NAR Issue Brief

Fiscal Year 2015 Budget

(As of March 14, 2014)

On March 4, 2014, President Obama released his budget for the 2015 fiscal year, which begins on October 1. Below is a highlight of the portions of his budget that impact real estate.

Real Estate-Related Tax Proposals:

- **Modify like-kind exchange rules for real property.** The proposal would limit the amount of capital gain that could be deferred under section 1031 from the exchange of real property to $1 million (indexed for inflation) per taxpayer per year.

- **Extend the exclusion from income for cancellation of certain home mortgage debt:** Gross income generally includes income that is realized by a debtor from the discharge of indebtedness. However, since 2007 there has been an exception to this general rule for discharges of qualified principal residence indebtedness. This provision expired at the end of 2013. The proposal would extend this exclusion for amounts of qualified principal residence indebtedness discharged before 2017, and to amounts that are discharged pursuant to an arrangement entered into before that date.

- **Tax carried interests as ordinary income:** A carried interest (a future profits interest), including a carried interest in a real estate partnership, would be taxed as ordinary income and not as capital gain. The rule would apply to general partners, unless they invested their own capital in the project. It would not apply to limited partners. Income from carried interests would be subject to payroll taxes, as well.

- **Limit the value of itemized deductions:** The President's budget once again includes the provision that would limit the value of all itemized deductions to 28% for single individuals with taxable income of more than $186,000 and $227,000 for married couples filing a joint return. Under the current law, the value of an itemized deduction is equal to the individual's tax rate. So, for example, deductions for a taxpayer in the 33% tax bracket are worth 33 cents on the dollar.

- **Modify and extend the tax credit for the construction of energy-efficient new homes:** Prior tax law provided a new energy-efficient home credit for eligible contractors for the construction of qualified new energy-efficient homes acquired for use as residences. This provision expired at the end of 2013. The proposal would extend the provision for one year, and for homes acquired after 2014 and before 2025, the proposal would be modified to provide a $1,000 energy efficient new home tax credit for the construction of a qualified ENERGY STAR certified new home acquired for the use as a residence. In addition, a $4,000 tax credit would be provided for the construction of a qualified DOE Challenge Home acquired for use as a residence.

- **Modify and permanently extend the deduction for energy-efficient commercial building property:** This enhanced deduction expired on December 31, 2013. The proposal would extend the deduction as under the prior law for one year, and then, for buildings placed in service after 2014, would increase the deduction for buildings that meet certain energy efficiency standards.

- **Extend 100% expensing of tangible personal business property:** The provision that allows businesses to write off immediately the cost of business equipment has been drastically curtailed under current law for 2014 and later years. For 2010 through 2013, businesses could deduct up to $500,000 in new equipment purchased in the year of acquisition. For subsequent years, the limit has dropped to $25,000. The proposal would permanently extend the $500,000 limit. However, the proposal would not extend provisions in the prior law allowing for limited expensing of certain real property.

- **Expand and simplify the tax credit provided to small employers for contributions to employee health insurance:** The Affordable Care Act (ACA) created a tax credit to help small employers (those with no more than 25 full-time equivalent employees with average wages of no more than $50,000) provide health insurance for employees and their families. The maximum credit for 2014 and later years is 50% of the employer's contribution to the premium (limited by the average premium for the small group market in the employer's rating area). The credit is phased out on a sliding scale between 10 and 25 full-time equivalent employees as well as between average wages of $25,000 and $50,000. The proposal would increase the group of eligible employers to those with up to 50 full-time equivalent employees and would begin the phase-out of the credit at 20 full-time equivalent employees. The phase-out would also be made more gradual and the rating area limitation would be eliminated.

- **Exempt foreign pension funds from the application of the Foreign Investment in Real Property Tax Act (FIRPTA):** Under current law, when a nonresident alien individual or foreign corporation sells an interest in U.S. real estate, any gain on the sale is generally subject to U.S. tax. Gain of a U.S. pension fund from the disposition of a U.S. real property interest generally is exempt from U.S. tax, but gain of a similar pension fund created or organized outside the U.S. from the disposition of that same property would be subject to U.S. tax under FIRPTA. The proposal would exempt the application of FIRPTA gains of foreign pension funds from the disposition of U.S. real property interests.

- **Implement the "Buffet Rule" by imposing a new "Fair Share Tax":** The proposal would impose a new minimum tax, called the Fair Share Tax (FST), on higher-income taxpayers. The tentative FST would be assessed at a 30% rate on adjusted gross income (AGI) over $1 million and would be reduced only by a credit equal to 28% of allowed itemized charitable contributions. Final FST is the excess, if any, of the tentative FST over the sum of: (1) the taxpayer's regular income tax (including the 3.8% tax on net investment income), (2) the alternative minimum tax, and (3) the employee portion of payroll taxes.

