Current topics and trends in real estate tax

BY MARK LEE LEVINE
WELCOME
Current Topics and Trends in Real Estate Tax

Objectives:

1. Provide an Update on Tax Issues Impacting Commercial Real Estate and Personal Tax Issues
2. See where we are today on these issues;
3. What is likely to Pass or Not Pass in Congress;
4. Provide for Planning Opportunities, given the above points.
References are made to the *Real Estate Transactions, Tax Planning* text, written by Dr. Mark Lee Levine and Dr. Libbi Levine Segev, published by West Publishing Co. (2015).

See also the Levine text, *Exchanging Real Estate*, published by PP&E, c/o Now in Electronic Form and Hard Copy.

Many Slides are with the Courtesy of Professor Mark Vogel.
REMEMBER--

- The Income Tax Law created more criminals than any other act of government! (Barry Goldwater)
PART I  ATRA &
Other Updates

WHAT ARE SOME OF THE
KEY TAX POSITIONS OF THIS
ACT THAT IMPACTED REAL
ESTATE?

HOW DO WE PLAN WITHIN
THE ACT?

WHAT IS NEXT?—PART II
American Taxpayer Relief Act & SUBSEQUENT EVENTS
RECENT AUTHORITIES

AMERICAN TAXPAYER RELIEF ACT OF 2012 (ATRA OF 2012), SIGNED BY PRESIDENT OBAMA ON JANUARY 2, 2013, SUBSEQUENT CASES, RULINGS AND OTHER AUTHORITIES HAVE FURTHER CHANGED THE AREA OF REAL ESTATE TAX PLANNING.
New Tax Rates

Under the American Taxpayer Relief Act of 2012 (ATRA of 2012), new tax rates were created. The tax rates beginning after 2012, that is, beginning January 1, 2013, have tax brackets of 10%, 15%, 25%, 28%, 33%, 35% and the new added 39.6%.

(The 39.6% rate existed and was sunset for some time. However, this was reinstated by the ATRA of 2012.)

SUMMARY OF RATES: 0 TO 39.6%
New Tax Rates

- The 39.6% rate only applies to taxpayers that exceed the threshold amount. The threshold amount, when filling a joint tax return, is $450,000.
- $400,000 for those filing a separate return. If a couple is filing separately, the threshold amount is $225,000 each.
- The tax rate thresholds are adjusted for inflation for years after 2013.
Starting in 2013--Summary

- Brackets: 10, 15, 25, 28, 33, and 35%, and add:
- 39.6% for excess over Thresholds:
- a. Joint Returns: $450,000
- b. Single: $400,000
- c. Married/file separately: $225,000
- Indexed for Inflation after 2013: YES
Changes for 2014

- The 2014 Highest Rates Hit at:
  - A. $457,600—Married/Joint Return
  - B. $406,750—Single
Possible 3.8% Increase Tax

MEDICARE TAX—A FEW QUICK THOUGHTS ON THIS ADDITIONAL 3.8% TAX, WHERE APPLICABLE—

(GOOD EXAMPLES BY PROF VOGEL & IRS)
Net Investment Income Tax

1. What is the Net Investment Income Tax (NIIT)?
The Net Investment Income Tax is imposed by section 1411 of the Internal Revenue Code (IRC). The NIIT applies at a rate of 3.8 percent to certain net investment income of individuals, estates and trusts that have income above the statutory threshold amounts.

2. When does the Net Investment Income Tax take effect?
The Net Investment Income Tax goes into effect on Jan. 1, 2013. The NIIT will affect income tax returns of individuals, estates and trusts for their first tax year beginning on (or after) Jan. 1, 2013.
### Who Owes the Net Investment Income Tax?

