
 - \$70,300 for single
 - \$54,700 for MFS
- Phase out thresholds are also temporarily increased after 2017 to \$1 million if MFJ and \$500,000 for all other individuals

› Corporations

- AMT is repealed

Net Operating Losses (NOLs)

- › NOLs arising in a tax year ending after 2017:
 - Are generally not allowed to be carried back, but
 - May be carried forward indefinitely
- › NOLs arising in a tax year beginning after 2017 may only reduce 80% of taxable income in a carryback or carryforward tax year

State and Local Tax Deduction Limitations

- › For tax years after 2017 and before 2026, individual taxpayers are limited to a deduction of \$10,000 for state and local:
 - Property taxes,
 - Income taxes, and
 - Sales taxes

Mortgage Interest Deduction - Individuals

- › For tax years after 2017 and before 2026, the deduction is modified
 - Deduction for home equity interest is suspended for 2018 through 2025
 - Maximum acquisition debt is limited to \$750,000 (\$375,000 for MFS) for 2018 through 2025
 - Debt incurred on or before 12/15/17 is subject to \$1 million (\$500,000 for MFS) acquisition debt limit

Excess Business Losses

- › Excess business losses of non-corporate taxpayers not allowed for tax years beginning in 2018 through 2025
- › Any disallowed excess business loss treated as an NOL carryover to the following year
- › Excess business loss is the excess of:
 - The taxpayer's aggregate deductions for the tax year from the taxpayer's trades or businesses, determined without regard to whether or not such deductions are disallowed for such tax year under the excess business loss limitation; over
 - The sum of:
 - The taxpayer's aggregate gross income for the tax year from such trades or businesses, plus
 - \$250,000 MFS or \$500,000 MFJ

Miscellaneous Itemized Deductions

- › All miscellaneous itemized deductions subject to the 2% of AGI limit temporarily repealed for tax years beginning after 12/31/17 and before 1/1/26

Federal Estate and Gift Taxes

- › Basic exclusion for federal estate and gift tax and exemption for generation-skipping transfer tax doubles from \$5 million to \$10 million (before adjustments for inflation)
- › Applies to estates of decedents dying and gifts and generation-skipping transfers made after 2017 and before 2026

Other Employer Items

- › Cash and gift cards paid to employees for safety or length of service considered wages
- › Cannot deduct expenses of a qualified transportation fringe benefit:
 - Transportation in a commuter highway vehicle for travel between the employee's residence and place of employment
 - Transit passes
 - Qualified parking
 - Qualified bicycle commuting reimbursement (only applicable after 2026 but employee must pick up into income from 2018 through 2025)
- › No deduction allowed for expenses incurred for providing any transportation, or any payment or reimbursement, to an employee for travel between the employee's residence and place of employment, except as necessary for ensuring the employee's safety
- › Does not change the employee's exclusion of the benefit from income (except in the case of qualified bicycle commuting reimbursements as noted above)

Other Employer Items (cont.)

- › Exclusion for qualified moving expense reimbursements includible as wages to the employee for tax years 2018 through 2025
- › New tax credit for paid family and medical leave under Family and Medical Leave Act (FMLA)
 - The credit is available to employers for paid leave provided under FMLA beginning in 2018
 - An eligible employer is allowed the FMLA credit in an amount equal to the applicable percentage for the wages paid to any qualifying employee during the period in which the employee is on leave
 - Applicable percentage means 12.5% increased (but not above 25%) by 0.25 percentage points for each percentage point by which the rate of payment exceeds 50%
 - Only available with respect to wages paid in tax years beginning in 2018; the credit terminates after 2019

Questions for our Presenters?



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Thank you.

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