Real Estate Opportunities in CARES Act

Berkowitz Pollack Brant Advisors + CPAs
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Agenda for Today

- QIP Updates
- Business Interest Expense
- 1031 Exchange Relief
- Opportunity Zones
- Acceleration of Disaster Losses
- Net-Operating Loss Carrybacks

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New Rules on Deductibility of Qualified Improvement Property

Background:

- The PATH Act, for tax years 2016 and later, introduced a new asset category: Qualified Improvement Property (QIP).
- The Tax Cuts and Jobs Act (TCJA), for tax years 2018 and later, combined qualified leasehold improvements, qualified retail improvement property, and qualified restaurant property into one category: QIP.

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New Rules on Deductibility of Qualified Improvement Property (Cont'd)

Due to a drafting error in the TCJA:

- Assigned a 39-year recovery period to QIP.
- Ineligible for bonus depreciation.
- Changed the alternative depreciation system (ADS) recovery period to 40 years.

The *Retail Glitch Fix!*

The CARES Act made <u>three changes</u>:

- Assigned a 15-year recovery period to QIP, retroactive to 1/1/2018.
- Changed the definition of QIP to “any improvements <u>*made by the taxpayer*</u> to an interior portion of a nonresidential building, after the building was first placed in service, with exceptions.”
- Changed the ADS recovery period from 40 to 20 years.

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Tax Savings and Cash Flow Benefits

- The effective date of the changes to QIP are retroactive to January 1, 2018
- Bonus depreciation is available for QIP placed into service in tax year 2018 and later years
- Immediate cash savings opportunities

Additional bonus depreciation may create net operating losses (NOLs) for certain taxpayers which can be carried back five years under the new NOL provisions under the CARES Act.

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Tax Savings and Cash Flow Benefits (Cont'd)

Not filed 2019 taxes yet?

- Analyze eligible QIP immediately to identify tax saving opportunities

Already filed 2019 taxes?

- Change may be implemented in tax year 2020.

In addition:

- Consider a cost segregation study to additional QIP eligible for bonus depreciation
- Consider tangible property regulations to determine if previously capitalized costs could be deducted as an expense

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Interplay with the Business Interest Expense Limitation – Section 163(j)

- Taxpayers who previously elected to be considered Real Property Trades or Businesses (RPToB) are not eligible for bonus depreciation on QIP
- The election is deemed irrevocable
- The CARES Act provides relief

Interest Expense Limitation

- CARES Act generally allows corporate taxpayers to increase 30% of ATI interest expense limitation to 50% of ATI for any tax year beginning in 2019 and 2020
    - Taxpayers may elect to use 2019 ATI (in lieu of 2020 ATI) for purposes of computing 2020 section 163(j) limitation
    - Partnerships – special rule
        - For 2019 returns, ATI limitation is 30% at the partnership level, but partners may treat 50% of any 2019 excess business interest expense as automatically deductible on their 2020 returns
        - For 2020 returns, ATI limitation increases to 50% and partnership may elect to use 2019 ATI

Interest Expense Limitation (Cont'd)

Following TCJA, real estate and farming businesses could make an irrevocable election to be excepted from interest expense limitation rules

- Trade off is switching depreciation to ADS on residential and nonresidential real property, including Qualified Improvement Property (QIP)
- Under the new CARES Act, QIP is retroactively eligible for bonus depreciation (for tax years 2018 and later)

Rev. Proc. 2020-22

- relief for real estate and farming businesses that want to revoke this election or make late elections for 2018 and 2019 tax years

1031 Exchanges Relief

Notice 2020-23 – Limited Relief

- 45-day and 180-day period deadlines that fall between April 1 and July 15 are extended to July 15, 2020
- No 45-day period extension for exchanges that originated before February 16
- Also, no 180-day period extension for exchanges that were due to be completed prior to April 1

1031 Exchanges Relief (Cont'd)

Lobbying for expanded relief

- March 23rd letter to the Treasury and the IRS
    - 19 real estate trade associations
    - Requesting postponement of the 45-day and 180-day period deadlines by 120 days
    - Similar to relief typically provided by the IRS for tax payers located in federally declared disaster areas

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Qualified Opportunity Funds Relief

Notice 2020-23

- 180-day reinvestment period deadlines that end after April 1 and before July 15 are extended to July 15, 2020
    - No relief for 180-day periods that expired before April 1

Note: under final OZ regulations, partners with eligible passthrough gains can elect to begin the 180-day period on the original due date of partnership’s tax return (March 15, 2020 for calendar year partnerships).

