“Is all of this good or bad? It is neither. It’s different. Some of these changes really help the real estate industry as a whole. Some of these will really help individuals. And some of these won’t change one thing for certain people. One thing it’s definitely not, however, is simple.

The New Tax Act

What’s in Store for the Real Estate Industry?

industry expert

By Tony Pelura

Tax time. The most wonderful time of the year. Everything is always stress-free, rules are easy to understand, and anything new is clearly stated and simple. If this were a test, the answer to those statements would be FALSE.

The Tax Cuts and Jobs Act was signed by President Trump on December 22, 2017. The Act makes sweeping changes to the U.S. tax code and impacts virtually every taxpayer. It is the largest tax change since 1986 and is the largest overhaul of the Internal Revenue Code in over 30 years, affecting every taxpayer type. It includes reductions in tax rates for both individuals and businesses, the elimination or reduction of many deductions, exclusions, and credits with the enhancement of other deductions and credits. The corporate AMT is eliminated, the taxation of pass-through entities is reformed, and international taxation laws are changed to move the United States from a worldwide system to a territorial system. In 1986, it took Congress over two years to work through the changes. In 2017, it took 60 days. The major goal of tax reform was to simplify tax filing. As with most things that Congress does, it did the exact opposite of that. On top of all of that, the IRS is currently closed as part of the government shutdown. While this may seem a bit scary there are many provisions and changes that actually do help both individual taxpayers and business owner.

In the past year, we have seen many different articles and talked with many different people in regards to the new tax act. Unfortunately, there has been a lot of miss-information and confusion about what is and what isn’t. This is especially true in the real estate industry. Hopefully, this will go through and clear out some of the biggest areas of concern.

1. **Mortgage interest is no longer deductible! –** This is not true. Mortgage interest on a primary and secondary mortgage are still deductible on the Schedule A as an itemized deduction. However, the limit on new mortgages is $750,000 instead of the $1 million cap. If you hold a previous mortgage, you are still entitled to the deduction on the old cap. Interest is still deductible on rentals as well.
2. **I can’t take a home equity line and deduct the interest! –** This one is a maybe. Interest is still deductible on home equity loans (or second mortgages) if the proceeds are used to substantially improve the residence. If they are not used to improve the property, then no deduction.
3. **The new standard deduction increase and the limit on property tax deductions means I can’t write off anything when I purchase a house! –** This is also a maybe. The deduction for mortgage interest and property taxes are still there. However, the new tax law increased the standard deduction and decreased the state and local tax deduction (SALT), that it may mean that many people who itemized in the past will now take the higher standard deduction. If that is the case then the interest and property taxes are not a tax deduction to them.
4. **1031 exchanges went away! –** This is not true. This provision is a great tool for the real estate market and has been used successfully many times. A 1031 exchange is a way to sell a property without having to immediately pay taxes. The idea is that you will roll over any gains into the purchase of a new property, which allows you to defer paying taxes until you sell the new property. The rules can be complicated but they are a useful tool when applied to property. The change that has led to some confusion is that a 1031 exchange used to be for any item the IRS deemed property (which was a lot). The new law limits the exchange just to real property or real estate.
5. **Entertainment expenses are gone. I can’t take clients out to a game or dinner! –** Unfortunately, there is more truth to this than not. Meals are still deductible (up to 50%) on qualified meals that have a business purpose (no you can’t deduct your own lunch every day). However, the entertainment part is gone. This includes taking a client out to a baseball game, fishing, golf or paying for membership dues at the boat club. Even if these are used to gain business, they are no longer able to be written off.

A large change that affects every agent, property manager, and independent broker is the 20 percent pass-through deduction. This deduction (199A) is a tax deduction that any non-corporate taxpayers may deduct up to 20 percent of domestic qualified business income from a partnership, S corporation, or sole proprietorship (most, if not all of the real estate industry). On the surface, it is a simple calculation to deduct, up to, 20 percent of your pass-through income. There are income phase-outs and not all businesses are eligible to take the full deduction. There was some talk that all real estate professionals would not be able to take full advantage of these deductions. However, the final regulations do allow real estate professionals to take this credit under normal business operations. Rentals and passive, real estate income may be ineligible and would have to be determined on a case by case basis (if anyone is really interested the final regulations on just this deduction it just came out and is 247 pages – so much for simplification).

There are many other positive rules applicable to the real estate industry as well. The depreciation write-offs for businesses and rental properties increased. In plain English, we can expense more immediately instead of portions over a period of time. The mileage deduction increased, the provision to deduct gains on primary residences is left intact ($250,000 single and $500,000 married is still tax-free) and the write-offs for personal passenger vehicles used for business is more substantial. On top of all of that, the tax rates did go down and the AMT exemption amounts did go up.

Is all of this good or bad? It is neither. It’s different. Some of these changes really help the real estate industry as a whole. Some of these will really help individuals. And some of these won’t change one thing for certain people. One thing it’s definitely not, however, is simple.

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