Practice Update

Tax Reform: The Impact on Real Estate

February 8, 2018
By Sanford J. Davis and Peter O. Larsen

The new tax law commonly referred to as the "Tax Cuts and Jobs Act" (the "Act") – signed into law on December 22, 2017 – makes far reaching income tax law changes that will impact both commercial and residential real estate. This Akerman Practice Update focuses on the provisions most relevant to real estate investors, operators, managers, developers, REITs, and funds. The below areas of analysis are hyperlinked to facilitate navigation of this update

In reviewing the below analysis of the myriad and substantial changes to the tax law, please contact the authors or a member of our real estate team for any questions, comments, or further discussion.

Changes in Tax Rates and Deductions

Related People

Richard Bezold
Sanford J. Davis
Peter O. Larsen
Eric D. Rapkin

Related Work

Corporate Tax
Federal Tax Litigation and Controversy
Real Estate
Real Estate Acquisitions and Sales
Real Estate Financing
Tax

Tax Reform

Sweeping Changes to Federal Tax Law and the Impact on Businesses and Individuals

New Law Delivers a Bundle of Executive Compensation and Employee Benefits Changes for the Holidays

The Act makes major changes to the taxation of individuals, pass-through entities, and corporations, the highlights of which are as follows:

Pass-Through Taxation

Tax rates for individuals on business income earned through tax “pass-throughs”-- meaning partnerships, limited liability companies and partnerships, sole proprietorships and S corporations -- have been meaningfully reduced under the Act by two changes: (1) first, a 2.6 percentage point reduction in the top marginal income rate, from 39.6% to 37%, and (2) second, a potential further reduction to 29.6% for certain income that is “qualified business income” (“QBI”). Together, these two rate reductions for ordinary income represent a 10 percentage point reduction from the pre-Act 39.6% top individual marginal rate -- this is real relief for owners of pass-through businesses including real estate owners and investors that earn rental income. The rate reduction on QBI to 29.6% is not automatic, but rather importantly turns on the relative amounts of the underlying business’ qualifying income, wages and tangible property investment, with exception for ordinary income from REITs and Publicly Traded Partnerships (PTPs).

The potential optimum QBI 29.6% rate arises from the new deduction against taxable income generally equal to 20% of the sum of QBI from each qualified trade or business and certain income of REITs and PTPs (effective through 2025) -- the QBI deduction amount depends on the individual’s taxable income, QBI, and the applicable qualified business wage and property factor limitations.

Under the 20% QBI deduction wage and property limitation, the deduction generally may never exceed the greater of two referenced amounts, one based on “wages” and the second on a hybrid of “wages” and “tangible property” of each qualified business, as follows:

New Act Eliminates Deduction for Settlement of Sexual Harassment Claims Subject to a Confidentiality Agreement

- 50% of W-2 wages paid to employees, or
- 25% of W-2 wages paid to employees plus 2.5% of the acquisition cost basis (unadjusted) of tangible, depreciable assets including personal and real property used in the business and which are not fully depreciated.
- Only when the full 20% QBI deduction is realized after application of the "wage and property" limitation does a business owner realize a full 20% QBI deduction and an effective 29.6% tax rate.
- The 20% QBI deduction does not apply for self-employment and net investment income (i.e., Medicare) tax purposes.

Dividends of ordinary income from REITs, as well as PTPs taxed as pass-throughs, are <u>not</u> subject to the QBI wage and property limitation (i.e., REIT and PTP ordinary income automatically receives the full 20% deduction and is taxed at the optimum QBI pass-through rate of 29.6%). The Act does not change the 20% tax on REIT distributions of capital gain. PTP distributions to the extent of qualified income and ordinary income realized by PTP holders from disposition of the PTP interest (allocable to non-capital gain assets) will receive the full 20% QBI pass-through deduction.

Income from "specified service trades or businesses" (e.g. medical, accounting, investment management, trading, and dealing in securities, and law) and the performance of services as an employee generally are not eligible for the QBI deduction except for lower income taxpayers.

