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Technical Report 1040

August 1994

Real Estate Center

Director

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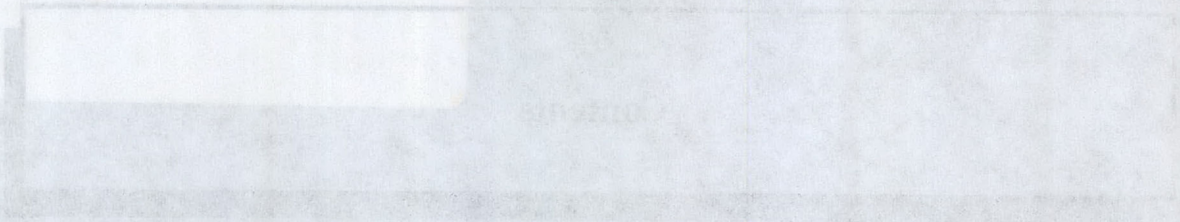


Summary

This report provides a general summary of major provisions of the 1993 Tax Act affecting real estate. As noted below, some provisions are effective for 1993, and others start in 1994.

- For married taxpayers who have taxable income more than $140,000, the top individual marginal tax rate has risen from 31 percent to 36 percent for 1993 and 1994. The 1993 and 1994 marginal tax rate for married taxpayer taxable incomes of more than $250,000 is 39.6 percent. In addition, starting in 1994, all self-employment income is subject to a Medicare hospital insurance tax (part of the social security tax) of 2.9 percent without limit. The combination of income taxes and self-employment taxes coupled with phaseouts of personal-dependency exemptions and itemized deductions will result in **effective** tax rates of 45 percent or more for married taxpayers with taxable income greater than $250,000.
- The top long-term capital gains tax rate remains at 28 percent. While **effective** tax rates on capital gains may exceed 32 percent as the result of phaseouts of personal-dependency exemptions and itemized deductions, capital gains are now relatively more valuable because of the rise in tax rates on ordinary income.
- Individuals subject to the alternative minimum tax pay at rates of 26 or 28 percent beginning in 1993. Under prior law, the rate was 24 percent. Contributions of appreciated real, personal and intangible property no longer create a tax preference item for the alternative minimum tax, starting in 1993.
- Losses and credits from certain real estate activities are no longer disallowed by the passive loss rules, starting in 1994. The new relief is designed especially for real estate brokers, salespersons and other real estate professionals.
- The write-off period for nonresidential real estate (including hotels and motels) increases from 31.5 years to 39 years for property placed in service after May 12, 1993.
- The deductible portion of meal and entertainment expenses declines to 50 percent from 80 percent, starting in 1994.
- Allowable moving expenses are now a deduction for adjusted gross income rather than an itemized deduction. Yet, there is no longer a deduction for indirect expenses, such as costs related to buying and selling a residence (e.g., brokerage commission), pre-move house hunting or temporary living.
- In limited ways, pension funds and other exempt organizations can invest more easily in real estate because some debt-financed real property exceptions have been relaxed.
- Low-income rental housing tax credits for investors are now permanent. Among other changes, units occupied by full-time students qualify for these credits, starting in 1993.

Tax Rates, Deductions and Capital Gains

Several key provisions of the 1993 Tax Act are interrelated, prompting a simultaneous effect on both a taxpayer's tax liability and **effective** marginal tax rate. The effective marginal tax rate on additional income is the increase in tax divided by the additional income. Thus, if $10,000 of additional income results in a $3,500 tax increase, the effective marginal tax rate on that income is 35 percent. Under the 1993 Tax Act, effective marginal tax rates can exceed 45 percent for married taxpayers who have more than $250,000 in taxable income–a rise of 10 percentage points from previous rates. Married taxpayers with taxable income of more than $140,000 can face effective tax rates exceeding 40 percent.

The effective marginal tax rate is affected by higher income tax rates and self-employment tax increases, as well as the interaction between income tax rates and phaseouts of personal-dependency exemptions and itemized deductions. Each is briefly discussed and illustrated in this report. Some provisions of the 1993 Tax Act become effective for 1993, and others start in 1994.

Individual Tax Rate Structure

Prior to the 1993 Tax Act, tax bracket rates for individuals were 15, 28 and 31 percent. The act adds 36 and 39.6 percent brackets for high-income taxpayers. For 1993 and 1994, the 36 percent bracket begins at $140,000, and the 39.6 percent bracket begins at $250,000 for married taxpayers filing jointly. For single taxpayers, the 36 percent bracket begins at $115,000, and the 39.6 percent bracket begins at $250,000. The 15, 28 and 31 percent brackets have been widened to reflect inflation. Complete rate schedules for 1992, 1993 and 1994 are in the appendix.

