# Impact of the 2017 Tax Act on Real Estate — Key Issues

by Mark Lee Levine, CCIM, JD, LLM (Tax) and Libbi Levine Segev, JD, MS-RECM, LLM (Tax)

## The Tax Act of 2017 Becomes Law

The Tax Act of 2017[1] provides many changes to the federal income tax law, most of which start in 2018. Most of the rules sunset after 2025, although there are a few exceptions. The Act, signed by President Donald Trump on Dec. 22, 2017, contains tax changes that affect real estate.

Given the haste in which the Act was passed and the reconciliation between the two branches of Congress, many issues will require further refinement to understand the idiosyncrasies. Nevertheless, many changes in this Act are relevant to taxpayers in general and to commercial real estate professionals and investors on the specific tax issues related to real estate.

An examination of some of these issues follows. For more detail, see the Code[2]and the other authorities cited in the footnote.[3]

## Tax Rates

One of the most discussed issues when the 2017 proposed tax changes was being considered were the rates that would be applicable to individuals and entities. As finalized, the Act allows for several tax brackets. The below two charts compare the 2017 and 2018 brackets. Although

[1] This Act is sometimes referred to as the Tax Cuts and Jobs Act of 2017. This was signed into law by the President on 12/22/17.
[2] See Internal Revenue Code of 1986, as amended, especially under the 2017 Act, HR 1. The “Code” herein referenced is referring to this 1986 Act as amended. See also, Levine, Mark Lee and Segev, Libbi Levine, Real Estate Transactions, Tax Planning, Thomas Reuters West (2018).
[3] Id.

the rates are not significantly different, the biggest changes are in the top bracket with a reduced rate of 37 percent replacing 39.6 percent.[4]

**Income Tax Brackets for 2017**

| Tax Rate | Individuals | Married Filing Jointly | Head of Household |
|---|---|---|---|
| 10% | Up to $9,325 | Up to $18,650 | Up to $13,350 |
| 15% | $9,326-$37,950 | $18,650-$75,900 | $13,351-$50,800 |
| 25% | $37,951-$91,900 | $75,901-$153,100 | $50,801-$131,200 |
| 28% | $91,901-$191,650 | $153,101-$233,350 | $131,201-$212,500 |
| 33% | $191,651-$416,700 | $233,351-$416,700 | $212,501-$417,700 |
| 35% | $416,701-$418,400 | $416,701-$470,700 | $416,701-$444,550 |
| 39.6% | Over $418,400 | Over $470,700 | Over $444,550 |

**Income Tax Brackets for 2018**

| Tax Rate | Individuals | Married Filing Jointly | Head of Household |
|---|---|---|---|
| 10% | Up to $9,525 | Up to $19,050 | Up to $13,600 |
| 12% | $9,526-$38,700 | $19,051-$77,400 | $13,601-$51,800 |
| 22% | $38,701-$82,500 | $77,401-$165,000 | $51,801-$82,500 |
| 24% | $82,501-$157,500 | $165,001-$315,000 | $82,501-$157,500 |
| 32% | $157,501-$200,000 | $315,001-$400,000 | $157,501-$200,000 |
| 35% | $200,001-$500,000 | $400,001-$600,000 | $200,001-$500,000 |
| 37% | Over $500,000 | Over $600,000 | Over $500,000 |

The corporate tax rate also was an important topic in the discussion surrounding the 2017 Tax Act. The Trump Administration's argument was that the U.S. is not competitive, as to income tax rates, when compared to other nations since the U.S. has very high corporate rates. Congress addressed this issue in the 2017 Tax Act by reducing the highest corporate rate to 21 percent, starting in 2018![5]

[4] In addition to the variance at the top rates of 37 percent compared to 39 percent, under the 2018 rates, a taxpayer does not reach the highest rate until there is more income when comparing the 2018 to 2017 rates. In 2017, joint filing taxpayers do not hit the 35 percent rate until taxable income is over $416,700.