Owners with taxable income below a threshold amount ($157,500 or, in the case of a joint return, $315,000) automatically qualify for a full 20% deduction, without being subject to either the "wage and property" limitation or the specified service limitation. The wage and property limit phases in proportionately and becomes fully applicable upon the first $50,000 of taxable income above the relevant threshold (or the first $100,000 of taxable income above $315,000 in the case of a joint return).

Akerman Insights

- The 29.6% rate for REIT dividends resulting from the automatic 20% deduction on REIT ordinary income dividends will allow REITs to stay largely in step with the rate reduction afforded corporations, giving REIT investors an approximate 10 percentage point tax rate reduction compared to pre-Act law and an approximate 6.4 percentage point overall rate current advantage over corporate shareholders after two levels of tax. Similar favorable treatment is accorded to PTP qualified business income such as real property rental income or oil and gas income (while fees generated by investment management PTPs would not qualify).
- Realization of the optimum 29.6% QBI rate by other categories of pass-through business owners is by no means a certainty, as the net result will be facts and circumstances based, rather than industry specific. The "wage and property" limitation alternative prong providing a 2.5% of tangible property factor (added by the final Conference agreement) might enable businesses with substantial capital investments and relatively small payrolls to better realize the full 20% QBI deduction and obtain the optimum QBI 29.6% pass-through rate. Real estate companies, with sufficient "wage and property" limitation factors, would benefit to the extent they generate ordinary income (capital gains remain taxable generally at 20%). To better reach their full 20% QBI deduction, real estate companies with small payrolls may end up utilizing the alternative prong 2.5% of tangible property cost factor, rather than the purely payroll-based factor. For example, a pass-through real estate business owned by a family may have a low payroll relative to its net rental income but a high investment in real estate that would drive the governing "wage and property" limitation amount.

- While the Act limitation on deductibility of state and local income taxes (discussed below) will impact real estate owners along with other pass-through business operators, the maximum 10 percentage point reduction from pre-Act law tax rates under the 29.6% QBI pass-through rate, where obtainable, should in terms of taxes saved more than offset the lost federal tax savings from non-deductibility of state and local income tax. However, for employee and capital "lite" businesses whose W-2 wage and property cost factors are not sufficiently large relative to business income, the loss of federal tax savings from the cap on deductibility of state and local income taxes will have a greater impact.
- For example, a California pass-through realty development business, owned by two principals, that subcontracts out many functions may have both low wage and property limitation factors leaving their effective tax rate near 37% while their California income taxes (borne at a maximum 13% rate) would no longer be fully deductible -- in that case, the lost federal tax savings from deduction of their California income taxes (representing in 2017 about 5% of their income, i.e., 39.6% of 13%) would be greater than their tax benefit under the 20% QBI deduction. Alternatively, if the California company were a tech start-up, with large option and appreciation right incentive compensation programs, but low base compensation, and low cost personal property, a pass-through tax structure may not produce any significant QBI deduction benefit, unless the business acquired real estate to house its operations. Similar effects and considerations apply to businesses operating in other high tax locations such as New York City, where the combined state and local rates together exceed 10%.
- Some businesses may determine that the lower overall Act tax burden to shareholders under a regular C corporation tax structure -- under a 39.8% combined federal rate from both corporate and shareholder level taxes -- is more beneficial

or appropriate than a pass-through structure. Factors in this calculus include the (A) 8.6-to-16 percentage point spread assuming no corporate distributions when compared to the higher 29.6% QBI and 37% general individual rates, (B) capital expenditure needs of the business, projected cash flow, and likelihood of desired periodic cash distributions of earnings, (C) benefit of corporate tax deductibility of state and local income taxes, and (D) necessary amounts of wages and tangible property under the "wage and property" limitation factors to generate the maximum 20% QBI deduction under a pass-through structure.

State and Local Taxes

Individuals now face a new $10,000 cap on their deduction of certain taxes for federal tax purposes: (i) all state and local income (or sales taxes in lieu of income taxes), and (ii) state and local property taxes that are not paid or accrued in carrying on a trade or business or an investment activity. In contrast, the Act does not change the deductibility of state and local income taxes of corporations.

