Tax Reform Summary for Commercial Real Estate

On Dec. 22, President Trump signed the Tax Cuts and Jobs Act into law making sweeping changes to the tax code. There is some good news for commercial real estate with **1031 like-kind exchanges for real estate being retained**. The Historic Tax Credit for certified historic structures has also been preserved, although the credit must now be taken over a 5-year period.

This summary is intended to highlight those provisions affecting commercial real estate. Please consult a tax professional regarding your individual circumstances.

A more-detailed analysis of the law's impact on commercial real estate is to come so please check back in for updates.

Here are the key provisions of the new tax law impacting commercial real estate:

- **<u>1031 Like-Kind Exchanges</u>**: Eliminates the use of the exchange for personal property but **preserves the exchange for real estate**.

- **<u>Carried Interest</u>**: The new law allows for carried interest to be taxed as capital gains for investments that have been held for three years.

- **<u>Corporate Alternative Minimum Tax</u>**: The new law repeals the corporate AMT.

- **<u>Corporate Rate</u>**: The corporate tax rate has been reduced from a top rate of 35 percent to a flat 21 percent rate.

- **<u>Depreciation</u>**: Cost recovery periods remain the same and do not include the lower recovery periods proposed in earlier versions of the legislation. Nonresidential real property, residential real property, and leasehold improvements retain the 39-year, 27.5 year, and 15-year recovery period, respectively. Separate definitions for qualified leasehold, qualified restaurant, and qualified retail improvement property are replaced with one "Qualified Improvement Property" definition.

- **<u>Estate Tax</u>**: The exemption on estate taxes has been raised from $5 million to a baseline $10 million, which was doubled from a $5 million exemption set in 2011. Indexed for inflation, this exemption is $11.2 million for 2018. The exemption amount reverts to 2017 levels (indexed for inflation) beginning Jan. 1, 2026.

- **<u>Historic Rehabilitation Credit</u>**: The 20 percent credit for the rehabilitation of certified historic structures has been retained but must be taken over a 5-year period. The 10 percent credit for non-certified, pre-1936 buildings has been repealed in the new law.

- **Low Income Housing Tax Credit**: The new law maintains the current low-income housing tax credit of 4 percent or 9 percent (depending on whether tax exempt bonds are used) of the eligible cost of a low-income housing project. The corporate tax rate reduction will reduce the impact of the tax credits and could negatively impact the amount of low-income housing being developed.

- **Mortgage Interest Deduction**: The cap on the mortgage interest deduction has been reduced to $750,000 from $1 million. Current mortgages up to $1 million are grandfathered into the new law. Through Dec.31, 2025, interest paid on home equity debt is no longer deductible unless the loan proceeds are used to "substantially improve" the home.

- **Pass-Through Treatment**: The new law allows a deduction for "qualified business income" from a partnership, S corporation, and sole proprietorship at 20 percent (not 23 percent as had been proposed in prior versions of the legislation). The threshold for the 20 percent deduction is at $157,000 for single filers and $315,000 for joint filers with it being phased out for individuals making up to $207,000 and joint filers up to $415,000.

- **Qualified Opportunity Zones**: This new incentive allows for the designation of opportunity zones in low-income communities and provides tax incentives for investments in these zones, including deferring the recognition of capital gains that are reinvested in the zones. Governors submit nominations to the U.S. Department of the Treasury for the designation of a limited number of opportunity zones.

- **Qualified Private Activity Bonds**: The new law maintains the deductibility of qualified private activity bonds for affordable housing construction, local transportation and infrastructure projects, and for state and local mortgage bond programs.

- **Standard Deduction**: The standard deduction is doubled to $12,000 for single filers and $24,000 for joint filers. The deduction is indexed for inflation. This increase in the standard deduction reduces the number of filers who will be able to take advantage of the mortgage interest deduction and property tax deduction.

- **State and Local Tax Deduction**: Deductions for state and local taxes will now be capped at $10,000, not indexed for inflation, which will mean a higher tax bill for property owners in high-tax states. The new law continues to allow the deduction for state and local property and sales taxes accrued in conducting a trade or business.