

Real Estate Update

Health Care Reform Will Impact Real Estate Investments

By John D. Sullivan

What does health care reform have to do with real estate investments? Well, the devil is in the details.

The Health Care and Education Reconciliation Act of 2010 (PL 111-152) (“Reconciliation Act”), which was passed along with the Patient Protection and Affordable Care Act (PL 111-148) ostensibly to address “technical” changes in the law, includes several new provisions that address mechanisms to fund the Patient Protection and Affordable Care Act.

One of these new provisions directly impacts real estate investments.

Medicare Tax on Unearned Income

Beginning January 1, 2013, the Reconciliation Act imposes a 3.8% Medicare tax on unearned income that exceeds a threshold amount. This includes net income from the sale of investment property and rental income. Net investment income is defined as investment income reduced by deductions properly allocable to that income. (*See* Reconciliation Act § 1411(a)(1)(A))

This provision does not apply to owner-occupied homes. However, based on other provisions of the Reconciliation Act, an indi-



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vidual taxpayer is also subject to a 3.8% Medicare tax on the excess of its Modified Adjusted Gross Income over the threshold amount. Thus, the sale of an owner-occupied home could raise the Modified Adjusted Gross Income enough to trigger the tax.

This is the first time the federal government will apply the Medicare tax on unearned income. (See A. Nevius, *Journal of Accountancy* (May 2010))

This new tax along with other Medicare taxes is expected to raise more than \$210 billion to pay for the Patient Protection and Affordable Care Act.

1031 Exchanges

The IRS will need to clarify how this tax applies to Section 1031 tax-deferred exchanges, since the taxpayer does not actually receive any funds, and the 1031 deferment provisions apply to income tax, not Medicare tax.

Threshold Amount

For married individuals filing a joint return and surviving spouses, the threshold amount is \$250,000; for married taxpayers filing separately, it is \$125,000; and for other individuals it is \$200,000. These thresholds are not indexed for inflation.

On any given day, the sale of a rental house or other investment real estate, or income from a rental property, could push middle-income investors over the threshold and subject them to this new tax.

Conclusion

Investors should be aware of this future tax when investing and considering the eventual sale of real estate.