- The new $10,000 cap for individual deductions applies to taxes paid directly with regard to income earned via pass-through entities as well as to an allocable share of income tax paid by a pass-through entity.
- Congress, as part of the final bill reconciliation maneuvers, preserved the deductibility of property (but not income) taxes paid in carrying on a business or an activity related to the production of income.

Akerman Insights

- The limitation on state income tax deductions will increase the effective cost of the state and local tax burden by 39.6 cents per state income tax dollar (representing the pre-2018 federal tax savings from the deduction of state and local tax under pre-Act maximum individual federal rates)

-- e.g., assuming a state individual income tax rate of 5%, the loss of deductibility at the federal level would raise the cost of such taxes from $3.02 to $5 per $100 of income. Real estate owners (both operators and regular businesses) otherwise fare well to the extent that state and local property taxes incurred in a trade or business or an investment activity remain fully deductible outside of the $10,000 cap.

Estate Tax

The Act doubles the estate tax exemption to $22.4 million for married couples and to $11.2 million for unmarried individuals. The Act does not eliminate the income tax basis step-up to fair market value for property held at death, which will therefore continue to shelter appreciation on such assets.

Akerman Insights

- The Act lessens the estate tax burden on all business property owned by the family, whether farms, real estate, or closely held businesses, while continuing the valuable basis step-up for property passed on to the next generation, a feature on the chopping block whenever estate tax repeal is discussed.

Link to Top

Like-Kind Exchanges

Tax-free treatment of like-kind exchanges of real estate (other than held primarily for sale) was preserved but exchanges of personal property generally after 2017 will no longer qualify (including the portion of realty exchanges attributable to personal property associated with real property). The new provision applies to exchanges completed after December 31, 2017, unless it is a deferred exchange that started in 2017.

Akerman Insights

- The continuation of tax-free like-kind exchanges for realty represents an important item that the Act does not change, as a complete repeal could have a destabilizing effect on the real estate market (e.g., reduced purchases, sales, and reinvestment). This continuing benefit is particularly welcomed by real estate businesses as well as operating companies changing or expanding their place of operations.
- Large vehicle, transportation, and equipment lessors that have implemented large volume like-kind exchange structures may benefit from lower costs and a simplified structure by eliminating their LKE structures. It is possible, however, that individual states may "de-couple" from federal law and not allow 100% expensing of equipment which was intended to replace the need to use like kind exchanges for such property.

Link to Top

Excess Business Loss Limits and New NOL Carryover Rules

Losses generated in active business activities by non-corporate taxpayers (starting 2018 and ending in 2025) can be used to offset not more than $250,000 of non-business income (or $500,000, in the case of a joint return), under a provision that received little attention before its enactment. This rule is in addition to the passive loss rules that (since 1986) prohibit a non-corporate taxpayer from using passive losses to offset active business or portfolio income -- with this new active business loss limitation, active business losses have no utility against passive and portfolio income above the $250,000 or $500,000 allowance.

- Business losses in excess of the currently deductible portion may be carried forward and used against active business income in future tax years.
- The Act made several important changes to the net operating loss (NOL) rules for individual and

corporate taxpayers -- eliminating the two-year NOL carryback period and providing an indefinite carry forward period, while imposing an 80% ceiling on the amount of taxable income that can be offset by NOL carryforwards.

Akerman Insights

- The new excess business loss limitation for individuals generally will negatively impact real estate operators and developers, typically structured in pass-through form. The new 80% limitation on NOL utilization, which creates an effective minimum rate of approximately 4.2% under the new 21% corporate tax regime, and fashioned after the 90% of AMTI limitation on NOLs under the former Alternative Minimum Tax (now repealed by the Act), will significantly impact all industries except insurance.