[5] Not only was the rate at issue, but the date it would be effective was also discussed. Some Members of Congress favored the 21% ceiling rate applying only after 2018. However, as noted, the rate became effective for 2018 and a proposed delay in the effective date was eliminated.

**Standard Deduction**

The new Tax Act increased the standard deduction[6]. Starting in 2018, the standard deduction for individuals will be $12,000 and the deduction for a married couple, filing a joint return, will be double this amount at $24,000. This standard deduction is indexed[7] to increase for the coming years.

**Exemption**

Another approach to simplifying the tax law is to simply take away deductions. This approach is what Congress and the President undertook for exemptions. Although the exemption for 2017 was $4,150 per person, that exemption was suspended under the 2017 Tax Act[8]. As a result, there is no exemption deduction for 2018. The argument in part is that this exemption can and should be repealed (suspended), since the standard deduction was increased to a level to account, in part, for the loss of the exemption.

**Interest Deduction: Mortgages**

**Personal Interest Deduction**

The mortgage interest deduction is an important deduction that the tax law has allowed for many years under Code Section 163. The mortgage deduction applies for acquiring the taxpayers' principal residence and a secondary residence or just a secondary home.

There has been much debate as to whether such deduction should or should not exist.[9] In favor of the deduction, one argument is that it supports home-ownership, a social goal that has been considered a positive position in U.S. society. A counter argument is that a renter should not be penalized because he or she does not own their residence.

[6] See Code Section 63(c).
[7] See Code Section 1(f).
[8] See Code Section 151(d).
[9] See supra, footnote 2, the Levine text, Chapter 13 on the Interest deduction.

Although the deduction for such personal (not business) interest has been allowed for many years,[10] Congress had imposed a ceiling on the mortgage that can qualify to support the deduction at $1 million, which the 2017 passage reduced to a mortgage debt of $750,000 to calculate the interest deduction.[11]

Effectively, Congress has allowed the continued deduction (if itemizing) for interest, but it imposed a ceiling on such deduction by limiting the debt upon which the interest deduction is calculated. This ratcheting down of the qualified debt from 1 million to $750,000 is exactly what many in Congress, tax professionals, Realtors, and others argued would happen if Congress placed a limit (the $1 million) on the amount of the mortgage that could be employed when computing the interest deduction.

Instead of an immediate repeal of the interest deduction, this reduction in the debt allowed for the interest calculation has the effect of reducing the interest deduction. This approach was a compromise. The 2017 Tax Act did not repeal the Code Section 163 interest deduction for the home. But it did reduce the amount of such deduction for many taxpayers who will seek new loans in 2018.[12] . (There are provisions in the 2017 Tax Act to allow taxpayers to refinance an existing loan that exceeds the $750,000 amount, but which are less than $1 million.[13])

Under the 2017 Tax Act, Congress also eliminated the $100,000 home equity loan rule that allowed for a taxpayer to claim interest deductions on a base of up to $100,000.[14] Effectively, what Congress did with these interest deductions on the home loan is to tighten the requirements and reduce the effective base to allow for the interest deduction.

[10] Id.
[11] See Code Section 163(h)(3).
[12] The 2017 Act allows the deduction for qualified interest on the principal residence for a loan amount of up to 1 million, so long as the loan was already in place before Dec. 15th, 2017. Thus, these loans are grandfathered.
[13] See the 2017 Act as well as the modified Code Section 163 provision on this issue.
[14] Id.

**Business Interest Deduction**

Although business interest is not subject to the above rules limiting the deduction of interest, the 2017 Act limited some deductions of interest connected with businesses. The 2017 Act limits the deduction of interest for some businesses.[15] "Net interest" as a deduction is limited to 30 percent of the earnings as calculated before deducting for interest, depreciation, taxes and amortization, and other items. The good news is that smaller businesses, defined as one under $25 million annual revenue, are not subject to this limitation.

If an owner is subject to this limit, the deduction that was denied can be carried forward, indefinitely. Real estate and farm businesses can generally choose to avoid this interest limitation rule.

