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IMPACT OF THE NEW TAX ACT: COMMERCIAL REAL ESTATE ISSUES

Discussion Leader: **Terri Johnson, CRE**
Managing Partner, Capstan Tax Strategies

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Points for Discussion

- Brief Introduction
- Discussion point: **Bonus Depreciation**
  - Supplemental Material: Depreciation Accelerator
- Discussion point: **Qualified Improvement Property (QIP)**
  - Supplemental Material: Decoding Qualified Improvements
- Discussion point: **Interest Deduction Limitation**
  - Supplemental Material: ADS vs. MACRS Decision Tree
- Discussion point: **Other TCJA Issues**
  - Section 199A
  - Section 179 Expensing
  - State and Local Deductions
  - Like-Kind Exchanges
- Discussion point: **Bipartisan Budget Act of 2018 (179D and 45L)**

Brief Introduction: The Tax Cuts and Jobs Act (H.R. 1) [TCJA]

- Signed into law December 22, 2017
- First comprehensive tax reform since 1986
- Tremendous impact on all industries, including commercial real estate
- Most provisions will not take effect until TY 2018
- However, two major rules are retroactive – we'll revisit

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Bonus Depreciation Under the TCJA

- Bonus Depreciation for TY 2017 was set at 50% by the PATH Act
- The TCJA increases Bonus to 100% for properties placed-in-service between 9/28/2017 – 12/31/2022
- New Construction/Renovation
- Acquisitions now eligible – qualifying assets no longer have to be new, just "new to you"
- After 2022, Bonus rates will gradually decline

Year	Bonus Value
9/28/2017-12/31/2017	100% (50% election)
1/1/2018 – 12/31/2022	100%
2023	80%
2024	60%
2025	40%
2026	20%

Bonus Under the TCJA – Acquisitions of Real Estate

Driven by Date of the Written Binding Contract (WBC)

WBC for Purchase of Property Signed BEFORE 9/28/17	WBC for Purchase of Property Signed ON or AFTER 9/28/17
▪ Considered to have been acquired before TCJA comes into play ▪ Therefore, PATH Act Rules must apply and acquired assets would not be eligible for Bonus	▪ Acquired under TCJA, therefore TCJA Bonus rules apply ▪ 100% Bonus ▪ Remember that assets must have MACRS class lives of 20-years or less

Bonus Under TCJA – New Construction/Renovation

Driven by Date "Substantial" Construction Begun

Construction Begun Before 9/28/17	Construction Begun After 9/27/17*
PATH Act Rules Apply • Pre-existing phase-down rules Placed-in-Service by 12/31/17: 50% Bonus Placed-in-Service by 12/31/18: 40% Bonus Placed-in-Service by 12/31/19: 30% Bonus • Also applies to new spend on renovations post-acquisition	TCJA Rules Apply • 100% Bonus • Acquired assets are eligible *Regardless of when contract was initially signed (Reg 1.168(k)-1(b)(4)(iii)(A))*