3. **What individuals are subject to the Net Investment Income Tax?**  
Individuals will owe the tax if they have Net Investment Income and also have modified adjusted gross income over the following thresholds:

<table>
<thead>
<tr>
<th>Filing Status</th>
<th>Threshold Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Married filing jointly</td>
<td>$250,000</td>
</tr>
<tr>
<td>Married filing separately</td>
<td>$125,000</td>
</tr>
<tr>
<td>Single</td>
<td>$200,000</td>
</tr>
<tr>
<td>Head of household (with qualifying person)</td>
<td>$200,000</td>
</tr>
<tr>
<td>Qualifying widow(er) with dependent child</td>
<td>$250,000</td>
</tr>
</tbody>
</table>
WHO PAYS THIS TAX?

- Taxpayers should be aware that these threshold amounts are not indexed for inflation.

- If you are an individual that is exempt from Medicare taxes, you still may be subject to the Net Investment Income Tax if you have Net Investment Income and also have modified adjusted gross income over the applicable thresholds.
4. What individuals are not subject to the Net Investment Income Tax?
Nonresident Aliens (NRAs) are not subject to the Net Investment Income Tax.

5. What Estates and Trusts are subject to the Net Investment Income Tax?
Estates and Trusts will be subject to the Net Investment Income Tax if they have undistributed Net Investment Income.
What is Included in Net Investment Income?

6. **What is included in Net Investment Income?**
   In general, investment income includes, but is not limited to: interest, dividends, capital gains, rental and royalty income, non-qualified annuities, income from businesses involved in trading of financial instruments or commodities, and businesses that are passive activities to the taxpayer (within the meaning of IRC section 469).

7. **What are some common types of income that are not Net Investment Income?**
   Wages, unemployment compensation; operating income from a non-passive business, Social Security Benefits, alimony, tax-exempt interest, self-employment income, and distributions from certain Qualified Plans, ETC.
8. What kinds of gains are included?

To the extent that gains are not otherwise offset by capital losses, the following gains are common examples of items taken into account in computing Net Investment Income:

• Gains from the sale of stocks, bonds, and mutual funds.
• Capital gain distributions from mutual funds.
• Gain from the sale of investment real estate (including gain from the sale of a second home that is not a primary residence).
• Gains from the sale of interests in partnerships and S corporations (to the extent you were a passive owner).
9. Does this tax apply to gain on the sale of a personal residence?
The Net Investment Income Tax will not apply to any amount of gain that is excluded from gross income for regular income tax purposes. The pre-existing statutory exclusion in IRC section 121 exempts the first $250,000 ($500,000 in the case of a married couple) of gain recognized on the sale of a principal residence from gross income for regular income tax purposes and, thus, from the NIIT.
How does a Single taxpayer with income less than the statutory threshold calculate the Net Investment Income Tax?

Taxpayer, a single filer, has wages of $180,000 and $15,000 of dividends and capital gains. Taxpayer’s modified adjusted gross income is $195,000, which is less than the $200,000 statutory threshold. Taxpayer is not subject to the Net Investment Income Tax.
Examples of the Calculation of the Net Investment Income Tax

How does a Single taxpayer with income greater than the statutory threshold calculate the Net Investment Income Tax?

Taxpayer, a single filer, has $180,000 of wages. Taxpayer also received $90,000 from a passive partnership interest, which is considered Net Investment Income.

Taxpayer’s modified adjusted gross income is $270,000.

Taxpayer’s modified adjusted gross income exceeds the threshold of $200,000 for single taxpayers by $70,000.

Taxpayer’s Net Investment Income Income is $90,000.
The Net Investment Income Tax is based on the lesser of $70,000 (the amount that Taxpayer’s modified adjusted gross income exceeds the $200,000 threshold) or $90,000 (Taxpayer’s Net Investment Income). Taxpayer owes NIIT of $2,660 ($70,000 x 3.8%).
Itemized Deductions

- Change:
  - Phase out of Itemized Deductions;
  - Reduce the benefit of the deductions when TP are in a higher Rate

- BOTH OF THESE PASSED
What Did Congress Do on Itemized Deductions?