These rules have different effective dates and transitional rules. Thus, a review of the specifics of the rule is needed.[16]

**Pass-Through Entities with Gains**

Where there is an LLC, partnership, or certain other types of pass-through entities, the owners of such businesses must pick up the income on their returns. However, the 2017 Tax Act allows for another deduction to such owners, if qualified.

The owners might qualify to claim a 20-percent deduction from adjusted gross income for qualified business income. There are limits on how much can be deducted, many of the limits being tied to wages. Once again, reference to the rule is needed to examine the specifics for this change in the law.

**Expensing of Capital Expenditures and Use of Cost Recovery**

**Code Section 179:**

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[15] See Code Section 163(j).
[16] Id.

This rule has existed for many years. It has allowed a business taxpayer, with qualified property, to deduct the cost of most personal, nonresidential property, which is used in the trade or business.

Immediately prior to the 2017 Tax Act, this rule allowed taxpayers to deduct up to $500,000 of acquired qualified, personal property as opposed to being required to apply cost recovery to the property over a given number of years. This rule was enhanced by the 2017 Tax Act, giving taxpayers even more, immediate deductions.

Under the 2017 Tax Act, the Code Section 179 Rule allows taxpayers to deduct for qualified property, up to $1 million of property, that was acquired and placed in service under the provisions of the 2017 Act.

The benefit of such current write-off has been subject to limits, if the taxpayer acquired too much of the Section 179 property. In such an instance, the current deduction could be lost. However, the phasing out of such property deductions was increased to $2.5 million under the 2017 Tax Act.

As a result, the $1 million is reduced to the extent the property placed in service is more than $2.5 million. If the $2.5 million is not exceeded, there is no reduction in the use of the current Section 179 write-off.

For example, a taxpayer might place in service $800,000 and deduct the whole amount under Code Section 179.

Most of the property coming within Code Section 179 is nonresidential, trade or business, personal property, and not real estate. There are exceptions where qualified retail, residential, and leasehold improvements may fall within Code Section 179.

Further, some other areas for fire protection, air conditioning, and roof work may fall within this section.

There are other limitations as to the use of Code Section 179, for example, the use of autos for business.[17]

For a discussion of the many limits when attempting to apply Code Section 179, see the authorities in the footnote.[18]

**Code Section 168: Other Expenses**

Beyond Code Section 179, there is another possible, immediate write-off allowed for taxpayers.[19]

Although taxpayers in business have generally recovered, for tax purposes, their investments via depreciation or cost recovery, the 2017 Tax Act allows for more expedited recovery of such expenditures.

Under the 2017 Tax Act, some types of capital expenditures for property can be subject to an immediate, 100-percent deduction. This is for qualified new and used property acquired by the taxpayer for the taxpayer's business use. This rule has existed for years. However, the 2017 Tax Act generally has an effective date for such property placed in service after Sept. 27, 2017.

This Bonus write-off moves this approach far beyond the rule that existed prior to the 2017 Act. Under the prior rule, the bonus depreciation, was generally 50 percent of the basis of the property. But, this new 2017 Tax Act rule, for qualified property and taxpayers, allows for a 100-percent deduction. This bonus percentage is reduced for future years.

**Qualified Improvement Property and Depreciation:**

Qualified Improvement Property under the 2017 Tax Act generally includes property acquired after Dec. 31, 2017. It typically includes the grouping of property that involves improvements in

[17] See Code Section 280(F).
[18] See Code Section 179; see also Levine and Segev, Chapter 14, supra footnote 2.
[19] See Code Section 168.

retail, restaurants and leaseholds. This type of property can generally be depreciated over 15 years, using the straight line, as opposed to the normal 39-year life normally employed for depreciation of commercial, real property.

**Rehabilitation Credit**

The Code, prior to the 2017 Act, allowed for a credit when qualified rehabilitation work was undertaken on either older structures, built prior to 1936, or a certified historic property.

Under the 2017 Tax Act, the 10-percent credit for noncertified older structures was repealed. This generally applies for the credit for years after 2017. However, Congress did allow for a transition on this point, allowing the credit for those that could meet the transitional rules to show that the rehab project was underway in 2017.[20] This favorable, transitional rule was generated after the efforts of many commercial real estate professionals that worked with Congress.