Taxpayers whose tax bracket rates have increased to 39.6 percent will experience effective tax rates of 45 percent or more on some of their income. The higher effective rate is created by an increased self-employment tax along with an interaction between the rate schedule and other tax calculations.

Personal and Dependency Exemptions

The personal and dependency exemption for 1993 was $2,350. The 1994 exemption is $2,450. Thus, total exemptions for a joint tax return filed for 1994 by a married couple with two dependent children is $9,800 ($2,450 for each person).

One reason a high-income taxpayer's effective tax rate can exceed their tax bracket rate (36 or 39.6 percent) is the phaseout of personal exemptions. Exemptions are phased out by 2 percentage points for each $2,500 ($1,250 for married filing separately) or fraction thereof by which a taxpayer's adjusted gross income (AGI) exceeds the applicable "threshold." The 1994 thresholds, adjusted annually for inflation, are $167,700 for joint returns; $139,750 for head of household; $111,800 for single and $83,850 for married filing separately. The 1993 Tax Act makes the phaseout provision permanent. Under prior law, it would have expired in 1996. The 1993 thresholds were $150,000 for joint returns; $125,000 for head of household; $100,000 for single and $75,000 for married filing separately.

An example may help. Assume a husband and wife have a 1994 combined salary income of $218,000 and four exemptions totalling $9,800 (including two for dependent children). They are in the 36 percent tax bracket. If there is no other income, the exemptions are reduced to $5,684 ($9,800 less 42 percent). The 42 percent is computed as follows:

[($218,000 AGI - $167,700 threshold) / $2,500] rounded up x 2

Based on the phaseout rule, exemptions are eliminated once AGI reaches $122,501 **more than** the threshold amount. Referring to the above example, once AGI reaches $290,201 (or $122,501 above the $167,700 threshold), exemptions are eliminated. These phaseout calculations raise the couple's effective tax rate on some of their income to **more than** 40 percent even though they are in the 36 percent tax bracket. The same calculation can raise the effective tax rate above 45 percent for taxpayers in the 39.6 percent tax bracket. An example illustrating this phenomenon follows.

Itemized Deductions

The most common itemized deductions consist of home mortgage interest, property

taxes and charitable contributions. Another common category is miscellaneous deductions, which includes unreimbursed employee business expenses and tax return preparation fees. The total of **miscellaneous** deductions is reduced by 2 percent of AGI, and any amount remaining is included in the total of all itemized deductions.

Taxpayers whose total itemized deductions exceed their "standard deduction" list these deductions on Schedule A of Form 1040. Then, the total is subtracted when computing taxable income. Standard deductions for 1994 are $6,350 for joint returns; $5,600 for head of household; $3,800 for single and $3,175 for married filing separately.

Itemized deductions are phased out for taxpayers whose AGI exceeds a certain threshold. The 1994 thresholds are $111,800 for joint returns, head of household, and single; $55,900 for married filing separately. Like the phaseout of exemptions, the itemized deduction calculation results in higher effective tax rates for some taxpayers. The 1993 Tax Act makes the itemized deduction phaseout provision permanent. Under prior law, it would have expired in 1996. The 1993 thresholds were $108,450 for joint returns, head of household and single; $54,225 for married filing separately.

First, the computation requires the total of itemized deductions to be split into two parts. Part 1 contains three less common itemized deductions–medical expenses, casualty and theft losses, and investment interest (interest paid on loans used to acquire investment property). Part 2 is simply the total of all remaining itemized deductions (including miscellaneous deductions exceeding 2 percent of AGI).

The reduction of itemized deductions is 3 percent of AGI above the threshold. However, the reduction cannot exceed 80 percent of the Part 2 itemized deductions. Part 1 itemized deductions are never reduced.

For example, assume a married couple has $300,000 of AGI in 1994; $10,000 of Part 1 itemized deductions and $25,000 of Part 2 itemized deductions. AGI above the threshold is $188,200 ($300,000 less $111,800), and 3 percent is $5,646. Thus, the couple's deductible itemized deductions become $29,354 ($10,000 Part 1 plus $25,000 Part 2 reduced by $5,646).

If Part 2 deductions were only $7,000, the reduction would be limited to $5,600 (80 percent of $7,000), not $5,646. Hence, the couple's deductible itemized deductions would be $11,400 ($10,000 Part 1 plus $7,000 Part 2 reduced by $5,600). Notice that the 80 percent rule only benefits taxpayers who have relatively low amounts of itemized deductions.

Self-Employment Tax Rises

Real estate brokers and salespersons operating as independent contractors are considered self-employed for tax purposes. Self-employment status applies whether the broker owns a firm or is associated with one owned by others.