- As noted, under ATRA, Congress did deny deductions for those in high brackets
- Joint Returns: >300,000
- Joint/Sep file: >150,000
- Single: >250,000
- Lose 3% of the Amount over Threshold

Phase out of deductions is back
Phase-Out: Itemized Deductions

- Under the American Taxpayer Relief Act of 2012 (ATRA of 2012), there are now phase-outs, again, of itemized deductions; these are what have been referred to as the “PEASE” limitations.

- The intent is to look to taxpayers who have larger adjusted gross incomes and to have a phase-out of the benefit of itemized deductions.

- These rules apply in 2015 as well!
2014 Standard Deduction

CONGRESS PREFERENCES TAXPAYERS TO USE THE STANDARD Deduction!

$6,200—Single
$12,400—Married filing Joint

Phase out for 2014: Starts at:

$254,200—Single
$305,050—Married filing Joint
2014 Exemption and Phase Out

EXEMPTION

AND PHASE OUT! BACK!

2014 Exemption: $3,950

Phase out:

- $254,200—Single
- (full phase out: $376,700)
- $305,050—Married Filing Joint
- (Full phase out: $427,550)
Phase-Out Limitations
Exemptions

- Under the American Taxpayer Relief Act of 2012 (ATRA of 2012), there are now personal exemption phase-out limitations. Under the phase-out as to exemptions, which existed prior to the suspension of those rules under the Bush taxes, the threshold amount is now $300,000 when filing a joint return. It is $250,000 if filing a single tax return.

- This means that if taxpayers exceed this threshold amount, the exemptions claimed are reduced by 2% for each $2,500 or portion thereof which the taxpayer’s adjusted gross income exceeds the threshold amount noted.

- THIS CONTINUES IN 2015
In addition to the rules mentioned, the American Taxpayer Relief Act of 2012 (ATRA of 2012) provides some additional benefits for taxpayers in special earning levels.

For example, where taxpayers have a tax rate below 25%, the long-term capital gains and qualified dividends are not subject to any tax. See Code §1(h)(1)(B).
Capital Gain Rates

Further, even taxpayers who are subject to a rate that is 25% or more on their ordinary income will have a favorable position if their income is below the threshold amount of $450,000 for married couples filing jointly, or threshold amount of $400,000 for taxpayers filing as a single.

That is, their rate will be a maximum of 15% on these qualified long-term capital gains and qualified dividends.
Capital Gain Tax Rate

- Under the American Taxpayer Relief Act of 2012 (ATRA of 2012), the maximum long-term capital gain rate for 2012 was 15%. However, that amount was increased under the ATRA of 2012 to 20% regarding taxpayers with larger incomes.

- Generally speaking, this means that married taxpayers filing jointly with adjusted gross incomes of $450,000 or more will have a 20% maximum long-term capital gain rate.

- This 20% maximum long-term capital gain rate applies to single taxpayers with AGI of $400,000 or more. Thus, these taxpayers with higher incomes who thought they would pay a maximum of 15% for long-term capital gain tax are now subject to an additional 5% tax for a total 20%.
Dividends

Where dividends were subject to a maximum of 15% tax prior to 2013, under the ATRA of 2012, dividends are subject to a potential 20% tax, not 15%, for married taxpayers filing jointly who have adjusted gross income of $450,000 or more.

This threshold amount is $400,000 for individuals filing separate returns that could be subject to this higher tax rate.
Dividends

- Dividends and capital gains can also be subject to the additional Medicare surtax rate of 3.8% on investment income.

- However, this is an additional tax that is beyond the normal capital gain tax or dividend tax noted. This issue is discussed later.)
Standard Mileage Rates

- Business Travel: 56 cents
- Medical & Moving: 23.5 cents
- Charity: 14 cents (amount set by statute)
Guidance on Bonus Depreciation

American Taxpayer Relief Act of 2012 (ATRA 2012):

1. Three types of property qualify for a 15-year recovery period:
   a. Qualified leasehold improvement property (QLIP).
   b. Qualified restaurant property (QRP).
   c. Qualified retail improvement property (QRIP). (See CCA 201203014.)