The certified historic credit of 20 percent, which existed prior to the 2017 Tax Act, continues under the 2017 Tax Act. The taxpayer must meet the requirements of the Code for this rehab credit.[21] Taxpayers claim the credit that is spread over a five-year period.

**IRC Section 1031: Real and Personal Property Exchanges**

For many years, members of Congress have raised the specter of a possible repeal of Code Section 1031. Some assert that Section 1031 favors the postponement of taxes — with little justification for such tax benefit. Although the National Association of Realtors, CCIM Institute, and other nonprofit real estate organizations have opposed a 1031 repeal, it appeared that there was strong support in Congress in 2017 for a repeal of 1031. Ultimately, the members of Congress concluded that 1031 would not be repealed for real estate.

[20] See Code Section 47(c).
[21] See Code Section 47. See also Levine and Segev, Chapter 23, supra footnote 2.

However, the 2017 Tax Act did repeal the rule for all property, other than real estate. As a result, most commercial real estate professionals will defer the gain on the exchange of tangible personal property, with some exceptions for transitional rules in place. Under the 2017 Tax Act change, such nonreal estate is disqualified under 1031 from the tax deferral benefits.

Certainly, commercial real estate professionals should be concerned with the potential that Congress may choose, in coming years, to eliminate 1031 exchanges for real property. However, 1031 continues to apply to real estate that meets the requirements of 1031 like-kind exchanges.[22]

**Carried Interest**

In some instances, taxpayers have received a carried interest in each project that they directed. In such cases, the taxpayer often claimed that any gain from the disposition of the interest was subject to being taxed as long-term capital gain.

The 2017 Tax Act addressed this issue by providing that if the interest might otherwise be qualified for long-term capital gain, such interest would not be taxed as long-term capital gain unless the carried interest was held for a minimum of three years[23].

**Alternative Minimum Tax**

Ever since the passage of the Alternative Minimum Tax, many arguments have been made about why the AMT should not exist. The arguments include the position that the AMT is not needed as there is already a regular income tax in place.

[22] Real property experts should recall that Congress changed the law some years ago to eliminate under 1031 the use of that Section when exchanging real estate for real estate, when the replacement property is located outside the US. That is, although real estate can qualify within 1031 such real estate will not qualify if the replacement property is outside the US.

[23] See Code Section 1061. If the holding does not exceed the 3 years, the gain is treated as short term capital gain.

Others argue that AMT is not needed because it is unfair to create an additional burden on taxpayers who have already complied with the regular tax rules. Further, the intent, when first passing the AMT, was to affect only those taxpayers in the higher income levels.

However, the AMT has affected many more taxpayers than the members of Congress anticipated. Before the passage of the 2017 Tax Act, the approach discussed was to simply repeal AMT. It appeared that there was strong support for such repeal.

However, when the Congressional Conference Committee finalized the position for the Tax Act of 2017, AMT was not repealed. Rather, the Act retained AMT, but increased the exemptions available to avoid AMT, thus attempting to address the prior complaints that many in the middle class needed relief from AMT.

The 2017 Tax Act increased the exemption to $109,400 for those taxpayers filing a joint return. At the same time, it increased the exemption for the single taxpayer or filer to $70,300. As a result, most taxpayers will not have to be concerned with AMT, especially since the exemption is now not subject to being lost or phased-out, unless the taxpayer has a very high taxable amount under AMT.[24]

For this approach to AMT, Congress chose to keep the law and insulate most taxpayers from the AMT by allowing for higher exemptions.

Although the *individual AMT* was not repealed, Congress did repeal AMT for corporations.[25] This change generally is effective in 2018. And consistent with the corporate tax rate ceiling of 21 percent such change, it is argued, will make U.S. corporations more competitive and more likely to want to do business within the U.S.

**Net Operating Losses**

[24] See Code Sections 55 and 56.
[25] See Code Section 55.

