

## The CARES Act: Cash-generating tax provisions for the construction and real estate industries

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The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) contains numerous tax and non-tax provisions benefiting both individuals and businesses. Many of those provisions will have a positive impact on the construction and real estate industries. Not only will they reduce taxpayers' current and future tax liabilities and thus minimize current and future cash outflow, but some of the provisions are also retroactive. This will allow many contractors, developers and lessors to either amend their prior-year tax returns to obtain refunds of taxes they previously paid or file a Form 3115 to claim "catch up" tax deductions in their current year tax return.

Below are 11 CARES Act tax provisions that can provide significant benefit to taxpayers with construction or real estate activities.

### 1. Expansion of the net operating loss rules

The CARES Act expands the cash-flow-generating benefits of net operating losses (NOLs) by temporarily eliminating the restrictions that were placed on NOLs by the Tax Cuts and Jobs Act (TCJA).

Under the CARES Act, NOLs that are created in tax years beginning in 2018, 2019 or 2020 can now be carried back for five tax years, resulting in refunds of taxes that were paid in those years, before they are carried forward to future tax years. Taxpayers who choose not to take advantage of this new NOL carryback opportunity must affirmatively elect to forego the carryback period.

In addition, the CARES Act now allows NOLs to eliminate 100% of a taxpayer's taxable income, rather than only 80%, further maximizing the immediate tax benefit of NOLs.

### 2. Limitation on losses for non-corporate taxpayers



Under the Tax Cuts and Jobs Act (TCJA), individual taxpayers were limited to claiming a maximum net business loss from their partnerships, S corporations and sole proprietorships of \$500,000 (married) or \$250,000 (single). Any net losses above this amount then carried forward to the taxpayer's following tax year as an NOL.

Under the CARES Act, this business loss limitation is eliminated for tax years 2018, 2019 and 2020. This means that if a taxpayer's deduction of business losses was limited on their 2018 or 2019 tax return, they can amend those tax returns to obtain a refund of some or all of the taxes paid in those years. As described under item 1 above, to the extent the ability to claim the full amount of the losses results in an NOL in those years, that NOL can also now be carried back five years to obtain additional tax refunds.

### 3. Technical correction for qualified improvement property (QIP)

The construction and real estate industries have been waiting for this correction since the error was first drafted into the TCJA in 2017. The TCJA inadvertently excluded qualified improvement property from bonus depreciation, meaning the cost of those improvements had to be depreciated over 39 years rather than being 100% expensed in the year the improvements were placed in service.

The CARES Act retroactively allows 100% bonus depreciation to be claimed on QIP placed in service on or after January 1, 2018. Because this change is retroactive, taxpayers may have an opportunity to amend their 2018 tax returns (and their 2019 tax returns if already filed) to claim bonus depreciation and receive a refund of income taxes they previously paid. Alternatively, they can choose to claim a "catch up" deduction on their 2020 return (or 2019 tax return if not yet filed) by filing a Form 3115, Request for Change in Accounting Method.

As a reminder, QIP is an improvement that is made by the taxpayer to the interior of a nonresidential building that is made after the building is first placed into service by any taxpayer. QIP specifically excludes expenditures for 1) the enlargement of a building, 2) elevators or escalators or 3) the internal structural framework of a building. Otherwise eligible property will not qualify if it is "tax-exempt" use property — either leased to a tax-exempt tenant under a disqualified lease or owned by a tax-exempt entity, either directly or through a partnership.

### 4. Temporary relaxation of the business interest expense limitation

Another result of the TCJA was a new 30% limitation on the deduction of business interest expense. The CARES Act temporarily increases that 30% limitation to 50% for tax years beginning in 2019 and 2020. For taxpayers that have already filed their 2019 tax returns, there is an opportunity to file amended tax returns to receive a tax refund.



In addition, for tax years beginning in 2020, taxpayers can elect to calculate their interest limitation using their 2019 adjusted taxable income, rather than their 2020 taxable income. Given that most taxpayers are expecting their 2020 income to be less than their 2019 income, making this election can result in a greater interest expense deduction in 2020.

A special rule for business interest expense applies for partnerships. While they are not allowed to use the new 50% limit for 2019, if they had excess business interest expense on their 2019 tax return that they passed out to their partners, those partners will now be able to deduct 50% of that excess interest in 2020 without limitation. The remaining 50% of the excess interest will be suspended until the partnership allocates excess taxable income to the partners, which will now be more likely to happen due to the partnership's ability to calculate their excess taxable income using a 50% limitation in 2020 rather than a 30% limitation.

#### 5. Withdrawals and changes to §163(j) elections

Real property trades or businesses that were subject to the TCJA's 30% business interest expense limitation of Sec. 163(j) had the option to make an irrevocable election to be an excepted trade or business and therefore not subject to the limitation.

If the business made this election, however, nonresidential real property, residential rental property, and QIP then had to be depreciated using the alternative depreciation system (ADS). Unfortunately, property depreciated using ADS is not eligible for bonus depreciation. This creates an issue for taxpayers now wanting to take bonus depreciation on their newly-qualifying QIP.