2. Only QLIP property qualifies for 100% bonus, but:
   a. If property meets definition of both QLIP and QRP, or of both QLIP and QRIP, the property is eligible for bonus.
   b. No bonus if property is only QRP or QRIP and not QLIP.
   c. 50% bonus for 2012 and 2013. Also qualifies for 15 years –MV Per Rev. Proc. 2011-26

SEE CHANGES BY TIPA OF 2014
TABLES FOR comparison-REPEAT
Beginning of 39.6% Bracket

<table>
<thead>
<tr>
<th>Category</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Joint &amp; Qualifying Widow (each)</td>
<td>$450,000</td>
</tr>
<tr>
<td>Single</td>
<td>$400,000</td>
</tr>
<tr>
<td>Head of Household</td>
<td>$425,000</td>
</tr>
<tr>
<td>Married Filing Separately</td>
<td>$225,000</td>
</tr>
<tr>
<td>Estates and Non-grantor Trusts</td>
<td>$11,950</td>
</tr>
</tbody>
</table>
Under the American Taxpayer Relief Act of 2012 (ATRA of 2012), changes were made to the AMT (Alternative Minimum Tax) to provide benefits or relief to those who were not intended, when the AMT was initially passed, to provide for AMT tax.

The change was designed to provide larger AMT exemptions for individuals, whether filing a joint or a separate tax return.

Therefore, under the ATRA of 2012, AMT continues, with the AMT tax rates at 26% or 28%, whichever is applicable. However, the AMT Exemption was increased by the ATRA of 2012.
2014 AMT Exemption

These will be adjusted each year:

- $52,800—Single
- $82,100—Married Filing Joint
Depreciation

- The American Taxpayer Relief Act of 2012 (ATRA of 2012) allowed a number of additional changes for depreciation and related activities.

- For example, under Code §179, there are additional allowances for expensing items that would otherwise have been subject to a smaller limitation under Code Sec. 179.

- Qualified Expenses for Restaurant Buildings, Retail Improvements and Leasehold Improvements can be subject to a 15-year amortization period, as opposed to a longer period of writing off depreciation.
Passenger Cars and Other Vehicles

2. Passenger automobile (or truck or van) not > 6,000 GVW:
   • 2013: $3,160 ($3,360), plus bonus depreciation ($8,000). (2014 - $3,160 & $3,460)
   • 2014: $5,100 ($5,400). (2015 - $5,100 & $5,500)
   • 2015: $3,050 ($3,250). (2016 - $3,050 & $3,350)
   • Then: $1,875 ($1,975). (Then - $1,875 & $1,975)

3. SUV > 6,000 GVW: No §280F limit; $25,000 §179 limit.
4. Truck or van > 6,000 GVW, not an SUV: No limits.
PART II: Example Items and What is Next?

1. More Proposals and Details on What Has Been Discussed so Far.
2. What Is Most Likely To Happen?
3. When Do These Changes Occur?
4. What Are The Implications From The Changes?
Now the Marginal Rate may include:

Rates noted above:
- Thus, highest base rate: 39.6%
- Add 3.8% where applicable
- May add .9% Earned Income Tax
- Capital Gain Rate up to 20% some cases

Marginal Rates for 2014
Areas of Federal Income Tax Planning

Tax Benefits Include:

- Tax Rates (brackets)
- Postponement of taxes (time value of money)
- Exclusions (elimination of taxation)
- Character of Gain/Loss (e.g. long term vs. ordinary capital)
- Deductions
- Credits, Accounting Benefits, and misc. points
- Categories of Income, Loss, Credits
There is great concern for the complexity of the tax law!
“I think it an object of great importance... to simplify our system of finance, and bring it within the comprehension of every member of Congress.”

Thomas Jefferson, 1802.
THE TAX CODE:

Complex?

