The Impact of Potential Obamacare “Repeal and Replace” on Investment Real Estate

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These days it is difficult to avoid a news story that relates to the future of Obamacare, health care or taxes. The presidential election came along with many questions and concerns about the future of such important things. In a market such as ours, where property values and profits can be substantial, even the slightest change in tax rates can have a real impact.

It is hard to imagine that there is a correlation between health care and real estate; however, when it comes to taxes, there certainly is. When the Affordable Health Care Act, or “Obamacare,” became law, many did not realize that it came along with a new separate 3.8% tax (i.e., “Medicare Tax”) on certain investment income, including income derived from the sale of investment real estate. For most who owned investment properties in New York City, this effectively resulted in an automatic capital gains increase of 3.8%. It also came at the same time that the capital gains tax rate increased from 15% to 20%. For all intents and purposes, the capital gains rate increased 8.8% overnight back then. However, the 3.8% Medicare tax portion of that came as an unexpected surprise for most.

The Medicare tax went into effect on January 1, 2013 and impacted taxpayers with an Adjusted Gross Income (AGI) over $250,000 for joint filers, $200,000 for single filers and $125,000 for married individuals filing separately. This 3.8% tax applied to income not derived in the ordinary course of trade or business (i.e., interest, dividends, annuities, royalties and rents, which are not derived in the ordinary course of trade or business) and gains attributable to the sale of property held for purposes not related to trade or business. The tax specifically excluded nonpassive income from S corporations, sole proprietorships, LLCs or partnership income, and does not apply to items which are excluded from gross income under the income tax (i.e., tax-exempt bonds, veteran’s benefits).

Intended or not, this tax directly impacted individuals who were not actively in the real estate business but who owned and profited from. This additional tax impacted income received both from the sale and leasing of such investment properties.

While the tax is not a “home sale tax” per se and does not apply to home sales generally, it may affect income realized from home sales in instances where certain criteria have been met. These include cases where a home sale may result in a capital gain that increases either net investment income or the taxpayer’s AGI. Under these circumstances, if the requisite thresholds are met, the tax applies to the lesser of the two metrics, which are: 1) investment income, or 2) excess of AGI over the $200,000 or $250,000 amount.

This potentially impacts not only second homes or investment properties but primary residences as well. In the case of a primary residence, individuals currently receive a $250,000 exemption on capital gains while married couples receive a $500,000 exemption. However, any income received over these exemption thresholds are subject to both capital gains and Medicare tax.

In March 2017, the Republicans in Congress sought to pass the American Health Care Act, which many had dubbed as “Ryancare” or “Obamacare Lite.” The Trump Administration described this legislation as “Repeal and Replace.” Although it couldn’t garner enough support to even warrant a vote, this piece of legislation would have eliminated the Medicare 3.8% tax. Regardless of one’s political views or political affiliations, generally each piece of proposed legislation has positive and negative impacts.

This particular piece of legislation would have quietly saved many 3.8% on their passive investment income. Most would agree that would be a positive—especially those with real estate investments. I certainly understand that the proceeds from the tax referenced were to be used to fund Medicare expenses and removing such may have a negative impact. But, focusing on the positive, one has to wonder whether less taxes on real estate investment income might result in more real estate investment.

Despite countless hours of media coverage concerning Obamacare and Ryancare, I do not recall ever seeing or hearing anyone discuss this tax reduction and how this could potentially have a positive impact on the real estate market. Whether Obamacare is revised, repealed or replaced, it will be interesting to see whether this additional 3.8% Medicare tax will survive. As things currently stand, although hard to believe, real estate and health care are indeed connected.

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