Link to Top

Limitation on Interest Expense

All taxpayers may deduct business interest expense only to the extent of the sum of (i) net business interest income and (ii) 30% of adjusted taxable income (ATI) (together, the “Interest Limitation”). Starting in 2018 and ending in 2021, ATI is defined as earnings before interest, tax, depreciation, and amortization. After 2021, depreciation and amortization deductions are not added back to reach ATI. The Interest Limitation essentially allows business interest expense deductions first up to the extent of business investment income and then up to 30% of business income as measured by ATI. Any interest that is not deductible in the year it arises may be carried forward indefinitely (contrary to the House bill originally limiting carry forwards to 5 years). Carried forward interest expense of a corporation is subject to the Section 382 limitation on use upon a change of control event.

- The Interest Limitation applies to all existing debt with no grandfather provision.

- Small businesses are exempt from the new limit provided they have annual gross receipts in the prior three years of $25 million or less (unless 35% or more of its losses are allocated to limited partners or entrepreneurs).
- A real property trade or business (broadly defined) may irrevocably elect to be exempt from the Interest Limitation if it elects to depreciate real estate straight line under the ADS (Alternative Depreciation System) recovery periods -- i.e., over 30 years for residential rental real property, over 40 years for commercial real property, and 20 years for Qualified Improvement Property (QIP). The election represents a trade-off between full deductibility of interest and lost depreciation expense in the front years. Farming businesses can also elect out provided they use ADS for farm business property.
- The amount determined to be deductible based on partnership ATI is taken into account in determining the partnership's non-separately stated taxable income or loss each year. If a partner holds an interest in more than one partnership, the limitation is determined separately for each partnership.
- Complex rules apply to the utility and carryforward of actual business interest expense above the new limitation as well as amounts of unused or excess Interest Limitation (i.e., unused Interest Limitation).

Akerman Insights

- The new limitation on interest deductibility may considerably further reduce the allowable deduction after 2021 when the ATI definition is measured net of depreciation and amortization expense (i.e., the 30% limit will apply to a lower earnings base-line).
- To determine whether a real estate business should elect to be exempt from the 30% limitation, quantitative modeling is needed to determine

whether there would be a net increase or reduction in deductible expenses when considering both the reduction in depreciation from a change to ADS depreciation (i.e., straight-line depreciation over 30 years for residential property and 40 years for non-residential property) and the increase in interest deductions by electing out of the 30% limitation. As a practical matter, some real estate businesses may find, given their level of net income and cost of borrowing, that they generally cannot, or do not need to, borrow above a threshold amount that would generate interest expense above the 30% limitation and therefore would gain little benefit under the election. Real estate businesses will also need to anticipate the change in the ATI base-line after 2021 to EBIT, which should then materially reduce the available interest deduction. Some operating businesses may find that leasing business assets and real estate is more tax efficient than owning where debt financing is needed.

Link to Top

Carried Interest

New Code Section 1061 partly cuts back the favorable treatment of carried interest profits in a manner quite differently than prior proposals eliminating capital gain treatment altogether. Under Section 1061, gain allocated "in respect of" the carried interest will qualify as long-term capital gain only if the underlying asset giving rise to the allocable gain was held for more than three years. The provision's language is designed to target managers and sponsors of hedge, venture capital, and private equity funds, though its reach may be broader.

- The Act defines a "carried interest" subject to this rule by reference to a partnership interest received in connection with the performance of "substantial services" in an "applicable trade or business” but leaves “substantial services” undefined.

- An applicable trade or business means either (i) raising and returning capital, or (ii) either investing or developing activities with respect to “specified assets.”
- Specified assets are defined broadly to mean securities, commodities, or real estate held for rental or investment as well as options or derivatives in the foregoing (and interests in partnerships relating to any of the foregoing).
- Exceptions are provided for allocations in respect of either (A) a capital interest commensurate with capital contributions or (B) amounts included in income by reason of a compensatory transfer of the applicable partnership interest upon grant or vesting. Many open issues will need to be clarified by the IRS under both exceptions.
- Also excepted are equity interests granted to employees of entities other than the issuing partnership where the employing entity conducts a business that is not an “applicable trade or business” (but the holder is required to provide services only to that employing entity). This provision’s apparent purpose is to allow key employees of portfolio companies to receive profits interest grants and capital gain treatment under the normal one-year threshold.
- The new three-year holding period also applies to the carried interest itself, meaning that gain from the sale or other disposition of a carried interest will not be long-term capital gain unless held for more than three years.

