CALIFORNIA CONTINUING EDUCATION, INC

PRESENTS

REAL ESTATE TAX EFFECTS FOR INDIVIDUALS

by

Curtis L. Harrington

HARRINGTON & HARRINGTON

PATENTAX®

P.O. Box 91719, Long Beach, CA 90809-1719

(562) 594-9784, Fax: (562) 594-4414

http:/www.patentax.com E-mail: curt@patentax.com PATENTAX®

Premise: Less to abuse will "lean up" the audit burden. TAX CUTS & JOBS ACT (TCJA)

Disclaimer: Educational Only: This outline is Educational Only and no part of this presentation can be considered as federal or state tax advice, opinion, or position and is not intended or written to be used, and may not be used, for the purpose of (a) avoiding tax-related penalties under the internal revenue Code or (b) promoting, marketing or recommending to another party any tax-related matters addressed herein, nor (c) constituting guidance on any tax or criminal matter. No any attorney-client relationship is created by this outline nor by the presentation. Cases listed are for educational purposes and have not been checked to see if they have been overturned on appeal. Do not rely upon any cases or principles stated, ever. Remember that regulations are coming –this content may be outdated by the time the regulations are released.

REAL ESTATE TAX EFFECTS FOR INDIVIDUALS- Table of Contents

I. Warm-Ups

Buyer paid taxes Deductible when paid. Prepaid cash basis taxpayers (so long as not deposit) Must be an owner (or equitable owner). Buyers deduct tax attributable only to the time the property is owned.

Special Assessment Taxes may not, in circumstances when it clearly benefits the property, be deducted.

Taxes non-deductible generally (1) customs duty tax, (2) Estate & Gift Taxes, (3) Federal Income & Excise Taxes, Fines or penalties, Restitution not previously taken into income, License fees, Social Security, Medicare and Railroad retirement tax.

1031 Exchanges now for real estate only.

Deductions subject to the 2% floor were repealed, and were a major source of invited tax audits. Unfortunately, child & work tax credits were also not eliminated. Three party verification items are a significant audit expense

II. Renting Your House

Type	Deductions	Gain/Loss
Personal use or rented <15 days, tax not reportable	Deduct, Interest, Property Taxes, Casualty losses	Gain: Cap (after 250 / 500k deduction). Ordinary tax on depreciation recapture **No Loss**
Rented >15 days & Income Recognized	Ordinary deductions for rental related expenses	Cap gain. Ordinary gain if recapture. Loss possible

III. State & Local Tax Deductions

State & Local Tax Deductions, (Real & Personal) Property, Income & Sales Taxes Limited to $10,000. May shift market toward more incremental home purchases.

-Married filing separately is limited to $5,000 each, so its aimed at in the direction of being (statistically) a “household tax” instead of some sort of personal consumptive limit.

-By not isolating on “real property tax” as a limitation (which could have been differentiated on the tax form), its a clear first step in clearly subsidizing states’ out-of-control taxes viewed in summary. Many states do not have state income tax, most states that do have state income tax may averages about 6% or less (33 states). High tax states like California and New York causing states to be significantly subsidized by the federal government. When top Federal tax rates were about 39%, 39/100 of state taxes paid by top marginal rate state tax payers was subsidized via a federal tax deduction.

-Given that the federal deduction included both income and property tax, the subsidy to high income tax states tended to be the highest (assuming that property tax acts as a common threshold breaker). California’s 13.3% subsidy is the nation’s highest.

-Proposed federal tax evasion schemes include a mechanism for making a charitable contribution to California, followed by the provision of state credit against the donor’s tax bill. Its true that state and local governments are legitimate entities for donation, but only for amounts that are not owed. Otherwise, all state, county & city tax payments would be deductible, & people would have been encouraged to do it for the past 30 years.