The deduction of net operating losses has generally been allowed for businesses for many years. The 2017 Tax Act continues to allow businesses that had a NOL to use it for years when there is a gain by the entity. Prior NOL rules allowed the business to carryback the loss for filing amended returns or carry the loss forward.

Under the 2017 Tax Act, the NOL losses, generally will only be carried forward. There is a perpetual carryforward. The amount of the NOL to be used each year is limited to 80 percent of the taxable income for the year in question.

**Pass Through Losses**

Starting in 2018, if there are pass through losses from a business, there is a limit of how much of the passthrough loss can be used in the given year. Currently, the losses that cannot be deducted usually are carried forward as an NOL. These rules also must be coordinated with the passive loss limitations rules under Code Section 469.[26]

**Charitable Deduction**

There was talk of Congress repealing the Code Section 170 deduction that allows taxpayers to deduct qualified contributions to qualified charitable recipients. This deduction applies only if the taxpayer itemizes deductions and does not claim the standard deduction.

The new law allows the continued use of a charitable, itemized deduction, assuming it was otherwise qualified under Code Section 170. Further, Congress also changed the rules to allow for an even greater deductible, charitable contribution.[27] In other words, the limit for the year for a qualified deduction to charity as an itemized deduction generally was 50 percent of

[26] See Code Section 469. See also Levine and Segev, Chapter 7, supra footnote 2.
[27] See Code Section 170(b)(1).

the adjusted gross income of the taxpayer. Under the 2017 Tax Act, Congress raised this limit by allowing such deductions, annually, to up to 60 percent of AGI.[28]

**Deduction for State and Local Taxes**

Prior to the new law, taxpayers had been allowed to claim a deduction for the state and local income taxes paid.[29] Under the 2017 Tax Act, the Congressional Conference Committee resolved various conflicts on this issue by allowing taxpayers who itemize to continue to deduct income taxes or sales taxes paid on the state and local levels, subject to these limitations.

1. The deduction is limited to a maximum of $10,000 of income taxes, sales taxes and property taxes;
2. No deduction is allowed for prepaid taxes in this area; and
3. The limit applies to income tax deductions, or sales taxes, as well as property taxes.[30]

**Casualty Losses**

Code Section 165 allowed for certain types of personal losses generated from casualties and theft losses to be deductible, even if they were personal in nature and not connected with a business.[31] The personal losses under Code Section 165 have been limited for many years.[32] Those limits included a requirement to itemize deductions, provide a minimum level of losses,[33]and meet other requirements under Code Section 165(c)(3).

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[28] The 2017 Act provided some other limits, such as denying the 80% charitable deduction that had been allowed, prior to the 2017 Act, when a contribution was made in connection with seating for certain college athletic events.
[29] See Code Section 164(b)(6).
[30] Thus, the total of the income taxes (or sales taxes, if elected) and the property taxes, cannot exceed the $10,000 amount. For taxpayers in some states, such as California, NY, Connecticut, etc., with high property taxes and/or high-income taxes, this change generates lost deductions and thus produces a higher taxable amount on the Federal income tax return.
[31] See Code Section 165. See also the Levine and Segev text, Chapter 10, cited supra, footnote 2. This Section distinguishes losses that are personal in nature as opposed to business or investment losses. The losses that are personal in nature are the type of losses that the 2017 Act addressed—and limited, as noted above.
[32] Id.
[33] See Code Section 165 (c)(3), where most losses needed to exceed $100, the total losses for the year were not deductible unless they exceed 10% of the AGI of the taxpayer, etc. With the 2017 Act changes, these limitations are

Under the 2017 Tax Act, for individuals, most nonbusiness casualty and theft losses are no longer deductible[34]. In most cases, this change does not adversely affect taxpayers as they now have a larger standard deduction. Prior to the 2017 Tax Act, the losses and thefts often were not deductible, given the many requirements that taxpayers were forced to meet to comply with Code Section 165 (c)(3).[35]

These changes were directed to limit the nonbusiness casualty and theft losses. The losses and thefts incurred in business and investments were not affected by this 2017 Tax Act change.

