How Can the CARES Act Help Your Real Estate Investment?

With the rapid expansion of the COVID-19 pandemic throughout the United States, and the month of April being earmarked as potentially encompassing the height of the virus' expansion, there is no question that the U.S. will continue to feel the vast ramifications of the outbreak through many facets. As it relates to small business owners, there comes no better time to explore the various aid and benefits that the recently established CARES Act can provide. The CARES Act was signed into law on March 27th and offers various advantages which small business owners, and more specifically property owners, can take advantage of.

From adjusting depreciation retroactively, to Business Interest Deduction adjustments and Net Operating Loss (NOL), the CARES Act has given owners multiple tools to tactically manage the tax treatment of their assets in their favor. I'd like to share with you more info on these tools, and how you can best use them to mitigate COVID-19's impact on your properties.

Qualified Improvement Property (QIP) [Non-Residential Only]

QIP is defined as improvements to an interior portion of a nonresidential building. It must be placed in service after the building was first placed in service and can include no improvements for the enlargement of the building, for elevators or escalators, or for the internal structural framework of the building.

Of note, the QIP definition was modified to only include improvements "made by the taxpayer". Accordingly, it can be deduced that improvements to a non-residential building acquired by a taxpayer, after having been previously placed in service by another taxpayer, will not meet the modified definition of QIP even if all other criteria are met.

Under the CARES Act, QIP is now classified as 15-year property and eligible for 100% bonus depreciation through 2022, as it was originally intended. Additionally, QIP will be subject to a 20-year life under the Alternative Depreciation System (ADS). The change is effective for tax years after December 31, 2017, i.e., it is retroactive to 2018 for calendar-year taxpayers.

Taxpayers who placed QIP in service in 2018 or 2019 can adjust their returns to take advantage of the changes to QIP depreciation. The impact of taking 100% bonus depreciation on QIP could be significant to many taxpayers. In some cases, these changes may create a net operating loss (NOL), which are discussed below.

Business Interest Limitation

The CARES Act signed into law a new ceiling for net business interest deductions, which is now 50% of adjustable taxable income (ATI). This is an expansion on the previous 30% level, effectively allowing owners to further reduce their taxable base by deducting an additional 20% of business interest from their ATI.

Net Operating Loss (NOL)

The CARES Act provides owners with useful tools to boost cashflow at a time where liquidity is of the highest priority, and new guidelines on tax treatment of NOL are no different. Owners have two different tools available to them, via the appointment of the Five-Year NOL Carry-Back and the extension of the NOL Carry Forward.

Five-Year NOL Carry-Back: The CARES Act will allow a five-year carry-back of NOL created in any tax year from 2018-2020. By carrying back NOL, owners will be given the potential to enhance liquidity at a time when access to current assets is critical to maintaining operations throughout the near term. Starting with a Cost Segregation study, identified NOLs can then be carried back for up to five years in order to claim potential tax refunds.

NOL Carry-Forward: As the CARES Act did not modify IRC Section 172(b)(3), a taxpayer, where advantageous, can still waive the Carry-Back and elect to carry NOLs forward to subsequent tax years. Carry-Forward losses generated in any tax year from 2018-2020 have been extended by the CARES Act to offset 100% of income. Previously, this threshold was set at 80% by the Tax Cuts and Jobs Act (TCJA). Owners should note that the Carry-Forward extension is only temporary, with the CARES Act reinstating it for tax years beginning after 2020. Special carryback rules are provided for taxpayers such as real estate investment trusts (REITs) and life insurance companies, which should be further investigated if applicable.

Summary

With multiple factors placing stress on the average owner, from operations to financing, there is one thing at the top of many owners' lists: access to liquidity. The CARES Act represents a powerful instrument which owners should strategically use to tap into available liquidity via a plethora of potential tax breaks. The tactical use of new or extended guidelines on Business Interest Deductions, Qualified Investment Property Depreciation and NOL Carry-Backs/Carry-Forwards could provide the precise operational boost that many owners will need to keep their properties and capital projects running on the right course.