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Qualified Opportunity Funds Relief (Cont'd)

Final OZ regulations

- 31-month working capital safe harbor for each infusion in the QOZB as long as amounts are designated and used for development of a T/B in a QOZ, including acquisition, construction, and/or substantial improvement of tangible property
- Federally declared disaster areas – QOZB's working capital safe harbor period may be extended up to an additional 24 months if there is a delay in capital deployment as a result of the disaster

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Qualified Opportunity Funds Relief (Cont'd)

Final OZ regulations

- If a QOF sells some of its QOZ property during the 10-year holding period, it is generally permitted to reinvest the proceeds in another qualifying asset within 12 months of receipt
- The regulations extend this deadline by up to an additional 12 months if the QOF's original reinvestment plan is delayed due to a federally declared disaster.

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Election to Accelerate 2020 COVID-19 Losses Into 2019

Background – Cash is King!

- Conservation of cash is key to survival for all businesses
- There is a longstanding tax provision designed to quickly put cash in the hands of taxpayers who suffer losses due to federally declared disasters
- COVID-19 is a federally declared disaster in all 50 states, which has activated this provision

Election to Accelerate 2020 COVID-19 Losses Into 2019 (Cont'd)

This provision provides an election to accelerate disaster losses to the immediately preceding taxable year

- Accelerates tax refunds due to disaster losses by a full year, and/or
- Reduces 2019 tax payments otherwise due on July 15
- Either way, this election puts more cash in the hands of affected taxpayers

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Requirements to Qualify for the Election

In order to qualify for the loss acceleration provision, a loss must

- Relate to the disaster
- Be sustained during the taxable year
- Not be compensated by insurance or otherwise
- Be caused by an identifiable event, and
- Be evidenced by a closed or completed transaction

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“Typical” Disaster vs. COVID-19 Disaster

“Typical” Disaster Losses

- Losses primarily from physical damage to tangible property, due to hurricanes, earthquakes, tornadoes, etc.
- Relatively easy to identify and quantify deductible losses

COVID-19 Disaster Losses

- Many losses will be to intangible assets in addition to tangible property
- More difficult to identify and quantify deductible losses

Examples of COVID-19 Losses Which May Qualify For Acceleration

Losses on Intangible Assets <u>Potentially</u> Qualifying for Acceleration:

- Securities that become worthless because of COVID-19
- Deal pursuit costs for deals abandoned because of COVID-19
- Unreimbursed costs of events cancelled because of COVID-19

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Examples of COVID-19 Losses Which May Qualify For Acceleration (Cont'd)

Losses to Tangible Property <u>Potentially</u> Qualifying for Acceleration:

- Inventory that is spoiled because of COVID-19
- Leasehold improvements which are abandoned because of COVID-19 (lessor or lessee)
- Other assets abandoned because of COVID-19

Examples of COVID-19 Losses Which Do Not Qualify For Acceleration

Losses not qualifying for acceleration include

- Increases in operating expenses due to COVID-19
- Business interruption losses due to COVID-19
- Other expenses normally deductible as ordinary and necessary expenses of a business

How To Claim 2020 COVID-19 Related Losses On A 2019 Return

- Election made on an original *or amended* 2019 Federal return
- Election must be made within 6 months from the due date of the original return, not including extensions
    - Election due by 9/15/20 for Partnerships and S Corps
    - Election due by 10/15/20 for Individuals
- *Election applies to <u>all</u> COVID-19 losses for 2020*
- Election can be revoked within 90 days of due date at taxpayer's full discretion

Interplay With The Business Interest Expense Limitation And QIP "Fix"

2020 COVID-19 losses taken on a 2019 return will reduce the 2019 business interest expense limitation

- For 2019, there will be a $1 reduction in the business interest expense limitation for every $2 of accelerated losses
    - Only applies to non-electing real estate businesses, *or to taxpayers revoking a previous election to take advantage of new bonus depreciation on 2019 QIP additions*
- Same reduction in 2020 for taxpayers electing to use 2019 income to compute 2020 interest expense deduction

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Net Operating Loss Carry Backs

- The CARES Act reinstated NOL carry backs that were eliminated in the 2017 tax act
  - Reinstated for NOLs generated in 2018 – 2020 only
  - Special 5 year carry back for these years
- 2018 and 2019 NOLs - whether adjusted by additional deductions from QIP, business interest expense and/or loss acceleration or not - can be carried back to generate refunds

Questions and Answers

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