- **Restore the estate and gift tax rules in effect in 2009:** Since the enactment of the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001, the estate and gift tax rules have been in a state of flux. Prior to EGTRRA, the top rate was 55%, plus a 5% surcharge to recapture the benefit of lower rate brackets. The exclusion was $675,000 and was scheduled to increase to $1 million by 2006. EGTRRA phased in a decrease in the tax rate to 45% and an increase in the exemption level to $3.5 million, and then repealed the estate and gift tax in 2010. Legislation passed in 2010 retroactively restored the estate and gift tax with a top rate of 35% and an exemption of $5 million through 2012. Then, the American Taxpayer Relief Act of 2012 permanently raised the top tax rate for estate and gift taxes to 40%. Beginning in 2018, the proposal would make permanent the estate and gift tax rules in effect in 2009. Thus, the top tax rate would be 45% and the exclusion amount would be $3.5 million for the estate tax and $1 million for the gift tax.

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- **Enhance and make permanent incentives for the donation of conservation easements:** The proposal would make permanent the temporary enhanced incentives for conservation easement contributions that expired at the end of 2013.

- **Eliminate the deduction for contributions of conservation easements on golf courses:** Deductions would be prohibited for any contribution of a partial interest in property that is, or is intended to be, used as a golf course.

- **Restrict deductions and harmonize the rules for contributions of conservation easements for historic preservation:** The proposal would disallow a deduction for any value of an historic preservation easement associated with forgone upward development above an historic building. Also, contributions of conservation easements on buildings listed in the National Register would need to comply with the same rules currently applicable to buildings in a registered historic district.

- **Independent contractors:** The IRS would be given authority for the first time since 1978 to provide additional guidance for employers who receive services from independent contractors. *The proposal would have no impact on the current law provisions that classify real estate sales agents as independent contractors. The existing special statutory provision would be retained.*

- **Allow conversion of private activity bond volume cap into low-income housing tax credits (LIHTCs):** Under current law, each state is given a limited amount of LIHTCs to allocate to projects within the state. In addition, a building owner can generate LIHTCs by financing the building with qualified private activity bonds (PABs), which are also subject to a volume cap. The proposal provides two ways in which the PAB volume cap could be converted into LIHTCs, thus increasing the availability of the credits.

- **Encourage mixed-income occupancy by allowing low-income housing tax credit (LIHTC)-supported projects to elect a criterion employing a restriction on average income:** In order for a building to qualify for the LIHTC, a minimum portion of the units of the building must be rent restricted and occupied by low-income tenants. At least 20% of the units must be rent restricted and occupied by tenants with income at or below 50% of the area median income (AMI), or at least 40% of the units must be rent restricted and occupied by tenants with incomes at or below 60% of AMI. The proposal would add a third criterion – at least 40% of the units in the project would have to be occupied by tenants with incomes that average no more than 60% of AMI. However, no rent-restricted unit could be occupied by a tenant with income over 80% of AMI.

- **Change the formulas for 70% present value (PV) and 30% PV low-income housing tax credits (LIHTCs):** Under current law, the amount of LIHTCs earned each year by owners of qualified rental housing depend in part on a credit rate called the applicable percentage. There are two of these applicable percentages, the 70% value credit rate and the 30% present value credit rate. The Housing and Economic Recovery Act of 2008 provided a temporary minimum rate of 9% for the 70% PV credit rate, which was extended through 2013. The proposal would allow the 9% temporary minimum applicable percentage to expire and would increase the discount rate used in the PV calculation for allocated LIHTCs.

- **Add preservation of federally assisted affordable housing to allocation criteria for low-income housing tax credits:** Under current law, each state must adopt a qualified allocation plan (QAP) to guide the allocation of LIHTCs. The tax law provides ten selection criteria that every QAP must include. The proposal would add preservation of federally assisted affordable housing as an eleventh selection criterion that every QAP must include.

- **Make the low-income housing tax credit (LIHTC) beneficial to real estate investment trusts (REITs):** Under current law, neither REITs nor their shareholders receive any benefit from credits such as the LIHTC. The proposal would permit a REIT that receives a LIHTC to designate as tax exempt some of the dividends that it distributes to its shareholders.

- **Implement requirement that low-income housing tax credit (LIHTC)-supported housing protect victims of domestic abuse:** To ensure that low-income units remain that way for decades, current law provides that no LIHTCs are allowed unless an extended low-income housing commitment (Long-Term Use Agreement) is in effect as of the end of the year. The proposal would require protections for victims of domestic abuse in all Long-Term Use Agreements.

- **Increase the 25% limit on land acquisition restriction on private activity bonds:** Under current law, the interest on certain bonds issued by state and local governments is excludable from gross income if the bonds meet certain requirements. One such requirement is that the bond cannot be part of an issue where 25% or more of the net proceeds are to be used for the acquisition of land. The proposal would increase the 25% land acquisition restriction to 35% on certain private activity bonds.

- **Tax credits for hiring veterans**: Available for hiring employees only, not independent contractors.

- **IRS Enforcement**: Provide more funding for IRS to crack down on "tax cheats."

FHA

- **Blighted Neighborhoods:** Provides $15 billion for Project Rebuild to address blight and rehabilitate homes in struggling neighborhoods.

