

2005 PROPOSED TAX LAW CHANGES

"EXAMINING THE POTENTIAL IMPACT ON REAL ESTATE"



Compliments of

FEDERAL TAX REFORM REPORT

The President's Advisory Panel on Federal Tax Reform recently released a 270-page report that recommended two ways to modify the U.S. Federal tax code. (This Federal Tax Reform report can be accessed at www.taxreformpanel.gov.) One plan is known as the "Simplified Income Tax Plan" and the other is the "Growth and Investment Tax Plan." Both of these proposals seek to make the tax code fair and simple. It is important to note that at this time, these are merely the panel's recommendations. There is a complicated and long legislative process that is involved anytime changes are made to the tax code.

MORTGAGE INTEREST DEDUCTION CHANGES

The mortgage interest deduction, which is currently capped at \$1.1 million, would be turned into a 15% credit and apply only to principal residences. In addition, the maximum debt eligible for the credit would be limited to 125% of the median sales price for the county, based upon Federal Housing Administration data (Current limits range between \$227,147 and \$411,704.) It is estimated that between 85% - 90% of all mortgages originated in 2004 fall below these levels. There would be transition tax relief for those with mortgages above the proposed dollar caps and the new caps would be phased in over a five-year period for pre-existing mortgages.

Potential Impact: Converting a deduction into a credit provides the same tax rate to all taxpayers, although taxpayers in higher tax brackets will lose more tax savings from converting a deduction into a 15% credit. In addition, limiting the credit to only principal residences may have a negative impact on the costs of owning vacation home properties, which might ultimately impact the demand for this type of property.

REAL ESTATE TAX CHANGES

The deduction for state and local taxes, including real estate taxes, would be repealed.

Potential Impact: This change, coupled with the change in claiming mortgage interest deductions, would make property ownership more expensive on an after-tax basis. Investors may begin to reallocate new investments away from real estate and into other investment alternatives.

PRIMARY RESIDENCE SALE CHANGES

The tax exclusion for capital gain on the sale of a primary residence would remain. However, the ownership and use period would be lengthened to three (3) out of five (5) years, versus the two (2) out of five (5) years requirement under the current law.

Potential Impact: Homeowners will generally need to stay in their principal residences for one more year to qualify for the \$500,000, married filing jointly, or \$250,000, single, tax exclusion available under IRC Section 121. This additional holding period requirement may reduce the volume of property sales and negatively impact those services associated with the sale and transfer of real estate.



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