IV. **Divorce & Alimony**

- The deduction for alimony paid is repealed for any divorce or separate instrument executed after 12/31/18

-The combination of the “household” limit for State Tax deductions for marrieds should be taken advantage of by considering arrangements for a disposition of real estate in divorce that is designed to preserve the ability to deduct state and local tax. For example, where divorced spouse 1 is a high earner and spouse 2 is a low earner, the prior importanceof the alimony deduction by the payor spouse 1 might have been the only consideration, such that if spouse 2 retained the marital home, the real estate deduction inefficiency was dismissed. Under the new non-deductibility rules, the divorcing spouses might look at their circumstances with some concern to insure that the $10,000 state tax deduction per ex-spouse divorced spouse is maximized. Many mechanisms are possible.

-Spouses and their representatives were always supposed to take to account the theoretical gain on the sale of the marital residence in making a wealth distribution. The spouse that keeps a high gain marital home was supposed to be compensated with additional cash to pay the taxes. The combination of limits on state tax deduction and on lack of alimony payor-non-deductibility and recipient-non-inclusion will probably result in greater incidence of marital home sales pre-divorce and less magnitude alimony transfer payments. It could be a steep learning curve for family law attorneys.

V. Mortgage limits

Acquisition Indebtedness: incurred in acquiring, constructing, or substantially improving any qualified residence of the taxpayer, and is secured by such residence $750,000 under the new TCJA ($1,000,000 limitation grand fathered). If interest increases, this limitation may begin to dominate.

VI. Moving Expenses

If the effective cost of moving increases by virtue of elimination of the ability to deduct expenses, will this significantly affect the market for real estate for employees?

The TCJA states: SUSPENSION FOR TAXABLE YEARS 2018 19 THROUGH 2025 Except in the case of a member of the Armed Forces of the United States on active duty who moves pursuant to a military order and incident to a permanent change of station, subsection (a)(6) [the exclusion of the moving expense fringe benefit] shall not apply to any taxable year beginning after December 31, 2017, and before January 1, 2026. (b) EFFECTIVE DATE... beginning after December 31, 2017.

Further, the whole of §217 relating to moving expenses for employees and independent contractors is suspended "TAXABLE YEARS 2018 Through 2025".

The language that (a)(6) applies means that any payment for moving will now be included in the compensation of the employee or independent contractor but without an "accounting for" deduction. Suspension of §217 prevents all deduction by the taxpayer for relocating.

The above may have a number of possible impacts?:
(1) Companies may be forced to encourage a move by incentivizing employees with salary increases. Employee may balancing the ability to recoup either (a) the costs of moving or (b) the tax on moving assistance money from the company with the larger salary.

(2) Companies might try to make a "move caravan" where some employee moved goods might "ride along" with the company's plant equipment, records and files. An elongated

move period opens the opportunity to make a more efficient move of company assets, and accommodate employee freight at no extra cost to either the company or the employee.

(3) The IRS Publication 521 (applicable for 2017) has examples of reimbursement, including what happens when company moving policy works out to be less than the actual expenses, which is often the case. On the other hand, corporate moves may not be taking place as efficiently as they could be. Publication 521 illustrates that the details, charts, and categories of moving expense are not simple, and likely require extensive probing on audit. The cost to IRS to audit the “moving expense benefit” is likely greater than the tax reduction savings to both the employee and employer.

(4) Tax incentives given by states and cities might include (at a substantial reduced cost by a contract with a mover) that might move employees into the jurisdiction at the expense of the destination jurisdiction. (In terms of a collapsed transaction - where “Team Texas” considers $500,000 in tax credits, part of those tax credits could be in the form of moving services to be provided directly by a destination state economic development commission.)

In the TCJA environment, what better way could money be spent than to entice employees to move to the destination jurisdiction knowing that they would be unlikely to move away even if the company went elsewhere in 5 years?” Since government is its own “charity”, and since the benefit is supplied by other than the employee’s employer, this could work out as a true fringe -- it would cost the company nothing, and would not result in taxable income to the employee. Further the destination jurisdiction could selectively supply this benefit to the employees of highest value, based upon either the destination jurisdiction’s criteria, or upon advise of the employer’s evaluation. Selective employee rewards could statistically help to leave behind the employees that are non-essential, or that would burden the company more to move the employee than to hire a new employee in the destination company location.

