

Business

Barry Jensen editor/591-2300



Thursday, December 13, 1984 O&E

(T-R-80079)

Depreciation period also altered by '84 tax act

By Sid Mittra
and Dean Calvert
special writers

Part V

The change in the Tax Reform Act of 1984 that has received the widest publicity is the provision that alters depreciation periods. Income-producing properties, whether or not they are packaged as a tax shelter, must be depreciated or written off over 18 years rather than the 15 year provided by the 1981 Tax Act.

The write-offs produce deductions that reduce the owner's current tax liability. Specifically, available depreciation under the new law is decreased by 1 percent for each of the first four years of ownership.

Since the availability of bigger deductions in the early years of ownership is the key advantage of accelerated depreciation, the new law represents a slight cutback in such benefits.

INCIDENTALLY, ONE exception to this rule is the 15-year recovery for low-income housing.

The new tax law has repealed OID rules, thereby affecting the seller-financing transactions. The OID (Original Issue Discount) rules permitted the seller of a real estate property to lend the money to the borrower, postpone receipt of interest to a later date and defer paying taxes on that interest.

Under the new law, if interest is credited to the lender, it can be taxed even if it is not paid. This means that sellers of property who take back a low-rate mortgage will be required to report and pay taxes on accrued but unpaid interest income.

THE HOLDING period for long-term gains treatment has been cut from one year to six months. This provision should not have a significant effect on real estate, since people generally hold onto property for longer periods anyway.

However, shortening the holding period appears paradoxical, since another provision of the new tax law discourages frequent turnover of prop-

erty. A property owner often takes depreciation on an accelerated basis. But if the property is sold before the stated "life" expires, the accelerated portion of the depreciation is subject to the recapture rules.

TAXES MUST be paid on the income sheltered by the deduction.

Popular leasing transactions involving total payments in excess of \$250,000 a year also have been affected.

No longer can a lower initial rent schedule be offset by a higher future rent schedule to achieve a "back-loading" of income with a corresponding reduction of taxable income.

The effect on investors: Initial-year deductions are reduced, thereby increasing the effective investment and lowering the rate return.

Another popular scheme that is practically eliminated by the new law is the "disguised sale" of property. Generally, when a property is sold to a partnership, taxes must be paid on the profit realized on that sale.

HOWEVER, NO taxes will be due if such a sale is "disguised" as a contribution, since the contribution of property to a partnership is generally a tax-free transaction. Under the new rules, the disguised sale of property will be disqualified, and the so-called contributions will be treated as a sale and taxed accordingly.

While the current tax laws are enormously complex, real estate continues to provide excellent investment opportunities. However, real estate investment decision-making is not for the lighthearted.

PLEASE consult your financial planner, CPA or attorney before you make your final decision to invest in a real estate tax shelter.

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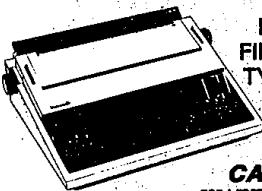
Sid Mittra

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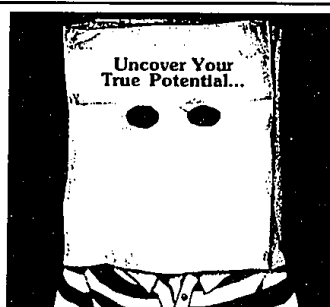
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