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Cares Act Provides Significant Benefits to Real Estate Industry

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The CARES Act includes several key benefits for real estate stakeholders as they face the effects of the Coronavirus (COVID-19) pandemic. Many professionals should be able to receive immediate significant tax refunds.

IN DEPTH

On March 27, 2020, President Trump signed into law the Coronavirus Aid, Relief, and Economic Security (CARES) Act (HR 748) to support the economy during the COVID-19 pandemic by providing temporary benefits to workers and businesses. In many cases, professionals active in the real estate industry are now able to receive immediate significant tax refunds and should consult their tax and real estate professionals to begin the process.

Read on for a summary of the key real-estate-related benefits in the CARES Act.

Losses from Active Real Estate Trades or Businesses May Be Used to Reduce or Eliminate Other Taxable Income

The CARES Act retroactively postpones until January 1, 2021, the effective date for the section 461(1) excess business loss limitation, which was added as part of the Tax Cuts and Jobs Act (TCJA). An "excess business loss" is the excess of (i) the aggregate deductions of the taxpayer for the taxable year which are attributable to all trades or businesses of such taxpayer, over (ii) the sum of (A) the aggregate gross income or gain of such taxpayer for the taxable year which is attributable to such trades or businesses, plus (B) $250,000 ($500,000 for married taxpayers filing jointly). This means that, since 2018, an individual has been able to use each year only up to $250,000 ($500,000 for a married couple) of losses from an active real estate business to offset other income of the individual. These rules apply to partnerships and S corporations by applying the excess loss limitation to the partner or shareholder on its allocable share of the partnership or corporate items of income, gain, deduction and loss. Additionally, section 461(l) requires applicable taxpayers to file Form 461, which can be tedious to complete. An excess business loss is disallowed under section 461(l) and is treated as a net operating loss (NOL) carryover to the following taxable year..

The CARES Act's postponement of the section 461(l) effective date allows individuals to use excess business losses to offset their non-business income.

This should provide significant benefits to real estate businesses that were otherwise unable to use excess business losses in tax years 2018 and 2019. The retroactive effective date of this provision means that non-corporate taxpayers may use excess business losses to offset other non-business income in tax years beginning in 2018, 2019 or 2020. This will also reduce the compliance burden on taxpayers as a result of section 461(l)(5)'s reporting requirement, which no longer applies to tax years beginning before 2021. After all business and non-business income is offset, any remaining excess business loss is treated as an NOL available to offset income in appropriate tax years.

The excess business loss limitation is not the only way individual losses are limited, but is the last of four loss limitation rules that can apply. First, the losses of a partner or S corporation shareholder are limited to the taxpayer's outside basis. Taxpayers then may be subject to the at-risk rules and the passive activity loss rules, both of which impose additional barriers that prevent taxpayers from deducting losses.

Net Operating Losses Can Be Used More Advantageously

Non-corporate taxpayers may further use their business losses in a complementary modification to the Code. The CARES Act modifies the NOL provisions, which were also significantly restricted under the TCJA. Beginning in 2018, most taxpayers were not allowed to carry back NOLs to prior tax years, although taxpayers were granted the ability to carry them forward for an indefinite period of time. The TCJA also limited the use of NOLs to no more than 80% of taxable income, determined without regard to the NOL deduction itself.

The CARES Act loosens these restrictions in a number of beneficial ways. First, NOLs arising in a tax year beginning in 2018, 2019 or 2020 can be carried back five years, as far as tax year 2013, a year in which the corporate tax rate was 35%. The CARES Act also temporarily removes the taxable income limitation, allowing an NOL to fully offset corporate-level income for years 2018, 2019 and 2020.

The CARES Act's amendments to the NOL provisions amplify its amendments to section 461(l), allowing taxpayers to carry back previously disallowed excess business losses. As a result, all excess business losses arising in 2018–2020 that would otherwise be capped by 461(l) are currently available to offset non-business income, but also can be carried back five years—as far back as 2013, for tax year 2018 losses—to offset both business and non-business income.

The CARES Act Fixes the Retail Glitch

The CARES Act corrects the so-called "retail glitch," by restoring to restaurants, retail shops, hotels and any other business that makes interior improvements to nonresidential real property the ability to immediately deduct costs associated with their qualified improvement property (QIP). The TCJA intended to allow these businesses immediate write-offs for costs associated with their QIP. Instead, the final text mistakenly failed to classify such property as having a 15-year recovery period, causing companies to depreciate their improvement costs on a 39-year depreciation schedule.

The CARES Act includes technical corrections that clarify that QIP is classified as 15-year property under the modified accelerated cost recovery system (20-year property for alternative depreciation system) and eligible for 100% bonus depreciation. This correction will take effect as though it were originally enacted in the TCJA. As a result, subject to certain requirements, businesses can immediately amend their 2018 and 2019 tax returns to claim the one-time QIP deductions that were disallowed for their 2018 and 2019 tax years.

The CARES Act Provides Cash Flow Support to Tenants, Allowing Them to Pay Rent

The CARES Act sets forth a number of tax and non-tax provisions that will provide immediate liquidity to individuals and businesses, some of which is specifically geared toward facilitating rent payments. For example, the Paycheck Protection Program set forth in the CARES Act authorizes the US Department of the Treasury to provide small businesses with almost $350,000 billion in federal loans, which, under certain circumstances, may be forgivable in whole or in part. These forgivable loans effectively function as a grant from the government for companies that manage to keep employees on payroll and pay crucial bills—including, specifically, their rent and utilities—for a period of eight weeks after the origination of the applicable loan. Individuals will similarly benefit from the "2020 recovery rebates," the blockbuster provision in section 2201 of the CARES Act that provides US residents a rebate of up to $1,200 ($2,400 for married taxpayers filing jointly), with an additional $500 per child.

The CARES Act also increases the amount of interest expense businesses are allowed to deduct under section 163(j). This will allow businesses to incur more debt, enabling them to pay employees and maintain cash flow during the pandemic without incurring a limitation on the amount of interest deducted.

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