TAX REFORM IMPLEMENTATION

May 9, 2018

TAX CUTS & JOBS ACT

- Signed into law on December 22, 2017
- Provisions Generally Effective in 2018
- Key Tax Reduction Provisions for Multifamily Sunset in Many Cases (e.g., after 2025)
- NMHC requesting Treasury guidance in key areas

TAX RATES

- Prior Law Tax Rates
  - Individual: 39.6 percent max rate (effective at $418,400 single filers / $470,700 married couples)
  - Flow-through entity: 39.6 percent max rate
  - REIT: 39.6 percent max rate on dividends
  - Corporate: 35 percent max rate
- Tax Cuts & Jobs Act
  - Individual: 37 percent max rate (effective at $500,000 individuals / $600,000 married couples) (through 2025)
  - Flow-through entity: 20 percent deduction (29.6 percent max rate) for qualifying business income (through 2025)
  - REIT: 20 percent deduction for REIT dividends (through 2025)
  - Corporate: 21 percent max rate (permanent)

TAX RATES – THE 20% DEDUCTION

- Flow-through entity 20 percent deduction mechanics
  - For taxpayers earning over $157,500 (single filers) and $315,000 (married couples), deduction is limited to *greater* of:

    1. 50% of the taxpayer's share of aggregate W-2 wages paid by the business; OR
    2. 25% of the taxpayer's share of aggregate W-2 wages paid by the business *plus* 2.5% of the unadjusted basis, immediately after acquisition, of all qualified property (i.e., structures but not land).
  - For taxpayers over thresholds, no deduction for specified services, including: Consulting, brokerage services, financial services, trades or business based on the skill or reputation of one or more employees or owners, or services that involve investing and investment management or dealing in partnership interests.
  - Applies only to property held at the end of a taxable year.

TAX RATES – THE 20% DEDUCTION

Scenario: A multifamily firm purchases an apartment building for $20 million ($14 million attributable to the structure, $6 million attributable to the land). The building generates net annual income of $1.25 million.

Maximum Deduction Before Limitation: The maximum pass-through deduction would be $250,000 (20% of $1.25 million).

Deduction Limitation Calculation: The deduction would be limited to 2.5 percent of unadjusted basis (i.e., 2.5 percent of $14 million), or $350,000.

Maximum Deduction Available to Taxpayer: The taxpayer gets the full deduction of $250,000, regardless of the wage limitation.

TAX RATES – THE 20% DEDUCTION

- NMHC Asking Treasury to Clarify:
  - Taxpayers can group multiple partnerships into a single trade or business.
    - Statute does not define trade or business.
    - Grouping may be helpful if taxpayer has:
      - Buildings with no or little qualifying basis and other buildings with significant basis
      - Management company separate from the real estate
  - All REIT dividends eligible even if held through mutual fund.
  - In case of Like-Kind Exchange, basis in acquired property should be no less than basis of relinquished property plus cash provided for in the exchange.

TAX RATES – THE 20% DEDUCTION

<u>Two Multifamily Buildings</u>

Building 1: Cost Basis of $20 million ($14 million attributable to the structure, $6 million attributable to the land). The building generates net annual income of $1.25 million.

Building 2: Fully Depreciated but generates $1 million in annual income.

<u>Deduction for Each Building Computed Separately</u>

Building 1: Maximum Deduction Before Limitation: The maximum pass-through deduction would be $250,000 (20% of $1.25 million).
Building 2: Maximum Deduction Before Limitation: The maximum pass-through deduction would be $200,000 (20% of $1 million).

Building 1: Deduction Limitation Calculation: The deduction would be limited to 2.5 percent of unadjusted basis (i.e., 2.5 percent of $14 million), or $350,000.
Building 2: Deduction Limitation Calculation: The deduction is limited to 2.5 percent of unadjusted basis ($0), or $0.

Maximum Deduction Available to Taxpayer: The taxpayer gets a $250,000 deduction ($250,000 from building 1 plus $0 from building 2).