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THE DEPRECIATION ACCELERATOR FOR REAL ESTATE

POST-TCJA

YEAR	DATES	PROPERTY TYPE	BONUS (1) (for assets depreciated using MACRS class lives only)	QIP (2) *	179 EXPENSING (5)
2017	1/1/2017 – 12/31/2017	Acquisition	WBC(3) Signed Before 9/28/17: NONE	39-yr	N/A
			WBC(3) Signed After 9/27/17: 100% (or 50% Bonus election)	39-yr	
		New Construction(4) /Renovation	Construction Begun Before 9/28/17: 50%	39-yr	
			Construction Begun After 9/27/17: 100%	39-yr	
2018	1/1/2018 – 12/31/2018	Acquisition	WBC(3) Signed Before 9/28/17: NONE	15-yr SL| 20 year ADS	TCJA Rules are: as of 1/1/18, subsection (f) of section 179 was amended to include the following assets: • Roofs • Energy Efficient HVAC • Fire protection and alarm systems • Security Systems
			WBC(3) Signed After 9/27/17: 100%	15-yr SL | 20 year ADS	
		New Construction(4) /Renovation	Construction Begun Before 9/28/17: 40%	15-yr SL | 20 year ADS	
			Construction Begun After 9/27/17: 100%	15-yr SL | 20 year ADS	
2019	1/1/2019 – 12/31/2019	Acquisition	WBC(3) Signed Before 9/28/17: NONE	15-yr SL | 20 year ADS	TCJA Rules Apply
			WBC(3) Signed After 9/27/17: 100%	15-yr SL | 20 year ADS	
		New Construction(4) /Renovation	Construction Begun Before 9/28/17: 30%	15-yr SL | 20 year ADS	
			Construction Begun After 9/27/17: 100%	15-yr SL | 20 year ADS	
2020	1/1/2020--12/31/2020	N/A	100%	15-yr SL | 20 year ADS	TCJA Rules Apply
2021	1/1/2021 – 12/31/2021	N/A	100%	15-yr SL | 20 year ADS	TCJA Rules Apply
2022	1/1/2022 – 12/31/2022	N/A	100%	15-yr SL | 20 year ADS	TCJA Rules Apply
2023	1/1/2023 – 12/31/2023	N/A	80%	15-yr SL | 20 year ADS	TCJA Rules Apply
2024	1/1/2024 - 12/31/2024	N/A	60%	15-yr SL | 20 year ADS	TCJA Rules Apply
2025	1/1/2025 - 12/31/2025	N/A	40%	15-yr SL | 20 year ADS	TCJA Rules Apply
2026	1/1/2026 - 12/31/2026	N/A	20%	15-yr SL | 20 year ADS	TCJA Rules Apply

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Qualified Improvement Property THEN: QIP-PATH

- Established as a new property category under the PATH Act
- Defined as any improvement to an interior portion of a building which is nonresidential real property if the improvement is placed-in-service after the date the building was placed-in-service
- Restrictions associated with QLI, QRI, and QRIP didn’t apply
- No “Three-Year Rule”
- Didn’t have to be made pursuant to a lease
- QIP classified as 39-year after Bonus (other three categories classified as 15-year SL, not Bonus-eligible)

Qualified Improvement Property NOW: QIP-TCJA

- Any improvement to an interior portion of a building which is nonresidential real property if the improvement is placed-in-service after the date the building was first placed-in-service by any taxpayer.
- Replaces the separate categories of QLI, QRI, QRIP
- Classification based on assumption that QIP placed-in-service after 12/31/2017 will have a 15-year SL recovery period as intended by Congress (P.L. 115-97).
- Technical correction anticipated. Subject to change.

Interest Deduction Limitation

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- Starting 1/1/2018, companies are subject to a limitation on deductible interest expense
- The deductible amount is capped at 30% of adjusted taxable income, after certain adjustments
- Good news for smaller firms --
  - *If a firm's three-year average annual gross receipts are $25M or less yearly, it is completely exempt from the deduction limitation, and may depreciate property using MACRS class lives as usual*
- Larger firms may be able to elect-out
  - Real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing or brokerage trade or business
- If you elect-out, you MUST depreciate your real property using ADS (Alternative Depreciation System)
  - ADS classes are longer-lived, and properties depreciated with ADS are generally not Bonus-eligible

