

Musings on the Unified Tax Reform Framework - What It Means for the Real Estate Industry

October 2, 2017

This September, the Trump Administration, the House Ways and Means Committee and the Senate Finance Committee released a unified framework for a major tax reform effort. The framework is not a set of detailed legislative proposals, but rather is to serve as a template for the tax-writing committees in Congress that will develop legislation to implement the goals of the framework. The proposals in the framework are far reaching and would have a significant effect on broad sectors of the economy.

Following are some preliminary observations on how the proposals in the framework may impact our clients in the real estate industry.

- There would be a temporary ability to fully expense investments in depreciable assets for five years, but the full expensing will not be available for "structures." It is unclear whether taxpayers will be permitted to identify building components as non-structural through cost segregation studies and thus as eligible for full expensing. It is unclear whether intangibles such as goodwill will be eligible for full expensing.
- There is no reference to any potential elimination or limitation on tax deferred exchanges under Code section 1031. There had been some speculation that this could be in the mix as part of a tradeoff for full expensing, but section 1031 seems to have survived, with real estate not being eligible for full expensing.
- Interest deductibility will be limited for C corporations. The Congressional committees will consider the appropriate treatment of interest paid by non-corporate taxpayers. This will make the use of C corporation blockers for foreign investors much less attractive.
- The estate tax is proposed to be eliminated. In the past, repeal of the estate tax has come at the cost of carryover basis at death. Real estate owners and investors may be worse off if basis step up rules are eliminated as occurred in 2010 the last time the estate tax repeal went into effect. Underwater properties with significant debt in excess of basis will be a "forever" problem.
- The elimination of the estate tax will make direct investment by foreign individuals through partnerships feasible and more attractive alternative to a corporate blocker.
- There would be a new business income tax rate of 25% for partnerships. There is a vague reference to rules to prevent the recharacterization of "personal income" into business

income. Whether this is intended to refer to payments for services or could result in real estate investment income being classified as higher taxed personal income is unclear.

- There is no discussion of any change to long-term capital gain rates for individuals.
- There is no reference to carried interest reform. On the contrary, there is a hint of an opportunity to access the 25% business income rate if sponsors can successfully structure promotes as non-wage service “business income.”
- The framework would preserve the low income housing tax credit as well as the R&D credit, but other business credits, such as the new market tax credits and historic rehabilitation credit, could be eliminated in the discretion of the tax writing committees, subject to budgetary considerations. The value of the LIHTC to investors may, however, be negatively impacted by the reduction in corporate in business tax rates.
- The itemized deduction for state and local taxes is proposed to be eliminated. This proposal is generating a great deal of political opposition, but if implemented it would make living in high-tax jurisdictions less affordable and could impact real estate prices.

If you have any questions or would like to further discuss how these proposals could impact your business, please feel free to reach out to any of the members of the [Tax Group](#) at G&S. We will continue to monitor developments as the framework moves through tax-writing and political process and will provide our clients and friends with updates of significant developments.

This advisory should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended for general informational purposes only, and you are urged to consult your own lawyer concerning your situation and any specific legal questions you may have.