One key distinction for self-employed taxpayers is that they must pay self-employment taxes on their net self-employment income at tax rates that are **twice** the FICA (social security and Medicare) rates applicable for employees. Both self-employment taxes and regular income taxes are paid on net self-employment income. Brokers and salespersons need to anticipate their self-employment tax liability to accurately compute quarterly estimated tax payments. Tax penalties may be payable if estimated payments are insufficient to cover both the regular income tax and the self-employment tax.

To compute net self-employment income, a broker subtracts business expenses (e.g., automobile, advertising, allowable meals and entertainment) from gross commissions. The tax form used for this computation is Schedule C. Net income computed on Schedule C is included in AGI on the front page of Form 1040 for income tax calculations. Schedule C net income also is included on Schedule SE, the self-employment tax computation form. Both Schedules C and SE are attached to Form 1040 for filing.

The 1993 Tax Act increases the amount of self-employment taxes for high-income taxpayers. Table 1 illustrates how the self-employment tax is computed. The example assumes a broker's *net* income is $200,000. Net income is reduced automatically by 7.65 percent to calculate the adjusted amount of net income potentially subject to self-employment tax.

Table 1. 1994 Self-Employment Tax

	OASDI	MHI
Net earnings from self-employment before special deduction	$200,000	
Less: 7.65% x $200,000	-15,300	
Adjusted net earnings from self-employment	$184,700	
Wage base	$60,600	Not applicable
Less: FICA wages	-0	
Maximum base	$60,600	
Lesser of maximum base or adjusted net earnings from self-employment	$60,600	$184,700
Tax rate	12.4%	2.9%
Self-employment tax	$7,515	$5,356

Total self-employment tax = $7,515 + $5,356 = $12,871
Deduction for AGI is 50% = $6,436

As indicated by the table, the self-employment tax is composed of two parts–12.4 percent OASDI (social security taxes for old age, survivor's and disability insurance) and 2.9 percent MHI (Medicare health insurance). The 1994 cap, or maximum wage base, for OASDI is $60,600 ($57,600 for 1993). MHI applies to all net self-employment income without limit starting in 1994. The 1993 Tax Act removed the cap for MHI, which was $135,000 in 1993. Employee wages, if any, reduce the OASDI maximum because FICA (social security) taxes already would have been withheld by the employer. Employee wages have no effect on MHI because there is no MHI limit.

Note that adjusted net income for the broker in the example is $184,700. Because this amount exceeds the $60,600 OASDI maximum, the OASDI 12.4 percent rate is applied to $60,600 resulting in OASDI tax of $7,515. As there is no limit on MHI, the MHI tax is 2.9 percent of $184,700, or $5,356. The broker's total self-employment tax is $12,871 ($7,515 plus $5,356).

Although the self-employment tax raises taxes for most brokers, its cost is reduced somewhat because one half of this tax becomes a deduction for regular income tax purposes. For example, the broker with $200,000 net income and $12,871 self-employment tax is allowed a $6,436 deduction for computing taxable income. Assuming this broker is in the 36 percent marginal tax bracket for regular income tax purposes, the deduction provides tax **savings** of $2,317 (36 percent of $6,436). Thus, the net increase in tax liability associated with the self-employment tax becomes $10,554 ($12,871 less $2,317), reflecting an **effective** self-employment total tax rate of roughly 5.3 percent ($10,554 divided by $200,000).

Capital Gains

Since 1991, the maximum tax rate applied to long-term capital gains has been 28 percent. However, **effective** tax rates on capital gains exceed 28 percent for taxpayers affected by exemption and itemized deduction phaseouts discussed previously. Yet, because effective tax rates on ordinary income can exceed 45 percent, capital gain income is now relatively more attractive as the result of the 1993 Tax Act. The comprehensive example in the next section illustrates this phenomenon.

Long-term capital gains result from the sale of capital assets held more than one year. Common capital assets are stocks, bonds and real estate held solely for investment purposes. Gains from the sale of real estate used in a trade or business for more than one year are typically taxed exactly as though they are long-term capital gains.

Effective Tax Rates Example

Effective tax rates under the new law will be higher than the rates shown in the tax rate schedule for high-income taxpayers. This is attributable to the phaseout of exemptions and itemized deductions. The example in Table 2 illustrates how effective tax rates are computed for 1994.