Akerman Insights

- The Act creates uncertainty on the scope of Section 1061, in subsection (b), by giving the Treasury regulatory authority to write regulations that determine that the carried interest provision “does not apply to income or gain attributable to an asset that is not held for portfolio investment on behalf of third-party investors." No further clarification is indicated in the explanation accompanying the Act. This language suggests an outer-limit to the relationships in partnership form where the new three-year holding period should no longer apply. The regulatory exception granted focuses on the absence of two related elements generally central to the fund manager-investor relationship context -- a true third-party investor who is not actively engaged in providing substantial service and to whom the specified asset has a portfolio asset character.

- The carried interest rule will generally apply to all fund managers and employees that hold partnership interests. However, the new rule will not impact funds that typically hold portfolio investments (i.e., specified assets) for more than three years. Notably, the rule also carves out what appears to be an exception for key employees of lower tier operating companies, but further guidance on its application and reach is needed. There may be a further carve-out, as suggested by Section 1061(b), where there is really no partnership or JV with a passive third-party investor, but clarification from Treasury and IRS is needed.

Link to Top

Business Property Cost Recovery

Bonus Depreciation

Bonus depreciation provisions under pre-Act law allowed businesses to deduct 50% of the cost of certain eligible depreciable tangible personal property and realty improvements in the year placed in service under a variety of specific subcategories.

- The Act is intended to change prior law, as clearly evidenced in the accompanying Joint Explanatory Statement, by doubling the bonus depreciation rate to 100% and consolidating the eligible property categories into a new single QIP category eligible for bonus depreciation (the "Act bonus depreciation framework"). The Act retains the election not to claim bonus depreciation, and adds a one-year provision to use 50% bonus depreciation solely for property acquired in the first taxable year ending after September 27, 2017. Cost basis not recovered under a bonus depreciation allowance may be recovered under regular depreciation methods.

- A second major change under the new bonus depreciation framework is the elimination of a "first user" requirement of pre-Act law. Taxpayers may claim bonus depreciation on property with a prior use history (if acquired from an unrelated party).
- For tax years after 2022, under the new Act bonus depreciation framework the allowable expensing percentage steps down in 20 percentage point increments, ending in 2026 with a rate of 20%, and is completely phased out thereafter.
- Due to legislative drafting oversight, specifically, Section 168(e)(3)(E) -- the provision generally describing property to which a 15-year recovery period applies -- was not properly amended to include QIP.

Akerman Insights

- Until a technical correction or interim IRS pronouncement is made, the treatment of property meeting the QIP criteria will be uncertain. However, given the centrality of these provisions to spur capital investment, a fix should occur and be retroactive to January 1, 2018. The present interim uncertainty may well slow capital investment in 2018 (that might otherwise occur without the legislative defect).
- Real estate businesses are front line beneficiaries of the Act bonus depreciation framework applicable to qualified improvements, though bonus depreciation may result in negative effects under New York tax law, based on positions of the

NYS Department of Taxation that require NYS adjustments to federal income even where there is no federal tax benefit obtained (a problem existing before the Act).

Regular Depreciation

The Act did not shorten the general period for depreciation of real estate under the regular MACRS method (as the Senate and Joint Committee versions of the bill did not adopt the House approach to shorten regular depreciation periods under MACRS to as short as 25 years). Regular MACRS continues to depreciate non-residential real property (buildings and structural components) over 39 years and residential rental property (buildings and structural components) over 27.5 years.