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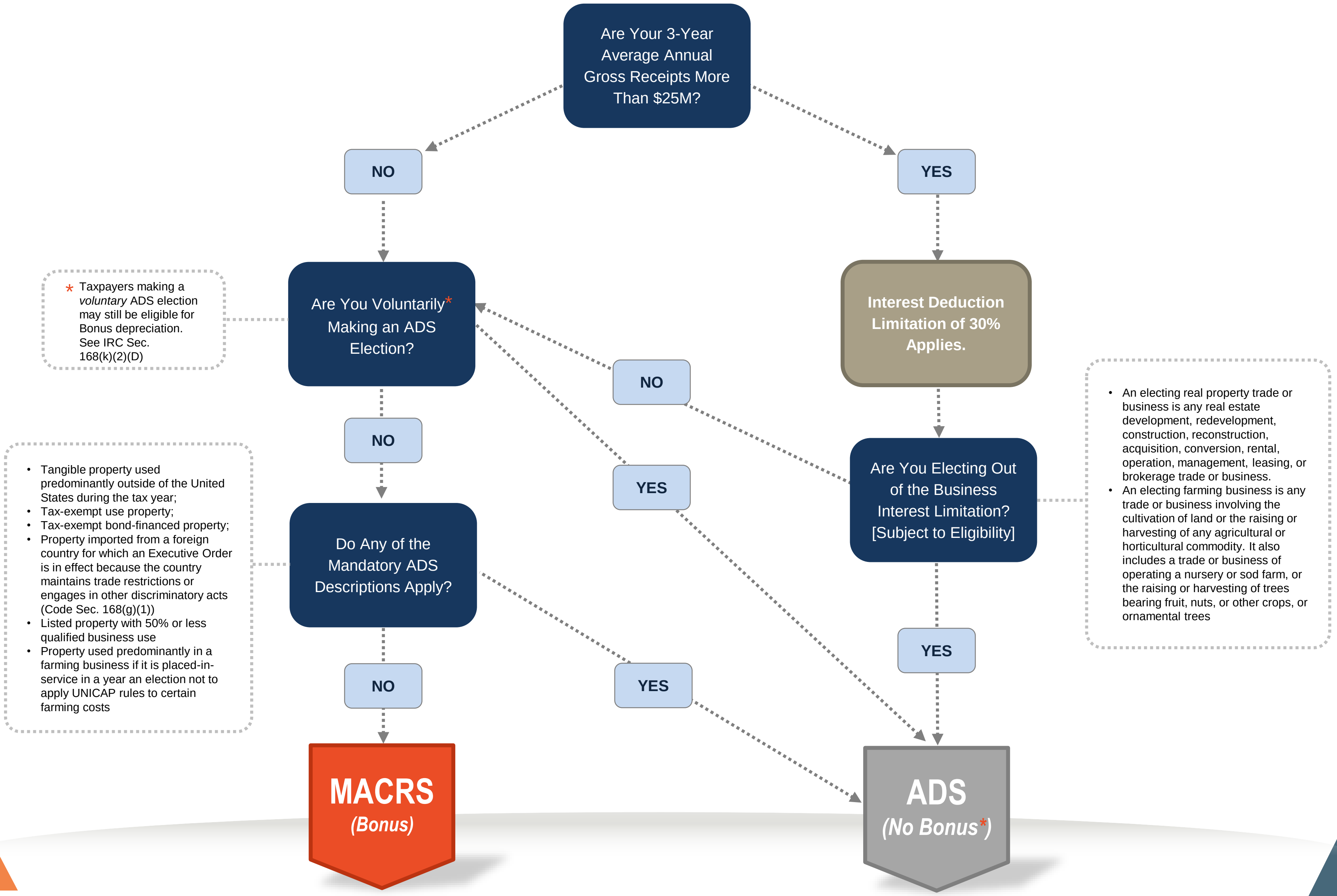
MACRS vs ADS Decision Tree



Section 199A Under the TCJA

- Improved Pass Through Deduction- Section 199A
  - Designed to provide non C corporate tax entities with tax relief

  Many tax scholars refer to the new combined tax rate for pass through users at 29.6% versus the top tax rate of 39%

- 20% pass through rate for qualified business income
  - From domestic sources and qualified trade or business
  - Includes income from Trusts and Estates with interest in flow through business
  - Excludes investment income
  - Many details to sift through for business owners*

* Be sure to consult your tax professional

Section 179 Expensing Under the TCJA

- WAS an entity-level election that allowed the full purchase price of business equipment to be written off in the year of purchase
- Effective 1/1/2018, the TCJA expands the eligible assets to include the following improvements to nonresidential building systems placed-in-service after the building was placed-in-service:
  - Qualified Improvement Property (QIP)
  - Roofs
  - HVAC
  - Fire protection and alarm systems
  - Security systems
- Increased the dollar limitation of the election from $510K to $1.0M
- Eliminated the exclusion of tangible personal property used in connection with lodging facilities (i.e. hotels)
- Assets may be new or used

State and Local Tax Deductions (SALT) Under the TCJA

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- TCJA limits annual itemized deductions for all nonbusiness state and local tax deductions, including property taxes, to $10,000.
- Previously, there was no cap on this deduction.
- This is going to hurt a lot of folks – they may want to consider cost segregation as a new source of deductions

Like-Kind Exchanges Under the TCJA

- Section 1031 real estate like-kind exchanges are preserved and will continue to be eligible for tax deferral
- Effective 1/1/2018, like-kind **personal property** exchanges are no longer permissible