- 3.8 Million Words
- 579 Changes-2010
- Tax Returns=6.1 Billion Man Hours=
  (3 million working yr)

Who Does Returns?

- 60% Pay someone
- 29 % buy Software*
  * Economist-5/24/12
"The hardest thing in the world to understand is the income tax."

Albert Einstein
TAX TALK PROPOSALS - CURRENT
Time For TAX REFORM
“In 1790, the nation which had fought a revolution against taxation without representation, discovered that some of its citizens aren’t much happier about taxation WITH representation.”

- Lyndon B. Johnson
TAX INCREASE PREVENTION ACT OF 2014 (TIPA)

The following slides cover some of the areas impacted in the real estate tax field by the TIPA of 2014.
Code Section 168(k)—Bonus Depreciation

Under the TIPA of 2014, the unique rule under the Code allowing for a first year 50% deduction for qualified property was extended through 2014. (Property that meets the definition of “longer lived” property and some transportation property are extended through 2015.)

What this means is that the benefit of deducting up to 50% of the cost of the property might apply to allow this acceleration of the depreciation for the property. See Code Section 168(k).
TIPA of 2014 Continues 15 Year Life on Some Property

The TIPA of 2014 continued the special 15 year life rule for qualified property that is leasehold property, restaurant property and some retail property.

Thus, under Code Section 168(e), through 2014, these types of qualified property will be able to use a 15 year life. They could also qualify for the Code Section 168(k) faster 50% first year depreciation write-off.
The TIPA of 2014 extended the special rule allowing some additional first year write off with business autos. Under that rule, in place of the stronger limits of Code Section 280F, limiting, for example, the maximum first year business auto write off in most cases to $3,160, the rule that had been in place through 2013 was to allow up to $8,000 of first year write off. The TIPA of 2014 sustained and continued this position through 2014. See Code Section 168(k).

Thus, with this continuation, the qualified taxpayer with the business auto could qualify the additional $8,000, along with the normal $3,160 auto depreciation limit, making the total $11,160. Without this extension, the limit would have reverted to the annual limit of $3,160.
The accelerated write off that Code Section 179 has allowed, by increasing the amounts that could be deducted in the current year by, placing qualified property in to service, was to have been substantially reduced for 2014. However, under the TIPA of 2014, the larger write off allowed by that Section was extended through 2014.

Thus, the potential of deducting up to $500,000 in the current year a qualified property is placed in service applies through 2014. And, the phase out limits, to reduce such potential deduction, were also continued through 2014.

Thus, there is not phase out loss of this deduction unless there is an amount placed in service in 2014 in excess of 2 million dollars. See Code Section 179.
WHY DO WE NEED TAX REFORM?

- Raise Revenue
- Eliminate “improper” tax positions
- Support decisions that are economically based, not tax driven
- Avoid/reduce complexity
- Increase voluntary compliance

Will Tax Reform Come This Year?
Current Administration Proposals

- Increase Tax Rates-ordinary income; capital gain rates, etc. (THIS PASSED UNDER ATRA)
- Tax “the rich”
- Eliminate loopholes
- Make the tax law more equitable
A Few Of The Many

- Flat Tax Or VARIATIONS
- Value Added Tax
- Reformed Existing System
- National Sales Tax
- Combinations
- Others
Tax reform jitters stymie investors in real-estate projects

With the passage of the House Ways and Means committee tax reform bill, lawmakers created a state of uncertainty and confusion in the federal tax field.

But the bill's bark could be worse than the bite.

For real estate, the potential of changing or eliminating capital gains, modifications of minimum tax and limitations on deductibility of interest and various other expenses create an air of uncertainty.

This uncertainty creates a state of indecision and causes many potential investors to postpone decisions.

Recognizing the concern over the changes, Congress has talked about making them effective in January 1988, or thereafter.

THIS EMPHASIZES a concern in Congress that the proposals create uncertainty among investors.

