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Tax Law's Impact on Real Estate Industry

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Published: April 5, 2018

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SAN FRANCISCO—The new tax law promises to have a significant impact on owners, investors and the real estate industry as a whole. In this **exclusive**, Steve Moskowitz, tax attorney with Moskowitz LLP, discusses the impact of tax reform on the real estate industry and the most notable changes to real estate taxation that take effect this year.

GlobeSt.com: How does the new tax law affect the commercial real estate industry?

Moskowitz: With a few exceptions, the new tax law is very favorable for the commercial real estate industry. Owners of pass-through entities may deduct up to 20% of their business income on their tax return. This is subject to certain limits and increased deductions for capital expenditures that will shield income for property owners who make capital investments and improvements in properties.

GlobeSt.com: Please explain the new 20% pass-through deduction that will benefit real estate owners. And what are the limitations on this?

Moskowitz: The new pass-through deduction will benefit commercial real estate owners holding title through partnerships, LLCs and S-Corps generating qualified business income. Rental properties with net income after amortization and depreciation will receive a 20% deduction on net income or a 2.5% deduction on a property's unadjusted basis. The pass-through provision is quite complex, but there are huge potential savings available to commercial real estate investors who carefully plan for these opportunities.

For example, imagine your client owns several rental properties, one of which was purchased many years ago for $2 million and is fully depreciated, but is now worth $20 million. If that property is producing $1 million net income from rent, the 199A deduction is limited by the qualified property limitation (2.5% of the unadjusted basis) to $50,000. If that same client also owns another property, which was recently purchased for $10 million and rents for $1 million per year, that property is not eligible for the section 199A deduction because the depreciation and interest deductions will offset all of its rental income. However, if your client borrows against the older property and pays off the loan for the new property with the proceeds, the second property is then eligible for a $200,000 section 199A deduction. The total section 199A has grown from $50,000 to $250,000.

GlobeSt.com: Does the new tax law retain depreciable lives of nonresidential investments? And how does this work under section 179?

Moskowitz: The new tax law will allow many real estate investors to fully expense qualified new and used property, with a recovery period of 20 years or less, acquired after September 27, 2017 and before January 1, 2023. This is a major tax benefit for the commercial real estate industry and may favorably impact returns to investors.

Under the previous tax rules, the bonus depreciation deduction was limited to 50% of the eligible new property. The new tax law allows bonus depreciation and immediate deduction of 100% of eligible property placed in service after September 27, 2017 and before January 1, 2023. Eligible property is expanded to include used property. These amounts are indexed for inflation for taxable years beginning after 2018.

The new tax law expands the definition of section 179 property to include certain depreciable tangible personal property improvements made to the nonresidential real property as long as the improvements are placed in service after the date the building was first placed in service.

Also, the deductible amount that can be expensed has doubled, from $500,000 to $1 million. This is great news for commercial and short-term rental owners. Non-residential properties can take advantage of Section 179 for fire systems, security systems, roofs and HVAC systems. When 100% first-year bonus depreciation isn't available, the Section 179 tax deduction provides similar benefits.

GlobeSt.com: Anything else commercial real estate professionals should know when filing their taxes this year?

Moskowitz: A 1031 Exchange, which has been part of the tax law for almost 100 years, allows real estate investors to exchange property for a 'like-kind' property without paying taxes immediately on the gain. The tax is deferred until the last 'like-kind' property is sold. The good news is that real estate investors can still leverage the 1031 exchanges under the new tax law.

GlobeSt.com: Where can real estate owners get additional information about the new tax laws that came into effect on January 1, 2018?

Moskowitz: The Urban-Brookings Tax Policy Center's website is a great free resource with a ton of excellent articles from national tax experts. The Tax Foundation's website also has a lot of current information. And don't overlook the IRS website. It is great starting point and has instructions for all of the forms.

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