CONGRESS RELEASES TAX CUTS AND JOBS ACT

House and Senate conferees on December 15 released the Tax Cuts and Jobs Act. Lawmakers hope to approve the final package early next week, with the House scheduled to vote on Tuesday, and send it to President Trump for his signature.

The Act includes numerous critical victories for the multifamily industry. It provides tax cuts for individuals, pass-throughs (e.g., LLCs, partnerships and S Corporations), and REIT entities, while leaving intact critical provisions promoting the development and operation of apartment housing. For example, multifamily firms will be able to continue to fully deduct business interest and conduct like-kind exchanges while depreciating buildings over 30 years or, in some cases, the present 27.5 years. Finally, in a victory for the production of affordable housing, the Act retains both the Low-Income Housing Tax Credit and Private Activity bonds.

Here is a summary of the key provisions in the Act. A detailed chart can be found following this article.

Individual Tax Rates and Pass-Through Income: The Act includes seven tax rate brackets applicable to both individual and pass-through income. The rate brackets range from 10 percent to 37 percent in contrast to today's top rate of 39.6 percent. The Act's maximum 37 percent rate is effective for taxable income exceeding $500,000 for single filers and $600,000 for joint filers. The rate reductions expire after 2025.

Not only does the Act reduce marginal income tax rates, but it also enables a portion of **pass-through business income to qualify for a 20 percent deduction, or a top effective rate of 29.6 percent**. The deduction on pass-through income is available through 2025.

For taxpayers earning over $157,500 (single filers) and $315,000 (married couples), the deduction is limited to the greater of: (a) 50 percent of the taxpayer's share of aggregate W-2 wages paid by the business; or (b) 25 percent of the taxpayer's share of aggregate W-2 wages paid by the business plus 2.5% of the unadjusted basis of all qualified property.

Estates and trusts are eligible for the 20 percent deduction.

The Act's deduction for pass-through income should be a significant benefit to the multifamily industry. While the Senate-passed bill would have provided a 23 percent deduction to pass-through income, the benefit was limited to 50 percent of a taxpayer's allocable wages. **NMHC/NAA made the case that the formula would have excluded many operators who have significant levels of capital deployed relative to wages**

paid. The alternative limitation for income derived from capital-intensive activities included in the conference report should be beneficial to the industry.

REITs: REIT dividends are fully eligible for the 20 percent deduction.

Business Interest: While the Act generally includes limitations on the deductibility of business interest, it allows multifamily firms to elect to fully deduct business interest. However, there are consequences regarding the depreciation of multifamily buildings for firms electing to preserve full interest deductibility. Firms with average annual gross receipts under $25 million over the past three years are exempt from limitations on interest deductibility.

Depreciation of Multifamily Buildings: For multifamily firms wishing to retain the full deductibility of business interest, the Act increases the current-law 27.5-year depreciation period applicable to multifamily buildings to 30 years. Firms able to abide by limits on interest deductibility will retain 27.5-year depreciation for multifamily buildings. Notably, the Senate initially sought a 40-year depreciation period for buildings, but **NMHC/NAA were able to secure an amendment during committee markup offered by Finance Committee Chairman Orrin Hatch (R-UT) to reduce the period to 30 years. This period is retained in the final bill.**

Depreciation of Assets Other Than Buildings: The Act enables multifamily firms to expense assets apart from buildings, such as land improvements and tangible personal property, placed in service from September 28, 2017, through 2022. Bonus depreciation, also known as an additional first-year depreciation deduction, applies thereafter (80% in 2023, 60% in 2024, 40% in 2025, and 20% in 2026).

The Act also **doubles to $1 million the amount qualifying property that a small business may expense in the year of purchased.** The $1 million limit is reduced once investment in qualifying property exceeds $2.5 million. Notably, qualifying property is expanded to include assets involved in furnishing multifamily housing and student housing, such as furniture and appliances.

Like-Kind Exchanges: The Act **preserves like-kind exchanges for real property**. A critical win for the industry, like-kind exchange rules play a vital role in supporting the multifamily industry by enabling investors to remain invested in real estate while still allowing them to balance their investments to shift resources to more productive properties, change geographic location, or diversify or consolidate holdings.

Carried Interest: The Act requires an asset to be held three years to receive capital gains tax treatment. NMHC/NAA encouraged lawmakers to maintain the three-year holding period in both the House and Senate bills as opposed to extending it further. The provision is effective beginning in 2018.

Low-Income Housing Tax Credit: The Act **preserves the Low-Income Housing Tax Credit (LIHTC) and private activity bonds**. The House-passed bill would have eliminated private activity bonds, jeopardizing the efficacy of the 4 percent LIHTC. NMHC/NAA worked tirelessly to advocate that private activity bonds be included in the final bill. Not addressed, however, is the loss of equity LIHTC would raise as a result of cutting the corporate tax rate to 21 percent.

Estate Tax: The Act immediately **doubles current law's estate tax exclusion ($5.49 million single filer / $10.98 million married couple) while retaining stepped-up basis**. The expanded estate tax exclusion expires after 2025 with the exclusion amount reverting to current law.