It is hoped that Congress will recognize that even passing such a bill with the understanding that it could be substantially modified by the Senate, which apparently was part of the compromise to force the bill through the House, does not eliminate the confusion and uncertainty. This in turn generates indecision and a "freezing" of the real estate economy, among others. If Congress recognizes the impact of a proposal, without its becoming law, it can be hoped it will look more carefully at effective dates and the implications of proposals.

We have been faced in recent months with what was referred to as the Treasury proposal, the Reagan proposal, or February 2, various other proposals in the House and the Senate, Republican positions and ultimately the House bill.

HOWEVER, WITH at least as much concern, one should focus on the effective dates of the proposals.

In some instances, such as the potential repeal of the investment tax credit at the end of 1986, this generated investors to sit on the sidelines waiting for what will ultimately be the tax results. As such, this can handicap the real estate economy in many instances.

Mark Lee Levine is a professor, tax attorney and real estate agent.
State Taxes

New York Times News Service

LOTTERY
ODDS OF WINNING: 500 BILLION ZILLION 5/4 MILLION TO ONE

GAS TAX
SALES TAX
INCOME TAX
STUPIDITY TAX

EIGHTY TICKETS, PLEASE!!
"Are you sure this will revitalize the economy?"
New Tax Laws Do Not Answer Debt Issues
In time of this grave national danger, when all excess income should go to win the war, no American citizen ought to have a net income, after he had paid his taxes, of more than $25,000 a year.

- Franklin D. Roosevelt
TRANSITION

- Clean up the old
- Fiscal policy impact
- Monetary policy impact
- Projections: accuracy, dependability?
- How long?
- How to transition?
- Combine various taxes?
- Danger: possible recession? etc?
- Other impacts?
GO AHEAD... RAISE OUR TAXES.

I am ready!
Looking Ahead...
TAX REFORM

FLAT TAX

- A
- B
- C
- D
- E
- F
- G
- H
- I
- J

(GASP)
I was hoping for a flat tax—not a tax flattening...
ESTATE TAX CHANGES
FOR 2013+ UNDER ATRA OF 2013

UNIFIED EST/GIFT EXEMPT:$5 MILLION

YES, Indexed for Inflation (now $5,340,000)

TOP RATE CAN MOVE TO 40% (up from 35%)

Portability of Exemption Continues
Estate and Gift Tax

Under the American Taxpayer Relief Act of 2012 (ATRA of 2012), changes were made in the estate and gift tax rules.

The estate and gift tax positions had been favorable to taxpayers for several years prior to 2013.

There was concern that the benefits of some of those favorable tax positions would be erased. However, Congress acted, with President Obama's signature, under the ATRA of 2012, to provide for the continuing unified exemption of $5 million, which is indexed for inflationary adjustments. (It is $5,340,000 for 2014.)
The highest tax rate was changed from 35% in 2012 to potentially 40% on larger estates for those who die in 2013 and thereafter.

The changes in this Act also allow:

**Portability of the exemption between spouses for estates starting in 2013.**

e.g., if husband and wife are each entitled to an exemption of $5 million, and the husband dies after 2012, having used only $3 million of the exemption, with proper filings, the remaining $2 million of the husband's exemption would be allowed for the wife.

Thus, the wife's exemption of $5 million would be increased with this additional $2 million for a total of $7 million.
Gift Tax—Annual Exclusion

--For 2013: 14,000 (up from 13,000)
--For 2014: 14,000 Remains (RP 2013-35)
REMEMBER--

What Will Rodgers Said:

“The Difference In Death And Taxes Is That Death Doesn’t Get Worse Every Time Congress Meets.”
REMEMBER—

DEATH AND TAXES AND CHILDBIRTH. THERE'S NEVER ANY CONVENIENT TIME FOR ANY OF THEM.

MARGARET MITCHELL
Will Code Sec 1031 Be Repealed?

- History of 1031?
- Reasons to Retain
- Reasons to Repeal
- Maybe just “modify” 1031?