The new law, however, makes the following changes for property placed in service after 2017:

- Adding a new 15-year depreciation period for QIP (replacing the pre-Act categories of qualified leasehold improvements, qualified restaurant property, qualified retail improvement property, and qualified improvement property) significantly without regard to pre-Act requirements that the improvements are subject to a lease, placed in service more than three years after the date the building was first placed in service, or made to a restaurant building. Due to the Act drafting error noted above, the Code was not properly amended to provide for the new QIP category as 15-year property.
- Shortening to 30-years the depreciation period under the Alternative Depreciation System (ADS) for residential rental property (from 40 years), with no change in the 40-year ADS depreciation period for nonresidential property, and shortening to 20 years ADS depreciation for certain qualified interior building improvements.

Real estate businesses that elect out of the new 30% of ATI limitation on business interest expense (see discussion above) are required to use ADS depreciation.

Akerman Insights

- The Act largely retains MACRS but introduces the newly defined QIP category qualifying for 15-year depreciation and shortens some ADS recovery periods (to periods not substantially longer than general MACRS recovery periods). The ADS recovery periods apply to real estate businesses electing out of the Interest Limit. Critically, as noted above in the depreciation discussion, interim IRS guidance and technical correction legislation is needed to clarify the treatment of QIP for purposes of the intended 15-year MACRS recovery period and eligibility for bonus depreciation. Due to the centrality of the Act bonus depreciation framework, one would expect that to occur in early to mid-2018 and be fully retroactive.
- Clients investing in QIP need to be speaking closely with their tax return preparers regarding the appropriate treatment under the bonus and regular depreciation rules.

Link to Top

Funds

All of the above provisions can impact real estate funds and their investors and managers. A few other new provisions of potential relevance in the fund setting are as follows:

Individual Investors

An investor's share of fund expenses, including management fees paid by the fund, are not deductible during the 2018-2025 period as a miscellaneous itemized deduction due to the latter's temporary repeal by the Act. Such expenses may not be capitalized as part of the investor's cost basis, so the investor will not receive any tax benefit from its share of management fees paid to fund managers. (Under pre-Act law, such expenses were deductible to the extent such expenses exceed 2% of adjusted gross income.)

Tax Exempt (TE) Investors

- *Excise Tax:* The Act provides for a 1.4% excise tax on the net investment income of a private institution of higher education of a certain size (i.e., at least 500 tuition-paying students, more than 50% of which are in the United States, and an asset value of $500,000 per student excluding assets used by the institution in its educational purposes) that would apply to income from an investment fund.
- *UBTI Computation:* Under the Act, a TE Investor may no longer use an NOL from one trade or business to offset UBTI (meaning unrelated business taxable income) from another trade or business. Rather, the NOL must be carried forward and used only against income of the same trade or business. The application of these new limitations in the context of debt-financed income is not clear under the new provision. These new UBTI rules may prompt TE Investors to use blocker entities or request contractual limitations on the percentage of fund capital that may be invested in operating company pass-throughs that generate UBTI (including debt financed income). Absent blockers, TE Investors may require separate information reporting from the fund of net income and loss sourced to each operating partnership that the fund is invested in.

Foreign Investors

- *Foreign Investment in Real Property Tax Act (FIRPTA):* The Act makes no changes to FIRPTA regarding taxation of the disposition of U.S. real property interests.
- *Investments in Rental Real Estate:* Foreign individual investors investing through pass-

throughs would benefit potentially from the 20% QBI deduction against income generated by U.S. real estate rental business (subject to the same limits that apply to domestic taxpayers) and otherwise continue to benefit from capital gains rates on FIRPTA gain on disposition. Foreign investors that invest through a U.S. corporate blocker will benefit from the 14% rate reduction (from the pre-2018 corporate tax rate) on both rental income and gain on sale, but the new corporate rate alone does not make a corporate investment structure more tax-efficient than a pass-through investment structure.