Active Loss Provision: The Act includes a brand-new measure from the Senate-passed bill that **limits active income losses of flow-through entities**. Under the provision, a taxpayer can deduct only $500,000 ($250,000 for single filers) of net active pass-through losses against wage or portfolio income. Disallowed losses may be carried forward as part of a taxpayer's net operating loss. Effective in 2018, this proposal sunsets after 2025.

At the onset of the tax reform debate, NMHC/NAA laid out a number of key tax reform principles aimed at preserving and promoting the multifamily business model. The industry's primary goal was to promote tax reform that fosters economic growth and investment in rental housing without unfairly burdening apartment owners and renters relative to other asset classes. To this end, NMHC/NAA successfully advocated for the multifamily industry's key principles, which included:

- Protecting Pass-Through Entities from Higher Taxes or Compliance Burdens;
- Retaining the Full Deductibility of Business Interest;
- Preserving the Ability to Conduct Like-Kind Exchanges;
- Ensuring Depreciation Rules Avoid Harming Multifamily Real Estate;
- Maintaining the Current Law Tax Treatment of Carried Interest;
- Preserving and Strengthen the Low-Income Housing Tax Credit; and
- Maintaining the Current Law Estate Tax.

Although every piece of complex legislation includes positive and negative provisions, NMHC/NAA believe the *Tax Cuts and Jobs Act* largely reflects the industry's priorities and keeps intact the critical elements of the multifamily business model. Apartment owners and investors should benefit from tax relief brought on by rate reductions and the deduction for business income while being able to fully deduct business interest and conduct like-kind exchanges. While owners will, in some cases, have to depreciate buildings over 30 years and have to hold assets for three years to be able to treat carried interest as a capital gain, the industry worked tirelessly to see that these provisions were as least harmful as possible. On the affordable housing front, the Act maintains the LIHTC and private activity bonds, which should help drive new construction of affordable units. Finally, the Act doubles the estate tax exclusion and maintains stepped-up basis.

The industry will now turn its focus to ensuring that regulations implementing these measures work as Congress intended. We will also focus on making permanent those proposals that would benefit the industry, but are set to expire in 2025 under this Act.

TAX REFORM: CURRENT LAW & TAX CUTS AND JOBS ACT		
Provision	**Current Law**	**Tax Cuts and Jobs Act (provisions effective beginning 2018)**
Business Tax Rates	Flow-through entity: Maximum rate of 39.6%. REIT dividend maximum rate of 39.6%. Corporation: Maximum Rate of 35%.	Flow-through entity: 20% deduction available for qualified pass-through income. For taxpayers earning over $157,500 (single filers) and $315,000 (married couples), deduction is limited to greater of 50% of the taxpayer's share of aggregate W-2 wages paid by the business OR 25% of the taxpayer's share of aggregate W-2 wages paid by the business plus 2.5% of the unadjusted basis of all qualified property (structures but not land). REIT dividends eligible for 20% deduction. Corporation: Maximum Rate of 21%. Flow-through entity deduction sunset after 2025. Corporate rate cut permanent.
Individual Tax Rates	Seven brackets ranging from 10% to 39.6%. Highest rate effective at $418,400 (single filers) / $470,700 (married filers).	Seven tax brackets ranging from 10% to 37%. Highest rate effective at $500,000 (single filers) / $600,000 (married filers). Rate structure expires after 2025.

Depreciation of Buildings	27.5 years.	30 years. 27.5 years if company elects to limit interest deductibility or has under $25 million in gross receipts.
Depreciation of Other Assets	Depreciated over applicable class life, though bonus depreciation available through 2019. Small businesses may expense up to $500,000 of qualifying property. Amount reduced over $2 million in qualifying property.	Real estate eligible for full expensing of non-real property assets placed in service from September 28, 2017, through 2022. Bonus depreciation applies thereafter (80% in 2023, 60% in 2024, 40% in 2025, and 20% in 2026). Small businesses may expense up to $1 million of qualifying property. Amount reduced over $2.5 million in qualifying property. Qualifying property expanded to include assets involved in furnishing multifamily housing and student housing, including furniture and appliances.
Business Interest Deductibility	Fully deductible for all businesses.	Fully deductible for real estate businesses that elect out of limits on interest deductibility. Limits on interest deductibility apply to firms outside of real estate with exception for businesses with average annual gross receipts of less than $25 million over past three years.
Like-Kind Exchanges	Available under current law for property held for investment.	Retained for real property.
Carried Interest	Taxed at capital gains rates if held at least 1 year.	Taxed at capital gains rates if held at least 3 years.
Low-Income Housing Tax Credit & Private Activity Bonds	Current Law includes both the LIHTC and Private Activity Bonds.	LIHTC and Private Activity Bonds retained as under current law. Efficacy of LIHTC reduced due to corporate rate reduction.
Estate Tax	$5.49 million ($10.98 million per couple) exclusion, 40% rate, and stepped-up basis for inherited assets.	Exclusion doubled. Stepped-up basis retained. Provision after 2025 and tax reverts to current law exemption amount indexed for inflation.
Active Losses	Fully deductible against active income.	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.

Historic Rehabilitation / New Markets Tax Credits	Historical Rehabilitation Tax Credit available under current law. New Market Tax Credit available under current law through 2019.	The 20% historic credit is retained but claimed over five years. The 10% historic credit for pre-1936 buildings is repealed. New Markets Tax Credit is retained through 2019 as under current law.