Real Estate Business Tax Relief Under the CARES Act

To the Editor:

After over two years of waiting, a fix to the Internal Revenue Code has provided those in the real estate business with helpful tax-reduction opportunities when they need it most.

On March 27, President Donald Trump signed into law the Coronavirus Aid, Relief and Economic Security (CARES) Act (P.L. 116-136). The CARES Act was primarily intended to provide much-needed aid to small businesses, tenants, and mortgage-holders suffering from the economic effects of the COVID-19 crisis. Lawmakers saw an opportunity to use the CARES Act to also correct what was widely believed to be a drafting error from the Tax Cuts and Jobs Act relating to qualified improvement property (QIP).

Specifically, the CARES Act provides much-needed relief to the restaurant, hospitality, and retail industries by fixing the "retail glitch" to treat QIP as 15-year recovery property (assets with a modified accelerated cost recovery system period of 20 years or less are eligible for bonus depreciation), meaning it allows taxpayers to claim 100 percent bonus depreciation for such property in the year in which the improvements are placed in service, rather than over a 39-year period. The change is effective retroactively to property placed in service after December 31, 2017.

What Is Qualified Improvement Property?

QIP is defined as any improvements made by the taxpayer to the interior portion of a nonresidential building, if such improvement is placed in service after the date the building was originally placed in service. Examples of qualifying improvements include installation or replacement of interior doors, plumbing, and electrical work. QIP specifically excludes expenditures for:

- the enlargement of a building;
- elevators or escalators; or
- the internal structural framework of a building.

The TCJA consolidated different types of improvement property (namely, qualified leasehold improvements, qualified restaurant property, and qualified retail improvement property) under the single definition qualified improvement property, with the intent to expand the types of improvements that qualified for bonus depreciation.

Pre-CARES Act

The TCJA produced some of the most sweeping changes tax law has seen in over 30 years. The transformative legislation was passed swiftly — just 51 days after it was introduced. One downside of the quick pace of drafting and passing the legislation is that some details and nuances were missed and resulted in some unintended consequences — the most infamous being the oversight that proved costly to real estate, retail, and restaurant investors looking for improvement property tax advantages.

The legislative history of the TCJA indicates that Congress intended for QIP to have a 15-year recovery period and would therefore continue to meet the requirements for qualified property eligible for bonus depreciation. The bonus depreciation would have increased the total QIP deduction from 50 percent to 100 percent of the cost of the upgrades. This key provision in the law was intended to encourage business investment by allowing the taxpayer to immediately deduct the cost of short-lived investments. The final statute, however, did not reflect this intent and a recovery period was not assigned to QIP, defaulting it to a 39-year recovery period. As such, it became ineligible for bonus depreciation after December 31, 2017.

These errors made many retailers worse off than before. Under the TCJA, improvements made in 2018 were essentially treated as if they would last until 2057, which those in the retail business know isn't practical. Many businesses that had invested in QIP projects owed more in taxes than they planned and couldn't afford to move forward with other improvements as a result. Once the "retail glitch" in the law was more widely publicized, many retailers decided to delay improvements until a change was made. The delay in making these improvements had effects industry-wide, including on commercial construction companies, architects, and manufacturers.

The IRS and Treasury indicated in final regulations on the TCJA bonus depreciation that they lacked the authority to change the glitch themselves through administrative means, leaving it up to Congress to correct it through legislation.

Various trade associations lobbied Congress for the correction to be made, including the National Retail Federation, the Real Estate Roundtable, and the Retail Industry Leaders Association. These industry groups warned that those in the real estate business would delay investments as a result of the error, which would have an economic ripple effect for service providers and manufacturers. Attempts were made in Congress, prior to the CARES Act, to pass legislation that would correct the law. Most promising was the Restoring Investment in Improvements Act. However, the bill never left committee. Luckily, lawmakers saw an opportunity in the CARES Act and acted.