The example in Table 2 assumes a joint tax return is filed by a married couple with four dependent children in 1994. Thus, the return has six exemptions. The base case columns in Table 2 indicate that itemized deductions are reduced because AGI exceeds the $111,800 threshold (following the computations discussed and illustrated earlier). Itemized deductions are assumed to consist mainly of mortgage interest, property taxes and charitable contributions. Thus, the 80 percent rule has no effect on calculations. Exemptions

Table 2. 1994 Effective Tax Rate

		Base Case		Add $10,000 Income
Adjusted gross income		$270,000		$10,000
Itemized deductions:				
Total	$20,000			
Reduction:	-4,746	15,254		300
3% x ($270,000-$111,800)				
Exemptions:				
AGI	270,000			
Threshold	167,700			
Excess	$102,300		10,000	
Excess/$2,500, rounded up	41		4	
Multiply by 2 percentage points	82%		8%	
Reduction:	12,054		1,176	1,176
6 exemptions x $2,450 x %				
Exemptions after reduction:	$2,646	2,646		———
(6 x $2,450) - reduction				
Taxable income		$252,100		$11,476
Additional tax on $10,000 income:				$4,544
$11,476 x 39.6%				
Effective tax rate on $10,000 income:				
Additional tax $4,544 = 45%				
Additional inc. $10,000				

are reduced because AGI exceeds the $167,700 exemption threshold. Calculations follow the same pattern explained and illustrated previously.

Effective Tax Rate on Additional $10,000

Table 2 columns labelled "Add $10,000 Income" demonstrate how an investor's effective tax rate exceed the 39.6 percent top tax bracket. An additional $10,000 of income increases the **reduction** of itemized deductions by 3 percent of $10,000, or $300, because AGI has already exceeded the $111,800 threshold. Thus, an additional $300 of AGI (more than the $10,000 of new income) is subjected to tax.

A similar result occurs with exemptions. Table 2 shows how the added $10,000 AGI increases the percentage reduction of exemptions by 8 percentage points, thereby reducing deductible exemptions by an additional $1,176 (6 exemptions x $2,450 x 8 percent). The $1,176 reduction of exemptions causes $1,176 more of AGI to be subject to tax.

In the final analysis, even though AGI increased by $10,000, **taxable income** increased by $11,476 because of additional phaseouts of itemized deductions and exemptions caused by the $10,000 rise in AGI. The couple is in the 39.6 percent tax bracket, yet the 39.6 percent rate is applied to the entire $11,476 increase in taxable income, not just the $10,000 increase in AGI. As a result, the effective tax rate for the $10,000 additional income is 45 percent, as shown in Table 2.

Can effective tax rates exceed 45 percent? Unfortunately, the answer is *yes*. Even for the taxpayers in Table 2, the effective tax rate would be more than 47 percent if the additional $10,000 were self-employment income. The phaseout of itemized deductions adds more than 1 percentage point to a high-income taxpayer's effective tax rate (3 percent x 39.6 percent = 1.19 percent). Furthermore, a high-

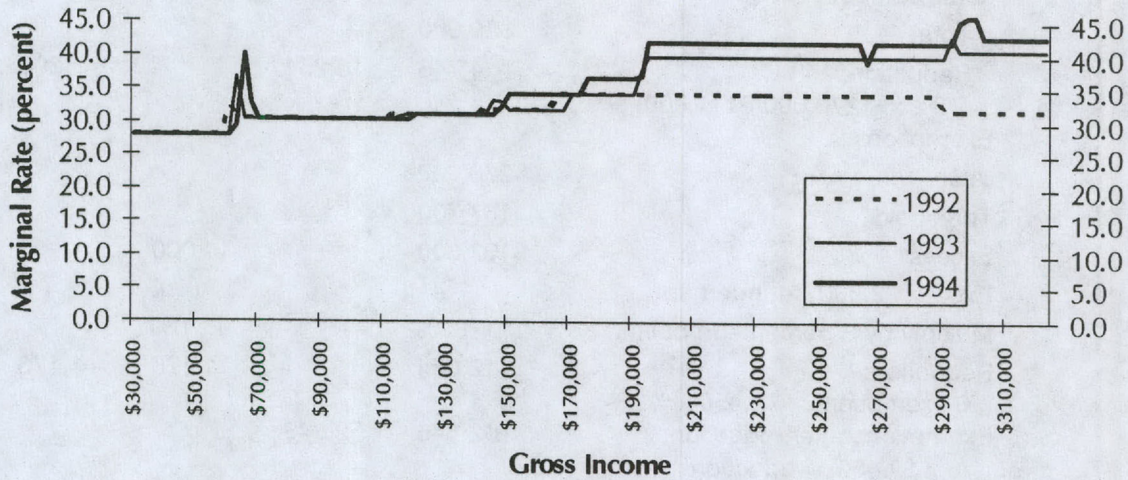


Figure 1. Effective Tax Rates for Married Taxpayers (Years Ending 1992, 1993 and 1994 with 100 Percent Self-Employment Income)

income taxpayer's effective tax rate increases .5 percentage points or more for **each** exemption. Thus, the more exemptions, the higher the effective tax rate. For the taxpayer in Table 2, phaseouts of itemized deductions and exemptions add more than 5 percentage points to the tax bracket rate of 39.6 percent.

