To Our Clients and Friends

Memorandum

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Tax Cuts and Jobs Act: Highlights for the Real Estate Industry

On December 22, 2017, H. R. 1, the Tax Cuts and Jobs Act (the "Act") was signed into law. The Act significantly revises many aspects of U.S. federal income tax law applicable to businesses conducted in corporate and partnership form, and will also affect the U.S. federal income tax treatment of many individuals. Notably, the Act will significantly impact real estate investors, sponsors and developers, and there are a number of special provisions applicable to REITs and REIT investors. Below is a brief summary of some of the Act's provisions that are expected to have the greatest effect on the real estate industry. For a more detailed summary of the Act's provisions, see our memorandum entitled "A Look at the New Tax Law and How It Impacts Your Business and Investments" (the "Tax Memorandum"). It should be noted, however, that the full impact of these far reaching provisions will, in many cases, only be known as implementing rules and market practices develop.

- Individuals may deduct up to 20% of any "qualified REIT dividends" received in a taxable year, as discussed in the section entitled "Deduction for Qualified Business Income of Individuals, Trusts and Estates" in the Tax Memorandum. Qualified REIT dividends include any dividends received from a REIT other than dividends designated as capital gain dividends or dividends that would otherwise qualify for capital gains rates. Generally speaking, the net effect of this deduction is that qualified REIT dividends will be taxed at a rate that is 80% of the rate that would otherwise apply to those dividends. Thus, for taxpayers in the 37% bracket, the rate on those dividends would be 29.6%.

- Under the Act, individuals may also deduct as much as 20% of "qualified business income" that is allocable to a qualifying real estate trade or business. Again, for taxpayers in the 37% bracket, this deduction would reduce the rate to as low as 29.6%. This deduction does not apply to capital gains, which generally continue to be taxed at a 20% rate.

- Sponsors may be adversely impacted by the new three-year holding period required to qualify for long-term capital gain treatment with respect to a partnership interest received in connection with the performance of services, as discussed in the section entitled "Carried Interest" in the Tax Memorandum.

- Participants in real estate trades or businesses may elect out of the new interest expense limitation that is discussed in the section entitled "Limitations on Interest Deductibility" in the Tax Memorandum. However, electing out will result in the depreciation periods of the associated real property becoming slightly longer and in the loss of the ability to immediately expense qualified improvement property.

- For taxable years 2018-2025, the new limitation on “excess business losses” generally will prevent real estate investors from using operating losses from their real estate business (including depreciation deductions) to shelter more than $250,000 ($500,000 in the case of joint filers) of their passive non-real estate income, such as dividends, interest and gains from the sale of passive non-real estate investments. This is discussed in the section entitled “Limitations on Use of Excess Business Losses” in the Tax Memorandum.
- Finally, although originally slated for complete elimination, the like-kind exchange (Section 1031 of the Internal Revenue Code of 1986, as amended) rules continue to apply to exchanges of real property. However, those rules no longer apply to exchanges of personal property, such as art work.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its contents. If you have any questions about the contents of this memorandum, please call your regular Fried Frank contact or an attorney listed below:

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