

Federal Tax Update Offers Tax Savings to Property Owners **by Steven A. Hoffer, C.P.A.**

Apartment owners are confronted with numerous decisions in the life of owning a property. Owners initially purchase and manage the property, but most make various economic and interrelated tax decisions. In recent years, Congress has passed and the President has signed into law tax legislation that has made real estate a tax favored vehicle for federal purposes.

The apartment owner has a window of opportunity in the next four and one half years, if there is a need to cash out part of a real estate portfolio and invest in more liquid assets.

Congress passed a tax measure in 2003, to lower the tax rate on most capital gains from 20 percent to 15 percent for regular tax purposes. It was originally set to expire at the end of 2008. The Tax Increase Prevention and Reconciliation Act was enacted on May 17, 2006. This act extended the 15 percent rate by two years through 2010. The apartment owner has a window of opportunity in the next four and one half years, if there is a need to cash out part of a real estate portfolio and invest in more liquid assets. If the owner determines that real estate is inflated temporarily, it may be worthwhile to dispose of it a low tax cost. The portion of the gain that was created by depreciation claimed on the real estate is subject to a tax rate of 25 percent (unrecaptured section 1250 gain), while the balance would be subject to the 15 percent tax rate.

A second tax system, alternative minimum tax, was enacted several years ago with the intention of having all taxpayers pay at least a minimum amount of tax. While the regular tax system rates have been reduced, the alternative minimum tax rates remain unchanged.

This has trapped more middle income, upper middle income and to some extent high income taxpayers being subject to this tax. This tax system does not allow many of the deductions which are allowed for regular tax purposes, such as state income tax and property tax. The Tax Increase Prevention and Reconciliation Act has increased exemption amounts which decrease tax income subject to this tax. The exemption amounts are \$62,550 for married individuals filing a joint return and surviving spouses and \$42,500 for unmarried individuals other than surviving spouses. The 15 percent tax rate allowed for regular tax purposes is also allowed for this tax system. Timely tax planning should be done to minimize the effects of this tax system.

One significant provision in this act is a new tax deduction enacted for energy efficient commercial buildings.

The Energy Tax Incentives Act of 2005 was signed into law August 8, 2005. One significant provision in this act is a new tax deduction enacted for energy efficient commercial buildings. It encourages commercial building owners to update their systems and structures, which must meet specific energy & power cost reduction requirements. The deduction is available for both new & used buildings. The maximum deduction is \$1.80 per building square foot less any energy efficient commercial building deductions taken in previous years. This deduction does not have dollar limit per a specific building. The building's tax basis will be reduced by the energy efficient commercial building deduction, which is effective for property placed in service in 2006 and 2007. If the preceding criteria were met and construction was undertaken and completed on a 100,000 square foot commercial building, the taxpayer would be entitled to take a federal tax deduction of up to \$180,000 (\$1.80 X 100,000 square feet).

A building will qualify for this new deduction only if it matches the subsequent criteria:

- It is property that is otherwise depreciable or amortizable.
- It is installed on or in any building located in the U.S. that is within the scope of Standard 90.1-2001 of the American Society of Heating, Refrigerating, and Air Conditioning Engineers and the Illuminating Engineering Society of North America (ASHRAE/IESNA).

- It is installed as part of (a) the interior lighting systems, (b) the heating, cooling, ventilation, and hot water systems, or (c) the building envelope.
- It is certified as being installed as part of a plan designed to reduce the total annual energy and power costs with respect to the interior lighting systems, heating, cooling, ventilation, and hot water systems of the building, by 50% or more in comparison to a reference building which meets the minimum requirements of Standard 90.1-2001 (as in effect on April 2, 2003). Detailed certification requirements must be met in order to qualify for the deduction, with IRS to promulgate regulations explaining how the fuel savings targets are to be measured. (Code Sec. 179D(c))

A partial deduction, based on differing conditions, is allowed if the building requirement of a 50% energy savings is not achieved. This partial allowance is outside the scope of this article.

Real estate can be a very valuable piece of an investor's overall portfolio. An investor will be confronted by an assortment of considerable issues over the life of the real estate investment, including prominently economic and tax issues. Economic matters, as a general rule, should be the overriding factor in major decision making, but supplementing a proactive tax plan will only enhance the overall return on your investment.

The preceding article is intended as a general overview of tax law. Readers are cautioned to consult their own advisors with respect to their individual and unique situations. Steven A. Hoffer, C.P.A., is a partner with Neiman, Kornblum, Farkas & Hoffer. For more information, please visit www.nkfhcpa.com or call (818) 907-0851.