A company that moves from one location to another can experience significant savings by (a) lowering their employees cost of living, (b) creating an event that tends to favoring productive employees over non-productive employees, (c) lowers employee payroll costs, & (d) Picking up tax credits from the destination jurisdiction. As an example, Pei Wei (asian diner offshoot of P.F. Chang) just relocated from Phoenix, Arizona to Irving, Texas after receiving $500,000 from the Texas Enterprise Fund, & $75,000 from the city of Irving. Half of their management staff of 24 in Phoenix stayed behind. It can be an incredible opportunity to re-shape & re-birth the corporate demographic of their company.

Curtis L. Harrington

Contact: **HARRINGTON & HARRINGTON - PATENTAX®**
P.O. Box No. 91719, Long Beach, CA 90809-1719 patentax.com
Tel. (562) 594-9784; Fax (562) 594-4414 curt@patentax.com

Specialty: High Technology Patent / Trademark / Intellectual Property Law & Taxation

Education: **B.S.** Chemistry - Auburn University (1974)
M.S. Electrical Engineering - California State University Long Beach (1990)
M.S. Chemical Engineering - Georgia Institute of Technology (1977)
J.D. - University of Houston School of Law (1983)
M.B.A. - University of Oklahoma (1985)
LL.M. *Taxation* - University of San Diego School of Law (1997)

Admitted to Practice: Supreme Courts of California, Arizona, Texas, & Nevada
U.S. Supreme Court; U.S. District Court, Central District of California
Internal Revenue Service U.S. Patent and Trademark Office
U.S. Court of Appeals for the Federal, Fifth & Ninth Circuits
California Dept. of Real Estate - Broker; Los Angeles County California EMT-Basic
U.S. Tax Court FCC-Commercial & Amateur Extra
Certified by The State Bar of California Board of Legal Specialization: Taxation

Languages Japanese Language Proficiency Examination, (Japan Foundation), Level 4; Kanji Proficiency Exam (Kanji Aptitude Testing Foundation) Level 7, recognized by Japan Ministry of Education, mastery of 640 kanji; some technical Russian reading ability.

Patents Issued Prepared and prosecuted more than 400 patents, in the electrical, chemical & mechanical technologies ; specialty areas: optics, fiber optics, cryogenics electromagnetics, & computers.

Litigation Associate counsel in patent & trade secret litigation; Municipal Court Judge pro tem & Superior Court Mediation program Attorney-Client fee Dispute Arbitrator, Long Beach Bar Association; Patent Panel, American Arbitration Association.

Teaching Adjunct Law Professor, Golden Gate University School of Law, LL.M. Taxation Program; Georgia Institute of Technology - previously taught heat and mass transfer laboratories, and analog and digital computer laboratory.

Member: **Current Member**: State bars of California (Business, Tax, & Criminal Sections), Texas, Arizona & Nevada; Central District Consumer Bankruptcy Attorneys Association (2011-2017); & Fellow, National Tax Practice Institute. **Past Member**: Member (2006-2011) & Chair (2010-11) of the Taxation Advisory Committee of the California State Bar Board of Legal Specialization; Member (2011-2016) & Chair (2014-15) of the California State Bar Board of Legal Specialization; Southern California Bankruptcy Inn of Court (2011-2012); Long Beach Bar Association. (Board. of Governors, 1994-95); Orange County Bar Association, (Co-Chair Technology Law Section 1996); National & CA Society of Enrolled Agents (Orange Co. Chapter President 2003-2004); Registered Parliamentarian - National Association of Parliamentarians; Business Management Committee of SEMA member (1997-98); CA Bar: CEB committee of (1999-2000); Taxation Section Executive Committee (2002-2005); Income & Other Tax subcommittee (Chair 2000-2002); Special Master, California State Bar Association for Search Warrants under Penal Code §1524 (2001-2002).