Bipartisan Budget Act of 2018

EPAct 179D

Reinstated for 2017 only

Extends the most recent rules for application

Up to $1.80/ square foot of deduction benefit

For new construction and renovation work

Three areas of construction:

- Interior lighting
- HVAC
- Building envelope

45L

Reinstated for 2017 only

Extends the most recent rules for application

$2,000 tax credit per dwelling unit

For new and renovation work to:

- Single family homes
- Multifamily three up to three stories

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The Impact of The Tax Cuts and Jobs Act: Case Study

Mixed Use Development Example

- Third phase of a three phase project – total spend $17M
- Construction begun 6/1/2017
- Placed-in-service 1/31/2018
- Substantial construction began before 9/27/2017 – PATH Act Rules apply even though placed-in-service after 9/27/2017
- Bonus rate driven by Substantial Construction Date, not placed-in-service date
- 15% moved to 5-yr, 10% to 15-yr

Mixed Use Development Example

PATH Act rules apply – 40% Bonus

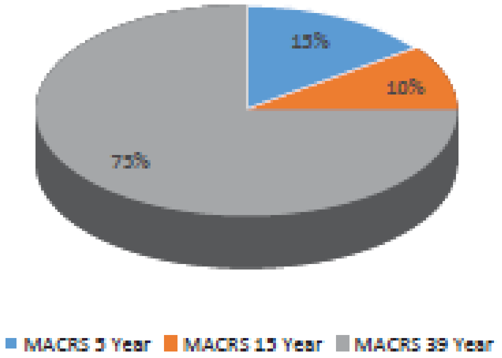
Summary of Benefits

Total Accelerated:	$4,250,000 (25%)
Additional Cash Flow (Year 1):	$644,294
Estimated 481(a) adjustments:	$0
10 Year Net Present value (NPV):	$924,078

Assumptions

Tax Year:	2018
Date Placed in Service:	January 31, 2018
Depreciable Cost Basis:	$17,000,000
Combined Tax Rate:	33 %
Discount Rate:	4 %

Allocation After CSS



Property Class	Recovery Period	Original Allocation		Allocation After CSS	
Personal Property	MACRS 5 Year	$0	0.0%	$2,550,000	15.0%
Land Improvements	MACRS 15 Year	$0	0.0%	$1,700,000	10.0%
Real Property	MACRS 39 Year	$17,000,000	100.0%	$12,750,000	75.0%
Depreciable Basis		$17,000,000	100.0%	$17,000,000	100.0%

Mixed Use Development Example

What if construction didn't begin until after 9/27/2017?

TCJA Rules would apply – 100% Bonus

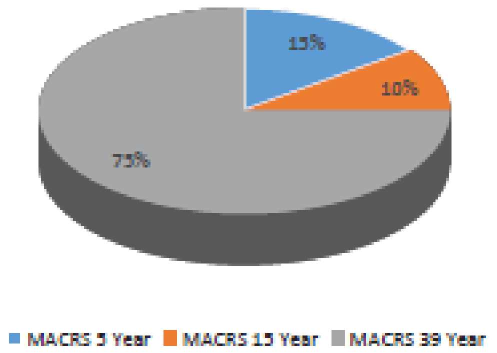
Summary of Benefits

Total Accelerated:	$4,250,000 (25%)
Additional Cash Flow (Year 1):	$1,367,984
Estimated 481(a) adjustments:	$0
10 Year Net Present value (NPV):	$1,100,609

Assumptions

Tax Year:	2018
Date Placed in Service:	January 31, 2018
Depreciable Cost Basis:	$17,000,000
Combined Tax Rate:	33 %
Discount Rate:	4 %

Allocation After CSS



Property Class	Recovery Period	Original Allocation		Allocation After CSS	
Personal Property	MACRS 5 Year	$0	0.0%	$2,550,000	15.0%
Land Improvements	MACRS 15 Year	$0	0.0%	$1,700,000	10.0%
Real Property	MACRS 39 Year	$17,000,000	100.0%	$12,750,000	75.0%
Depreciable Basis		$17,000,000	100.0%	$17,000,000	100.0%

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Questions?

Terri S. Johnson, CRE, Managing Partner
Capstan Tax Strategies
101 West Avenue, Suite 301
Jenkintown, PA 19046
215-885-7510 (o)
215-740-7605 (c)
tjohnson@capstantax.com