<u>Deduction for Both Buildings Part of a Group</u>

Maximum Deduction Before Limitation: The maximum pass-through deduction would be $450,000 (20% of $2.25 million).

Deduction Limitation Calculation: The deduction would be limited to 2.5 percent of unadjusted basis (i.e., 2.5 percent of $14 million), or $350,000.

Maximum Deduction Available to Taxpayer: The taxpayer gets a deduction of $350,000.

DEDUCTIBILITY OF BUSINESS INTEREST

- Prior Law
  - Business interest fully deductible.
- Tax Cuts & Jobs Act
  - Imposes limitation on business interest (exempts firms with less than $25 million in average annual gross receipts over past three years).
  - Real estate companies may elect to maintain full deductibility of interest.
  - Election requires longer depreciation period for buildings.

DEPRECIATION

- Prior Law
  - Depreciation of Residential Structures: 27.5 years.
  - Depreciation of Tangible Personal Property: Bonus depreciation through 2019 / MACRS thereafter.

- Tax Cuts & Jobs Act
  - Depreciation of Residential Structures: 30 years if electing out of limits on interest deductibility, otherwise 27.5 years.
  - Statute requires 40-year depreciation for structures in existence prior to 2018 for firms electing out of interest.
    - NMHC is asking Congress / Treasury to clarify existing structures be depreciated over 30 years.
  - Depreciation of Tangible Personal Property:

1. Full expensing through 2022.
2. Bonus depreciation thereafter through 2026 (80% in 2023, 60% in 2024, 40% in 2025, and 20% in 2026).

ACTIVE LOSSES

- Prior Law
  - Active business losses fully deductible against active business income.
- Tax Cuts & Jobs Act
  - Deduction of net active pass-through losses against wage or portfolio income limited to $500,000 (married filers) and $250,000 (single filers).
  - Disallowed losses may be carried forward as part of a taxpayer's net operating loss.
  - Provision effective through 2025.

OPPORTUNITY ZONES

- Opportunity Zones Designed to Drive Investment in Distressed Communities
- Up to 25 percent of Census Tracts may qualify as Opportunity Zones (states designate)
- Once Opportunity Zones certified, Opportunity Funds can be created to invest deferred capital gains:
  - Capital gains invested in Opportunity Funds may be deferred to as late as 2026
  - 10% basis step up if held at least five years, 15% basis step up if held at least seven years
  - No tax on Opportunity Fund gains held at least 10 years
- NMHC pushing to ensure multifamily housing will qualify and that Zones may be used in conjunction with LIHTC / NMTC.

LOW-INCOME HOUSING TAX CREDIT

- Prior Law
  - LIHTC in law to help finance affordable units.
  - Private Activity Bonds support LIHTC.
- Tax Cuts & Jobs Act
  - LIHTC and Private Activity Bonds retained as under prior law.
  - Lower corporate tax rate and chained CPI could lead to loss of 235,000 affordable units over next 10 years (Novogradac and Company LLP).
  - Recent Legislation: 12.5% increase in 9 percent Credits (2018-2021) & "Income Averaging"
  - NMHC now pushing for flat 4% LIHTC and reintroduction of MIHTC

ENERGY, FIRPTA & PARTNERSHIP AUDITS

- Energy
  - February: Congress extends two energy incentives (179D/45L) through 2017
- FIRPTA
  - March: Foreign pension funds exempt from FIRPTA include government funds and multi-employer funds. Also, REIT dividends received by foreign pension funds are FIRPTA exempt.
- Partnership Audits
  - March: Partnerships can push out adjustments through multiple tiers as IRS proposed in December 2017. Partnerships can also "pull in" adjustments as part of new partnership audit regime effective in 2018.

THANK YOU

- NMHC will seek to ensure regulations implementing the provisions operate as Congress intended.
- NMHC will look to make permanent beneficial tax provisions that expire.

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