THE TOP THREE WAYS TAX REFORM WILL AFFECT HEALTH CARE REAL ESTATE

On December 22, 2017, the president signed into law H.R. 1, the Tax Cuts and Jobs Act (the "TCJA"), which will apply to 2018 income for tax filings in 2019. The TCJA includes a number of commercial real estate provisions, several of which could create significant new opportunities specific to the health care sector.

THE CHANGE IN CORPORATE TAX RATES AND THE 20 PERCENT DEDUCTION ON PASS-THROUGH INCOME

One of the most noteworthy changes under the TCJA is the favorable tax treatment for businesses with regard to new tax rates for corporations and pass-through entities. In 2017, corporate taxes were allocated in progressive brackets ranging from 15 to 39 percent. However, the new tax law provides for a flat 21 percent tax rate for corporations. Furthermore, business income that passes through to an individual from a pass-through entity—such as a limited liability company, a partnership or an S corporation—will be taxed at individual tax rates less a deduction of up to 20 percent, which decreases the effective tax rate to approximate how these entities would be treated if they enjoyed the flat corporate tax rate.

Although there are several restrictions and caps that apply to these deductions, the favorable tax treatment will encourage potential investors to focus on more favorable after-tax yields when considering health care real estate investments.

The influx of available capital from the decrease in corporate tax rates and the deduction on pass-through income could result in additional passive capital flowing into the commercial real estate sector, resulting in a downward pressure on capitalization rates. Generally, the higher the capitalization rate, the higher the risk. Thus, lower capitalization rates could lead to significant investment opportunities in the health care real estate sector. This could positively affect hospitals' ability to partner with physicians and other non-corporate taxpayers the development of real estate.

BUSINESS INTEREST DEDUCTION: REAL ESTATE LOANS AND QUALIFYING PROPERTY

Under the TCJA, interest on real estate loans is still deductible, but using the deduction will lengthen the depreciation period for real estate assets. The new changes to the Section 179 deduction and depreciation rules favor real estate investments.

Previously, the maximum deduction was $500,000 of the cost of the qualifying property with various other restrictions. Effective January 1, 2018, under the TCJA revisions, business owners can fully expense up to $1 million of qualifying purchases of capital with a phase-out threshold limit of $2.5 million. Furthermore, the TCJA expands the definition of qualifying property for nonresidential real property to include roofing, fire alarm and security systems, and heating, ventilation and air conditioning systems.

The TCJA permits health-related facilities to deduct the full cost (up to the maximum deductions noted above) of qualifying personal property—any tangible property that is purchased for use in active conduct of the trade or business, such as new medical equipment or facility furnishings—in the first year rather than depreciating the property over multiple years. By expanding the deduction limits and qualifying property definition, the TCJA allows companies to have more available capital to either reinvest internally or to use for other potential investment opportunities

1031 TAX-DEFERRED EXCHANGE TREATMENT LIMITED FOR REAL AND PERSONAL PROPERTY

Under the pre-TCJA tax code, Section 1031 exchanges allowed investors to sell property—ranging from real estate to tangible personal property—and to reinvest the proceeds in new property while deferring all capital gains taxes to the extent that the property was held for a productive use in the taxpayer's business or for investment purposes.

However, the new tax law completely repeals personal property exchanges from Section 1031. Real estate exchanges are still subject to the same rules under the pre-TCJA code with regard to identification periods and exchange requirements. Although the transition rules permit personal property exchanges to have been completed by December 31, 2017, the new narrowed language will result in a shift in existing investment strategies for personal property.

For health care entities, like-kind exchanges of real property still remain a powerful tool. By re-investing profits in a more productive property that better suits current and future needs, health care entities can maximize their return on investments while minimizing their capital gains taxes.

If you have any questions about the TCJA or its potential impact on health care real estate, please contact:

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