How to Use New Tax Laws to Leverage Your Development

BY BRANDI SMITH

When Texas State Sen. Paul Bettencourt took his seat at the panel focused on tax laws, he did so having finally achieved a long-sought success: property tax reform.

"We were chasing New Jersey to be the highest tax rate in the nation. We decided to pull out and let Illinois and New Jersey stay Nos. 1 and 2," said Bettencourt. "We're actually going to start reducing our tax rate next year."

To understand how necessary the solution was, one must first understand the impact of the problem. To highlight it, Bettencourt cited the Harris County Appraisal District.

"For almost all the major business properties, there's actually a model of your property, specifically if you're on income and you're multi-tenant," he explained. "They'll actually estimate your income and your expenses. They'll do a reconciliation of their models, and then they do quality control before they send out the value notices. "

The result has been ever-increasing appraisal values. In 2017, he notes that 75 percent of properties saw their value go up. A year later, that number bumped up to nearly 89 percent.

"The economic impact of increasing taxes is a real problem in the state," said Bettencourt, illustrating why he led efforts for reform in the Texas Legislature.

The result is the Property Tax Reform & Relief Act of 2019, which, among other things, drops the rollback tax rate from 8 percent to 3.5 percent for most local governments. It also caps the school district rollback rate at 2.5 percent. Any tax increase over that triggers a public vote.

"This rollback rate had not been lowered in 38 years," Bettencourt said. "The good news is that as values go up, tax rates are going to start coming down more than they have."

Other facets of the reform passed include significant changes to appraisal review boards, such as term limits, and implementing a standardized-use model.

"Has anybody at the appraisal review board ever threatened that they should've raised the value, that the value should've been higher and you should be happy?" asked Bettencourt. "Well, that technique is now off the books."

Changes to deferrals, delinquent taxes, and disaster reappraisal are all part of the package as well.

"These bills will actually impact a lot of your projects that you're looking at," said Bettencourt. "They basically slow the growth of government while cutting the tax rates. If you did just one and not the other, you don't get the combined long term effect. So that's what I'm really happy about."

In the debate over how to manage property taxes, panelist Robert Martin, principal at Robert E. Martin & Associates, noted the option of a state

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income tax had been brought up repeatedly as a way to mitigate property and sales tax costs.

"Once a tax is in place, it's very hard to get it lowered," said Martin. "That's what scares me most about an income tax. I don't think the other taxes would not be lowered enough. Our whole business structure is based on the present tax structure, and during a transition, there could be a lot of problems."

While Bettencourt has had his eye on state tax issues, Martin has been watching changes at the federal level, specifically, those linked to the Tax Cuts and Jobs Act of 2017, the effect of which is just being felt on 2018 tax returns. "Fortunately, the real estate industry came out pretty well," Martin said, before running down some of the most significant impacts.

As far as housing credits, he said the 10 percent historical credit for pre-1936 structures was eliminated, though the 20 percent historical credit still stands.

"The only modification is that you have to take that over five years," said Martin.

He also mentioned that, at first glance, it didn't appear the low-income housing credit was changed. Though it did survive, Martin noted that it got hurt in the cut in corporate tax rates.

"Because the corporate tax rate went from 35 percent down to 21 percent, the value of the credit went down," he explained. "That industry of people who were working with low-income housing credits, from what I understand, has been hurt quite a bit."

Martin also tackled the 20 percent qualified business income deduction, which, he said, was added to equalize things since corporations received such a big tax break. Most personal service businesses, such as attorneys, accountants, and brokers, don't qualify.

"But there is a window there. If you have income up to $157,000 as a single person, or up to a little over $300,000, you still do get this 20 percent," Martin clarified, while mentioning that many tax preparers overlook this deduction because it's not automatic. "You have to go in and make the changes manually."

Opportunity zones, a topic discussed during the previous panel at the Houston & Southeast Texas Development / Redevelopment Summit hosted by REDNews, was also something Martin wanted to tackle if only to emphasize the incredible possibilities available even as time is running out.

"If you put your capital gains into an opportunity zone, not only do you defer the gain, you won't have to pay the tax in 2026, you also won't have to pay tax on down the road," said Martin. "The biggest problem is that not enough people know about it."

He said because the tax law involved so many other changes, opportunity zones have been a low priority for tax professionals. Martin added that, early

Paul Bettencourt

Bob Martin

on, the idea received negative feedback. There weren't any regulations, and people were afraid to get in. They thought opportunity zones were too risky," he said.

Since then, the Fed has released two rounds of guidance pertaining to opportunity zones, which REDNews has covered in-depth with the help of national experts.

In summary, Martin told the crowd there is a lot to be optimistic about when it comes to tax reform in the years ahead.

"Between the state property tax code and the federal code, you really should take advantage of this," Martin said. "This may be the Golden Age."