

JO Knows Electing Real Property Trade or Business

MAY 22, 2024 | BY: THE REAL ESTATE TEAM



Starting back on January 1, 2018, the Tax Cuts and Jobs Act (“TCJA”) implemented a new limitation to business interest. If the limitation applies, the taxpayer’s interest deduction cannot exceed the sum of : (1) the taxpayer’s business interest income for the taxable year; (2) 30% of the taxpayer’s adjusted taxable income for the taxable year; and (3) the taxpayer’s floor plan financing interest expense for the taxable year. This limitation can often come into play in real estate deals as a result of the limited partners.

However, the business interest expense deduction limitation does not apply to taxpayers who make the real property trade or business (“RPTB”) election. An RPTB is a trade or business that includes any real property development, redevelopment, construction, acquisition, conversion, rental, operational, management, leasing or brokerage. Effectively, it is a business that derives its revenue through the use of real property. Think of a rental property.

By making this election, a taxpayer must use the alternative depreciation system (“ADS”), which generally has longer recovery periods as compared to the general depreciation system (“GDS”), for new and existing nonresidential real property, residential rental property, and qualified improvement property (“QIP”). By making this election, a taxpayer cannot claim bonus depreciation for new nonresidential real estate QIP. First-year bonus depreciation would still be available for property with ADS lives of 15 years or less. The trade-off to receiving the full interest deduction is a slower depreciation deduction. Often, the trade-off works in favor of taking the full interest deduction but this election is permanent so it needs to be thought through with thoughts on the future plans for the property and improvements.

Making the RPTB election might seem beneficial for all taxpayers with business interest expense deduction limitation. However, a detail analysis should still be performed to determine the best course of action for your situation.

If you would like to learn more about electing real property trade or business and understand if the election would make sense for your business, please do not hesitate to reach out.

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