- **Housing Counseling:** Provides $60 million for housing counseling, a $15 million increase over 2014.

- **Foreclosure Mitigation:** Calls for $50 million for National Foreclosure Mitigation Counseling Program.

- **Counseling Demonstration Project:** Creates a demonstration project for the Homeowners Armed with Knowledge Program (HAWK), which combines FHA-insured mortgages with counseling to improve availability of homeownership opportunities.

- **Appropriations:** Notes that FHA will not need a mandatory appropriation from the US Treasury this year.

- **Lender Compare Ratios**: Indicates that HUD will seek legislative authority to revise calculation of the lender compare ratio.

- **Administrative Support Fee:** Requests authority to charge lenders "administrative support fee" to pay for risk management systems and also salaries & expenses

HUD

- **Financial Management Functions:** Calls for HUD to transition its core financial management functions to the Treasury in 2015.

- **Federally Assisted Contracts:** Converts federally assisted contracts to calendar year. This is expected to create a significant budget shortfall in the short-term, as loans that have been fiscal year-based will switch, and will lose funding. This will require a dramatic increase in funding in FY16, which is unlikely to be approved.

- **Housing Trust Fund**: Requests a $1 billion mandatory appropriation to capitalize the Housing Trust Fund.

RURAL HOUSING

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VETERANS ADMINISTRATION (VA)

- **Homeless Veterans:** Requests $1.6 billion for homeless and at-risk Veterans. Budget goal is to end veteran homelessness by 2015 and chronic homelessness by 2016.

BUSINESS ISSUES

- **Internet Policy Center:** Requests $7.5 million for National Telecommunications and Information Administration (NTIA's) new Internet Policy Center will enhance the Department of Commerce's coordination and policymaking across broadband stakeholders.

- **Small Business GDP Measure:** Calls for $2 million to initiate "Big Data for Small Business," a new data program that collects a new Small Business GDP measure to support decision-making by business owners and investors as well as small business analyses

- **Rural Broadband:** Provides $1.3 billion for broadband access to rural communities in need as part of USDA budget.

ENVIORNMENTAL ISSUES

- **HUD and EPA Lead Paint Programs:** For 2015, HUD's Office of Healthy Homes and Lead Hazard Control is receiving $120 million, a small increase over 2014 levels. This office is responsible for providing grants and technical assistance to states and localities for lead hazard control and mitigation activities in targeted, low-income housing. EPA supports lead-based paint and indoor air programs at 2014 levels but zeroes out grants to State radon programs. This includes administration, operation and enforcement of the disclosure as well as the lead paint residential renovation, repair and painting program.

- **FEMA Flood Insurance Programs:** FEMA's flood hazard mapping, mitigation and risk analysis program is proposed at $84 million, a decrease of approximately $10 million from 2014. The Flood Hazard Mapping and Risk Analysis Program (RiskMAP) supports the mapping and community engagement needs of the National Flood Insurance Program (NFIP). Risk MAP drives national actions to reduce flood risk by addressing flood hazard data needs, supporting local government hazard mitigation planning, and providing the flood risk data needed to manage NFIP financial exposure.

- **FEMA Floodplain Mapping Activities:** Floodplain mapping activities are proposed at $336 million, a small increase from 2014 levels. The program uses a multi-pronged strategy for reducing future flood damage through mitigation assistance grants, better, more accurate mapping and to assist flood victims to rebuild to current building codes. thereby reducing future flood damage. In addition, flood mitigation assistance grants target repetitive and severe repetitive loss properties and help reduce the drain on the National Flood Insurance Fund.

STATE/LOCAL ISSUES

- **Highway Trust Fund:** provides a plan for Congress to reform sections of the business tax code (especially U.S. companies operating overseas to avoid U.S. taxes) to fill the projected HTF shortfalls. Further, provides a four-year $302 billion surface transportation reauthorization, making MAP-21 more stable for states and local governments to create jobs and fund transportation projects. An emphasis will be to repair existing infrastructure a.k.a. "fix-it-first" policy.

    - **TIGER Grants (funded through HTF)**: permanently authorizes the "Transportation Investment Generating Economic Recovery" grant program. TIGER grants are competitively selected and are well regarded by state, local and Metropolitan Planning Organizations because the grants foster regional partnerships, spurs innovation, and creates jobs. To qualify for TIGER grants, transportation plans must include specific long-term outcomes and benefits.

- **Fixing and Accelerating Surface Transportation (funded through HTF)**: creates a new grant program for state and local governments to implement safety reforms (includes bike and pedestrian pathways) and traffic management programs inspired by existing successful transportation plans.

- **National Infrastructure Bank:** newly created entity tasked with connecting private and public capital. Transportation investments are made through loans and/or loan guarantees for national and/or regional projects. Ultimately, filling any funding gap from the HTF or grant programs,

- **America Fast Forward Bonds:** budget proposes changes to the Foreign Investment in Real Property Tax Act to enhance the attractiveness of investing in U.S. infrastructure and real estate.