Effective tax rates for married couples filing joint returns who have two dependent children are compared in Figure 1 for 1992, 1993 and 1994. Calculations assume all income is from broker commissions and thus are subject to self-employment tax as well as income tax. Figure 1 indicates that effective tax rates for high-income taxpayers increased in both 1993 and 1994. Effective tax rates more than 47 percent occur for some high-income taxpayers. Increases and decreases in the effective tax rates reflect increases in tax bracket rates along with phaseouts of itemized deductions and exemptions. Once itemized deductions and exemptions are fully phased out, the effective tax rate declines.

Figure 2 performs the same analysis as Figure 1, but for single self-employed individuals who have no dependents. The trends are similar to those in Figure 1. Note the top effective rate does not exceed 43 percent because only one personal exemption is being phased out.

Effective Tax Rate on Capital Gains Income

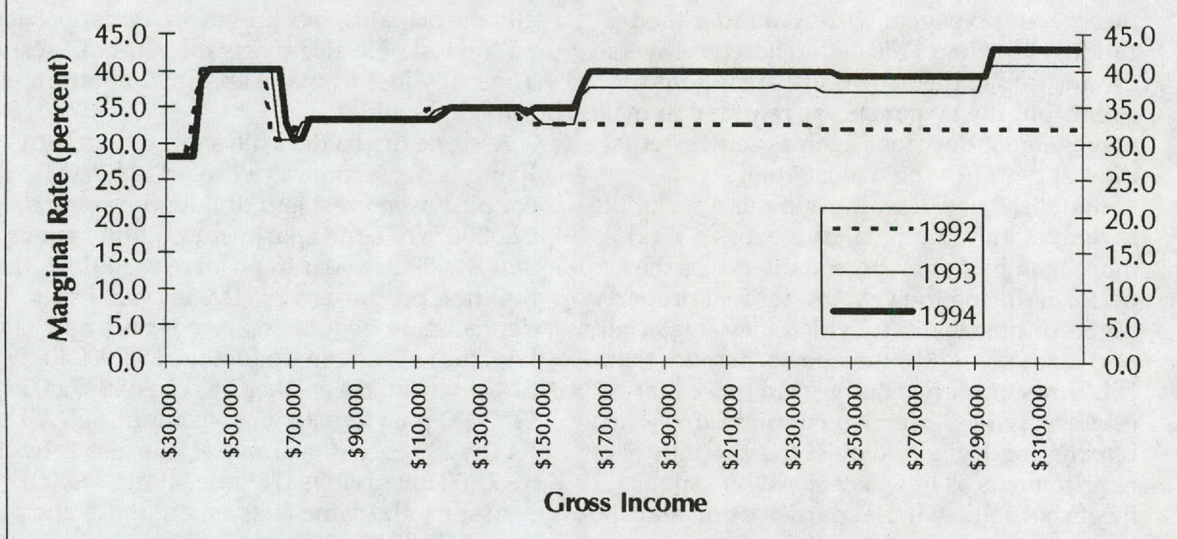
Calculations in Table 2 assume the $10,000 additional income is "ordinary income," such as salary, royalties, dividends, interest and so forth. Recall that long-term capital gains are taxed at a maximum tax rate of 28 percent. However, if the $10,000 in Table 2 were long-term capital gains income rather than ordinary income, the **effective** rate would be nearly 34 percent (not 28 percent), computed as follows:

$10,000 long-term capital gain taxed at 28 percent	$2,800
1,476 additional taxable income from phaseouts of itemized deductions and exemptions, taxed at 39.6 percent	585
Additional tax	$3,385

$$\frac{\text{Additional tax } \$3{,}385}{\text{Additional income } \$10{,}000} = \text{33.85\% Effective tax rate on \$10,000 capital gain}$$

As just shown, the 28 percent maximum long-term capital gains tax rate applies only to the gain itself. The extra taxable income created by phaseouts of itemized deductions and exemptions is taxed at 39.6 percent.

Figure 2. Effective Tax Rates for Single Taxpayers (Years Ending 1992, 1993 and 1994 with 100 Percent Self-Employment Income)



Alternative Minimum Tax Increases

The alternative minimum tax (AMT) is intended to increase the tax liability of taxpayers who receive large benefits from certain "tax preference" provisions in the tax law. These provisions include rapid depreciation, incentive stock options and deductions such as property taxes and miscellaneous itemized deductions. Prior to the 1993 Tax Act, the AMT tax rate for individuals was 24 percent. (Prior to the 1990 Tax Act, the alternative minimum tax rate was 21 percent.) The new law replaces the single rate with a two-tier rate structure starting in 1993, as follows:

Base	Rate
$0 - $175,000	26 percent
More than $175,000	28 percent

Taxpayers who benefit from tax preferences such as those just noted are required to compute two tax liabilities–one using the regular tax method (partially illustrated by Table 2) and the other using the AMT method. Briefly, the AMT method includes virtually all of the income of the regular method plus tax preferences and certain other adjustments. In essence, the taxpayer must pay the higher of the two tax liabilities.