- *Sale of Partnership Interests:* The Act overrides the recent Tax Court decision in *Grecian Magnesite* by imposing U.S. tax on gain on the sale by a foreign person of an interest in a pass-through entity to the extent a sale of the underlying partnership assets would produce effectively connected income (ECI), apart from FIRPTA gain attributable to U.S. real property. These new rules apply generally even where the disposition of a partnership interest is otherwise within a non-recognition provision, but provide Treasury regulatory authority to prescribe situations or conditions where a non-recognition provision may apply to defer gain recognition.
- *New Withholding Tax:* A buyer must now withhold 10% of the gross purchase price on the sale by a foreign person of an interest in a partnership unless the seller establishes that it is a U.S. person or that no portion of the gain is attributable to ECI-generating assets. Funds should consider requiring as a condition of transfer that the fund receive a copy of the withholding certificate and evidence of payment of withholding tax. The new withholding obligation should also apply to redemptions of foreign investors, although not explicit in the new provision. The 15% withholding tax applicable to dispositions of U.S. real property interests by foreign persons continues to apply.

Akerman Insights

- The foregoing new provisions impose on a range of investors some form of new tax cost on income or gain from investing in a U.S. fund.

Link to Top

Tax Credits and Bond Financing Provisions Relating to Real Estate Development

The Act on the whole preserves most capital market-related tax incentives that support financing for real estate projects and introduces a new "opportunity zone" concept to spur certain geographically targeted investment, as follows:

- *Historic Preservation and Rehabilitation Tax Credits:* The 20% credit for qualified rehabilitation expenditures made to rehabilitate certified historic structures is retained, with the change that the credit must be claimed ratably over a 5-year period. Further, the 10%credit for non-certified structures built before 1936 is eliminated. The House version bill would have eliminated all preservation and rehabilitation credits altogether.
- *Low Income Housing Tax Credits (LIHTCs):* The LIHTC, a key element of financing in the affordable housing market, was preserved starting with the House version of the legislation on November 16, 2017.
- *New Markets Tax Credits (NMTCs):* The Act maintains the NMTC though the House bill would have repealed this credit that incentivizes development in distressed areas. Investments in qualified equity investments in a qualified community development entity receive a 5% credit for the year of purchase and two successive years, and then a 6% credit in each of the next four years.
- *Private Activity Bonds (PABs):* The Act preserves the tax-preferred status of PABs, allowing federal tax exemption on interest payable to holders. PAB

tax-exempt status of interest paid to investors would have been terminated under the House bill but was saved by the Conference agreement. PABs may play an important role as a financing mechanism in a future infrastructure bill.

- *Qualified Opportunity Zones (QOZs):* The Act provides an entirely new tax incentive for investment in economically depressed areas, by allowing the deferral of capital gain that is reinvested, within 180 days of such realization event, in a "qualified opportunity fund" (organized for the purposes of investing in QOZ property). Qualifying investments will be determined by the designation of certain low-income community population census tracts as QOZs, with such designation to last for 10 years. Where an investment in a qualified opportunity fund is held for 10 years, at the election of the QOZ fund investor any resulting gain on disposition will receive a complete exclusion from gross income; the gain exclusion on sale of the QOZ fund interest is available for investments in QOZ funds made before 2027.

Akerman Insights

- A clear shift in direction of the legislation occurred at the Joint Committee level regarding the fate of several capital markets-related incentives. In the end, the Act retains the status quo in most regards and introduces a new QOZ provision, the potential of which is not yet clear. These provisions should continue to help attract and supplement capital for real estate projects.

Link to Top

---

tax advice, or a legal or tax opinion, and readers should not act upon the information contained in this communication without seeking the advice of legal counsel or advice from a tax advisor.

You may also be interested in...

Practice Update

Tax Reform: Sweeping Changes to Federal Tax Law and the Impact on Businesses and Individuals

January 12, 2018

In The News

Sanford Davis Quoted in *The Real Deal New York* on Outlook for REITs Under White House's Tax Reform Plan

May 09, 2017

In The News

Sanford Davis Quoted in *The Real Deal New York* on Tax Reform's Effects on REITs

January 4, 2018

Practice Update

Tax Reform: New Law Delivers a Bundle of Executive Compensation and Employee Benefits Changes for the Holidays

December 21, 2017

Practice Update

Tax Reform: New Act Eliminates Deduction for Settlement of Sexual Harassment Claims Subject to a Confidentiality Agreement

January 12, 2018