Fortunately, the IRS recently issued Revenue Procedure 2020-22, which allows taxpayers to withdraw their otherwise irrevocable §163(j) real property trade or business election in order to take advantage of the changes made by the CARES Act. The ability to withdraw an election made in 2018 or 2019 is particularly significant given taxpayers can now take bonus depreciation on QIP retroactively and carryback any NOLs that may result from that additional deduction.

#### 6. IRS allows for amended returns

Partnerships subject to the centralized partnership audit regime generally are prohibited from amending their tax returns and are instead required to file an Administrative Adjustment Request (AAR). This is a little-known rule that started impacting most partnership tax returns in 2018. The AAR process can be time-consuming and complicated and only allows partners to receive benefits from relief on the current tax year's income tax



return, rather than going back and correcting prior year returns. Thus, these affected partnerships wouldn't be able to obtain a benefit from the CARES Act's many pro-taxpayer changes until 2021, creating a significant delay in the tax relief available to them.

Given the breadth of changes enacted by the CARES Act after the March 15<sup>th</sup> filing due date for calendar year partnerships, the IRS decided it needed to provide these partnerships with an alternative to the AAR process. The IRS therefore issued Revenue Procedure 2020-23, which gives partnerships that filed their 2018 and 2019 returns on or before April 7, 2020 a limited opportunity to amend those tax returns. Amended returns file under this Revenue Procedure must be filed before September 30, 2020.

## 7. Corporate minimum tax credits

The TCJA eliminated the corporate minimum tax, greatly simplifying tax planning for construction contractors that are structured as C corporations. Corporations that had any remaining minimum tax credits at that time were allowed to claim them as refundable credits over several years, ending in 2021.

The CARES Act now allows those corporations to claim any remaining credits on their return for their tax year beginning in 2019. Alternatively, they can elect to claim the entire credit in their tax year beginning in 2018, which would require the filing of an amended tax return.

## 8. Employee retention tax credit

To encourage employers to retain their employees, employers can now claim a refundable payroll tax credit equal to 50% of the first \$10,000 of "qualified wages" they pay to employees between March 13, 2020, and December 31, 2020. Thus, there is the potential for a developer to claim a \$5,000 credit for each employee.

Employers with 100 or fewer full-time employees qualify for this credit regardless of whether they were open for business or were subject to a shutdown order. Employers with more than 100 full-time employees qualify for the credit if either 1) their operations were fully or partially suspended to a shutdown order or 2) their gross receipts during any quarter of 2020 declined by more than 50% when compared to the same quarter in the prior year.

"Qualified wages" for purposes of calculating the credit also depend upon the number of employees. Employers with 100 or fewer full-time employees can count all wages and healthcare benefits they paid to their employees. Employers with more than 100 full-time

employees can only count wages and healthcare benefits that they paid to employees when those employees were not actually providing services (e.g., wages paid to furloughed employees).

It is important to note that employers that take advantage of the Act's forgivable SBA loans cannot also claim this retention credit. Nor can employers claim both the work opportunity tax credit and this retention credit. Therefore, it is very important for employers to model their specific situation to determine which of these incentives will provide them the greatest tax and cash flow benefit.

## 9. Deferred payment of employer payroll taxes

To increase cash flow for employers, the CARES Act allows them to defer their payment of the employer share of the 6.2% social security tax attributable to the period from March 27, 2020, through December 31, 2020. Rather than paying those taxes when otherwise due, 50% can be deferred until December 31, 2021, and the remaining 50% can be deferred until December 31, 2022.

Similar to the employee retention tax credit above, employers cannot take advantage of both the CARES Act's forgivable SBA loans and this payroll tax deferral. Therefore, if a taxpayer's SBA loan is eventually forgiven, any deferred employer payroll taxes will become due and payable.

In addition, taxpayers using their research credits as an offset to the FICA portion of their payroll taxes may want to continue to do so, since that offset is permanent rather than a temporary deferral. Again, employers will need to model their specific situation to determine which incentives will provide them with the greatest benefit.

## 10. State income taxes

The above new provisions apply specifically to federal income taxes. While some states are adopting the same or similar provisions, not all are doing so. In addition, some states are offering their own unique tax incentives. Please refer to Wipfli's COVID-19 resource center ([/covid-19-resource-center](#)) for current state and local tax guidance.

## 11. Forgivable SBA loans

In addition to tax provisions, the CARES Act also included \$349 billion to fund the Payroll Protection Program. This new SBA loan program offered businesses with fewer than 500 employees a loan that could turn into a tax-free grant if certain requirements were satisfied. Unfortunately, the full fund balance was exhausted in less than two weeks. The



good news is that the construction industry was one of the primary recipients of those funds. In addition, Congress is currently negotiating \$300 billion of additional funding for the PPP.

Wipfli will continue to monitor all legislative activity with respect to the PPP and provide updates on our COVID-19 resource center (</covid-19-resource-center>).

### Help with CARES Act CRE provisions

If you have questions regarding the application of any of the tax provisions discussed above to your specific business, please contact a Wipfli tax professional. Visit our COVID-19 resource center (</covid-19-resource-center>) for more information on how construction and real estate firms can navigate the impact of the COVID-19 pandemic.

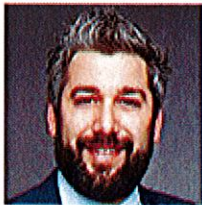
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