The increase in the AMT rate will undoubtedly cause more taxpayers to be subject to the AMT than under prior law. Thus, there is now a greater need to include the effects of the AMT when performing tax planning and investment analyses.

Passive Loss Rules Eased

Starting in 1994, losses and credits from certain real estate activities are no longer disallowed by the "passive activity limitation" rules. The new relief is designed especially for real estate brokers, salespersons and other real estate professionals. As explained later, eligibility requirements focus on demonstrating material involvement in real estate businesses. The chief benefit of the new rule is that eligible taxpayers can deduct **unlimited** real estate activity losses from active income (e.g., wages, salaries, commissions, self-employment income) and portfolio income (e.g., interest and dividends).

Under prior law, all rental activities (including real estate rentals) were generally treated as passive activities regardless of the level of the taxpayer's personal involvement. Losses

from passive activities were generally only deductible against passive income, which did not include active income or portfolio income. A special rule continues to allow full deductibility of as much as $25,000 of passive real estate losses against active and portfolio income for taxpayers with AGI (after modifications) less than $150,000. These taxpayers are allowed to delegate daily operations to agents but the taxpayers are required to make management decisions such as setting rental rates and approving major repairs.

Under the new law, individuals are eligible to deduct unlimited real estate losses if (a) more than half of all personal services they perform during the year are for real property trades or businesses in which they "materially participate," and (b) they perform more than 750 hours of service per year in those real estate activities. Married couples filing joint returns are deemed to meet the eligibility requirements as long as at least one spouse meets both the material participation and 750-hour requirements. Closely held corporations are also eligible if more than 50 percent of their gross receipts for the year are derived from real property trades or businesses in which the corporation materially participates. A corporation is closely held if five or fewer shareholders own more than 50 percent of the value of the outstanding stock at any time during the last half of the year.

Material participation requirements are met if the taxpayer is involved in real estate operations on a regular, continuous and substantial basis. Limited partners typically do not materially participate because active involvement could cause them to lose their limited liability status. Real property trades and businesses include real estate brokerage, management, rental, operation, leasing, development, construction, reconstruction, acquisition, or conversion. An example illustrates real estate loss rules and computations.

Randy Baxter works an average of 45 hours per week as a real estate broker (2,250 hours per year). Joan, Randy's wife, owns a 20-unit apartment building. Joan spends few hours at the apartment building because she devotes most of her time to raising their two-year-old twin daughters. Randy, however, spends an average of three hours per week (150 hours per year) managing the apartment building. Randy's involvement with the apartment building qualifies as material participation because it exceeds 100 hours per year, no other individual spends more time on the activity, and Randy is the spouse of the owner of the property. All of Randy's personal service time is in real estate activities in which he materially participates, meeting the material participation test. He also meets the 750-hour test. Thus, any loss from the apartment building is fully deductible.

Assume the Baxters file a joint tax return. Randy's net income as a broker is $75,000. The couple has interest and dividend income of $2,000. While the apartment building generates $4,000 per year in positive cash flow, the building produces a $35,000 tax loss from depreciation deductions. Under the new tax law, the couple can deduct the $35,000 loss directly from their other income of $77,000 ($75,000 plus $2,000) when computing AGI. At the 28 percent tax bracket, the loss provides a $9,800 tax savings (28 percent of $35,000).

Assume the same facts except that Randy earns $75,000 in commissions from selling life insurance. The new tax law would not apply because neither test is met. But because the couple's AGI is less than $150,000, the special $25,000 deduction rule still available from prior law can help the Baxters. The couple can deduct $25,000 directly from their other income of $77,000. The remaining $10,000 ($35,000 less $25,000) can be carried forward to future tax years and deducted against future passive income.

If Randy had earned $155,000 from life insurance commissions, none of the real estate loss would be deductible this year. The entire $35,000 loss would have to be carried to future years. The special $25,000 deduction rule is not available because the couple's AGI (before taking account of the real estate loss) exceeds $150,000.