**Medical Expenses**

Before the 2017 Tax Act, medical expenses[36] have been allowed as an individual, itemized deduction, if the taxpayer could meet certain threshold amounts. In general, the taxpayer who itemized expenses could deduct the costs for medical expenses.

Prior to the 2017 Tax Act, the taxpayer could not deduct even qualified medical expenses, except for the amount that exceeded a percentage of the AGI of the taxpayer. That percentage changed over the last few years, moving from 7.5 percent to 10 percent. For example, the taxpayer could only deduct the expenses during a year when the medical expense exceeded 10 percent of AGI.

For example, if the taxpayer had AGI of $100,000, and incurred qualified medical expenses of $15,000, only $5,000 could possibly be deducted. The $100,000 X 10 percent or $10,000 could not be deducted. As a result, of the $15,000 incurred, only $5,000 would remain as a deductible amount, given the 10 percent rule.

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not necessary, since most of these personal losses, aside from Presidential Disaster declarations, are no longer deductible by the individual.

[34] See Code Section 165(h).

[35] Id.

[36] See Code Section 213. See also the Levine and Segev text, Chapter 13.

Since the standard deduction was increased to $12,000 per person, the argument was that many of the itemized deductions were allowed before this substantial increase in the standard deduction. The medical expense deduction was one deduction that was thought to be expendable.

However, the Conference Committee chose to leave this medical expense deduction in the law, at least for now. Further, the deduction was changed to allow for qualified medical expenses to be deducted for the amount more than 7.5 percent of AGI.

This 7.5 percent rule applies for both 2017 and 2018 returns.[37] This change could prove to be helpful for those that itemize their deductions and that incur a large amount of medical expenses.

## Estate and Gift Taxes

The estate and gift tax issue were hotly debated during the past many months. There was talk about repealing the federal estate tax and the federal gift tax.

Under the 2017 Tax Act, Congress chose not to repeal the estate and gift taxes. Instead federal legislators addressed the issue that many individuals, such as farmers, have built an estate consisting of farm land, which should be somewhat insulated from the estate tax. The 2017 Tax Act increased the exemption available to the estates of decedents. However, such increase in the exemption amount did not eliminate all estate tax concerns, especially for larger estates.

The 2017 Tax Act increased the estate and gift tax exemption to an amount of approximately $11.2 million in 2018. This is a calculated amount based on indexing. This amount is indexed for inflation, allowing for the position that such estates may grow and thus the exemption should also be increased.

[37] See Code Section 213(f).

This rule applies for several years beginning in 2018. This change means that most individuals will not have an issue with estate tax or gift tax, since most estates will not exceed $11.2 million. There are further protections to avoid any estate tax, such as deductions that apply for gifts to a spouse[38] and other concerns.[39]

## Other Issues

There are many other issues in the tax area that were contained in the 2017 Tax Act and that are relevant to commercial real estate professionals.[40] This brief paper was designed to highlight the key 2017 Tax Act changes that might be most important to commercial real estate professionals in the coming months.

However, a thorough reading of the 2017 Tax Act will generate many other topics within the Act that could be important to practitioners. An analysis also will allow an examination in more detail about the key elements that apply within the rules already discussed.

An examination of the proposals that Congress did not pass also is worthwhile. It helps clarify what the law is, how it was changed under the 2017 Tax Act, and what might be coming in new legislative proposals.

***Mark Lee Levine**, CCIM, JD, LLM (Tax), is a professor and Chair Holder, Burns School of Real Estate and Construction Management in the Daniels College of Business at the University of Denver. Contact him at mlevine@du.edu. **Libbi Levine Segev**, JD, MS-RECM, LLM (Tax), is a teaching assistant professor in the Daniels College of Business at the University of Denver. Contact her at libbi.levine@du.edu.*

[38] See Code Section 2056; see also the Levine and Segev text, Chapter 43, cited supra, footnote 2.
[39] Id.
[40] See, for example, Code Section 67(c), where the miscellaneous itemized deduction rule was suspended under the 2017 Act.