CARES Act Change and the Effects on Real Estate

The CARES Act brought along a silver lining for many in the real estate business during a time when COVID-19 is particularly negatively impacting the industry. Section 2307 of the CARES Act added "qualified improvement property" as 15-year property, which qualifies it for 100 percent bonus depreciation through 2022. As a result, taxpayers in the real estate, restaurant, retail, and hospitality businesses can expect significant tax-saving opportunities.

With QIP qualifying for 100 percent bonus depreciation, the industry should expect to see an increase in the amount of these qualified improvements being completed at properties. Being able to fully recover the cost of their investments when they are placed in service should incentivize investors to redirect their cash flow towards these types of projects.

The IRS published guidance on April 8 allowing certain partnerships (and its partners) to more quickly take advantage of the new tax advantages brought about by the CARES Act, including the changes to bonus depreciation for QIP. The guidance was necessary because partnerships subject to the centralized partnership audit regime are not able to simply file amended returns to make changes to prior years' returns. In general, such partnerships are prohibited under the code from amending the information required to be furnished to their partners after the due date of the return. Without the option to file amended returns, such a partnership's only method of amendment is to file an administrative adjustment request (AAR).

If an AAR is filed, partners generally would not be able to take advantage of the CARES Act benefits from the AAR until they file their current year returns, which could be in 2021. The IRS responded to concerns and, under Rev. Proc. 2020-23, 2020-18 IRB 1, advised that eligible partnerships are allowed to file amended returns for tax years beginning in 2018 or 2019. The IRS provided additional guidance on April 10 (under Rev. Proc. 2020-22, 2020-18 IRB 1), allowing taxpayers that qualified as real property trades or businesses who previously elected, under code section 163(j)(7)(B), out of the interest limitation rules to withdraw such election. That election was previously non-revocable and precluded such taxpayers from claiming bonus depreciation on certain property, including QIP. This guidance was almost certainly provided to increase availability of the QIP bonus depreciation changes to projects that were previously shut out from taking advantage of it.

Tax advisers suggest promptly reviewing improvements to existing commercial buildings from 2018 and 2019 to identify QIP assets. Taxpayers who placed QIP in service in 2018 or 2019 may be able to adjust their prior years' tax returns to claim the bonus depreciation for QIP. Further IRS guidance on how to claim the additional QIP depreciation and other claims under the CARES Act should be available in the coming days. Taxpayers are encouraged to work closely with their tax professionals to ensure they are following the most effective course of action for their specific industry and circumstances.

Sujata Yalamanchili, Krystal Chapin, and
William S. Turkovich
Hodgson Russ LLP
Apr. 10, 2020

Dear IRS: It Shouldn't Be Business as Usual!

To the Editor:

The barrage of "relief" issued by the IRS for filing returns, time-sensitive matters such as Tax Court petitions, partnership administrative adjustment workarounds, and suspension of collection activity, has been accompanied by reminders of one type or another that after July 15, it'll be *business as usual*.That is: File your returns and documents and pay up or we're coming after you.

That's nonsense. The economic devastation — short run and long — will impact collectability of delinquent taxes for years. And this should be considered and addressed by the IRS now, not before the horror stories begin to pop up in the media and congressional offices. Imagine, for example, the IRS firing up the Automated Collection System shortly after July 15. Literally thousands of levy actions will proceed against taxpayers either unemployed or barely employed, or against businesspersons and independent contractors who have lost their entire income stream as the result of government action — not through any fault of their own. Moreover, it is likely that thousands of them have requested or will request relief as a result of their plight — only to find it impossible to call the IRS or to have their correspondence opened, let alone acted upon. All the while the IRS computer and collection personnel would grind away issuing levies on monies necessary for rent, food, and transportation money.

The IRS should not resume collection activity through the automated system until it has sufficient time to field every phone call and review every piece of correspondence from those persons and businesses that owe it monies, and there has been an additional period of time necessary for responses to relief requests — whether that is 30 or 60 or 90 days or longer. The government caused the problem for thousands of people attempting to comply with payment of their tax debt, and it should be responsible for subsequent responses to the problem. It should be noted, too, that if the collection activity commences without considering taxpayer distress factors, the Taxpayer Advocate Service may become overwhelmed with requests for relief