Write-off Period for Nonresidential Real Estate Lengthened

The minimum write-off period for nonresidential real estate (including hotels and motels) is increased to 39 years from 31.5 years for property placed in service after May 12, 1993. The previous 31.5-year period can be used for property placed in service before

January 1, 1994, if (1) the taxpayer contracted to purchase or construct the property on or before May 12, 1993, or (2) construction of the property commenced on or before May 12, 1993. The previous 31.5-year period also is available for property placed in service on or before May 12, 1993. The new rule does not change depreciation computations for real estate acquired prior to 1993.

Meal and Entertainment Deductions Reduced

The deductible portion of meal and entertainment expenses shifts down to 50 percent from 80 percent, starting in 1994. Thus, if a broker in the 31 percent tax bracket takes a client to dinner and spends $100 (total for both meals), only $50 is deductible in 1994. The 1994 tax savings are $15.50 (31 percent of $50). In 1993, the tax savings would have been $24.80 (31 percent of $80). For the 31 percent bracket taxpayer, the tax law change increases the after-tax cost of meals and entertainment approximately 9 percent ($24.80 less $15.50, divided by $100). For taxpayers forced into the 36 percent or 39.6 percent brackets by the new tax act, the increase in the tax cost of deductible meals and entertainment is lower–roughly 7 percent and 5 percent, respectively.

Moving Expense Deductions

Beginning in 1994, allowable moving expenses are a deduction for AGI rather than an itemized deduction. Deductions have been eliminated for indirect expenses, such as costs related to buying and selling a residence (e.g., brokerage commissions), pre-move house-hunting or temporary living. Under prior law, as much as $3,000 of indirect expenses were deductible. Now, deductible moving expenses include only the cost of moving household items, transportation and lodging during the period of travel from the former residence to the new residence. The cost of meals associated with the move is no longer deductible. The new law also increases the minimum distance of a deductible move to 50 miles from 35 miles.

Employer reimbursements of allowable moving expenses are excluded from gross income. Excess reimbursements increase gross income and are taxable. For example, assume $5,000 is the cost of moving household items and transportation during the move of an employee. Furthermore, assume pre-move house-hunting and the real estate commission from selling the prior residence (i.e., nondeductible indirect moving expenses) total $10,000. If the employer reimburses $12,000 to the employee, $5,000 is excluded and $7,000 increases gross income. Thus, the net effect of the moving expenses and the reimbursement on the employee's tax return is $7,000 more gross income for tax purposes.

Real Estate Rules Eased for Pension Funds and Other Exempts

In limited ways, pension funds and other exempt organizations can invest more easily in real estate. The new law relaxes the sale-leaseback restrictions to permit a limited leaseback of debt-financed real estate to the seller. The exception applies only where (1) no more than 25 percent of the leasable floor space in a building (or complex of buildings) is leased back to the seller, and (2) the lease is on commercially reasonable terms, independent of the sale and other transactions.

The new law relaxes seller-financing restrictions to permit seller financing by pension funds and other exempt organizations on terms that are commercially reasonable fixed rates. As under prior law, participations in income or profits will be treated as taxable (nonexempt) income for pension funds and other exempt organizations.

Real estate investments by pension funds and other exempt organizations also are encouraged by new rules that exempt gains from the sale or exchange of real estate or mortgages acquired from financial institutions in receivership or conservatorship.

Low-Income Rental Housing Tax Credit Now Permanent

Tax credits of various amounts are allowed for qualified low-income housing construction, rehabilitation or acquisition. Credits are received in annual installments for 10 years. The credits are designed to be sold by real

estate developers to profitable corporations that can use the credits to reduce their tax liability. The 1993 Tax Act makes the credit permanent. Other modifications make the credit available for units occupied by full-time students and certain projects receiving funds under the Investment Partnership Act. The new tax law also eases various operating requirements for low-income housing.

Other Tax Law Changes

- For 1993, self-employed individuals (i.e., real estate brokers) may continue to deduct 25 percent of health insurance costs regardless of whether they itemize deductions. Congress will likely pass legislation to make this health-care deduction available for 1994.
- Dues for membership in clubs for business, pleasure, recreation or any other social purpose are not deductible, starting in 1994. Such clubs include luncheon, athletic, airline, and hotel clubs.
- Discharge of mortgage indebtedness is excluded from taxable income for noncorporate taxpayers even if the taxpayer is neither insolvent nor bankrupt, starting in 1993. The depreciable basis of the real estate must be reduced by the excluded income.
- Purchases of depreciable personal property as much as $17,500 can be expensed in the year of purchase, up from $10,000, starting in 1993. Such property includes computers and peripherals, phones, office furniture and fixtures, machinery and equipment.
- The luxury excise tax on jewelry, furs, boats and aircraft is repealed, effective for 1993. The luxury tax still applies to automobiles retailing for more than $30,000.
- The limit on the national debt is increased to $4.9 trillion from $4.37 trillion.

This report is for information only. For specific advice, consultation with a tax advisor is recommended.

894-450-1040

Appendix

1992 Tax Rate Schedules for Individuals

Married filing jointly and qualifying widows and widowers

If taxable income is		Regular income tax liability before credits is			
More than	but not more than				of the amount more than
$0	$35,800	$0.00	+	15%	$0
35,800	86,500	5,370.00	+	28%	35,800
86,500		19,566.00	+	31%	86,500

Heads of Households

If taxable income is		Regular income tax liability before credits is			
More than	but not more than				of the amount more than
$0	28,750	$0.00	+	15%	$0
28,750	74,150	4,312.50	+	28%	28,750
74,150		17,024.50	+	31%	74,150

Single

If taxable income is		Regular income tax liability before credits is			
More than	but not more than				of the amount more than
$0	$21,450	$0.00	+	15%	$0
21,450	51,900	3,217.50	+	28%	21,450
51,900		11,743.50	+	31%	51,900

Married Filing Separately

If taxable income is		Regular income tax liability before credits is			
More than	but not more than				of the amount more than
$0	$17,900	$0.00	+	15%	$0
17,900	43,250	2,685.00	+	28%	17,900
43,250		9,783.00	+	31%	43,250

1993 Tax Rate Schedules for Individuals

Married filing jointly and qualifying widows and widowers

If taxable income is		Regular income tax liability before credits is			
More than	but not more than				of the amount more than
$0	$36,900	$0.00	+	15%	$0
36,900	89,150	5,535.00	+	28%	36,900
89,150	140,000	20,165.00	+	31%	89,150
140,000	250,000	35,928.50	+	36%	140,000
250,000		75,528.50	+	39.6%	250,000

Heads of Households

If taxable income is		Regular income tax liability before credits is			
More than	but not more than				of the amount more than
$0	$29,600	$0	+	15%	$0
29,600	76,400	4,440.00	+	28%	29,600
76,400	127,500	17,544.00	+	31%	76,400
127,500	250,000	33,385.00	+	36%	127,500
250,000		77,485.00	+	39.6%	250,000

Single

If taxable income is		Regular income tax liability before credits is			
More than	but not more than				of the amount more than
$0	$22,100	$0.00	+	15%	$0
22,100	53,500	3,315.00	+	28%	22,100
53,500	115,000	12,107.00	+	31%	53,500
115,000	250,000	31,172.00	+	36%	115,000
250,000		79,772.00	+	39.6%	250,000

Married Filing Separately

If taxable income is		Regular income tax liability before credits is			
More than	but not more than				of the amount more than
$0	$18,450	$0.00	+	15%	$0
18,450	44,575	2,767.50	+	28%	18,450
44,575	70,000	10,082.50	+	31%	44,575
70,000	125,000	17,964.25	+	36%	70,000
125,000		37,764.25	+	39.6%	125,000

1994 Tax Rate Schedules for Individuals

Married filing jointly and qualifying widows and widowers

If taxable income is		Regular income tax liability before credits is			
More than	but not more than				of the amount more than
$0	$38,000	$0.00	+	15%	$0
38,000	91,850	5,700.00	+	28%	38,000
91,850	140,000	20,778.00	+	31%	91,850
140,000	250,000	35,704.50	+	36%	140,000
250,000		75,304.50	+	39.6%	250,000

Heads of Households

If taxable income is		Regular income tax liability before credits is			
More than	but not more than				of the amount more than
$0	$30,500	$0	+	15%	$0
30,500	78,700	4,575.00	+	28%	30,500
78,700	127,500	18,071.00	+	31%	78,700
127,500	250,000	33,199.00	+	36%	127,500
250,000		77,299.00	+	39.6%	250,000

Single

If taxable income is		Regular income tax liability before credits is			
More than	but not more than				of the amount more than
$0	$22,750	$0.00	+	15%	$0
22,750	55,100	3,412.50	+	28%	22,750
55,100	115,000	12,470.50	+	31%	55,100
115,000	250,000	31,039.50	+	36%	115,000
250,000		79,639.50	+	39.6%	250,000

Married Filing Separately

If taxable income is		Regular income tax liability before credits is			
More than	but not more than				of the amount more than
$0	$19,000	$0.00	+	15%	$0
19,000	45,925	2,850.00	+	28%	19,000
45,925	70,000	10,389.00	+	31%	45,925
70,000	125,000	17,852.25	+	36%	70,000
125,000		37,652.25	+	39.6%	125,000

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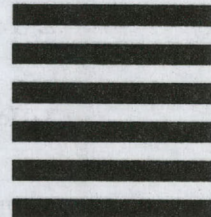

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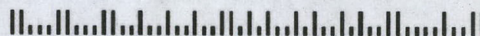

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