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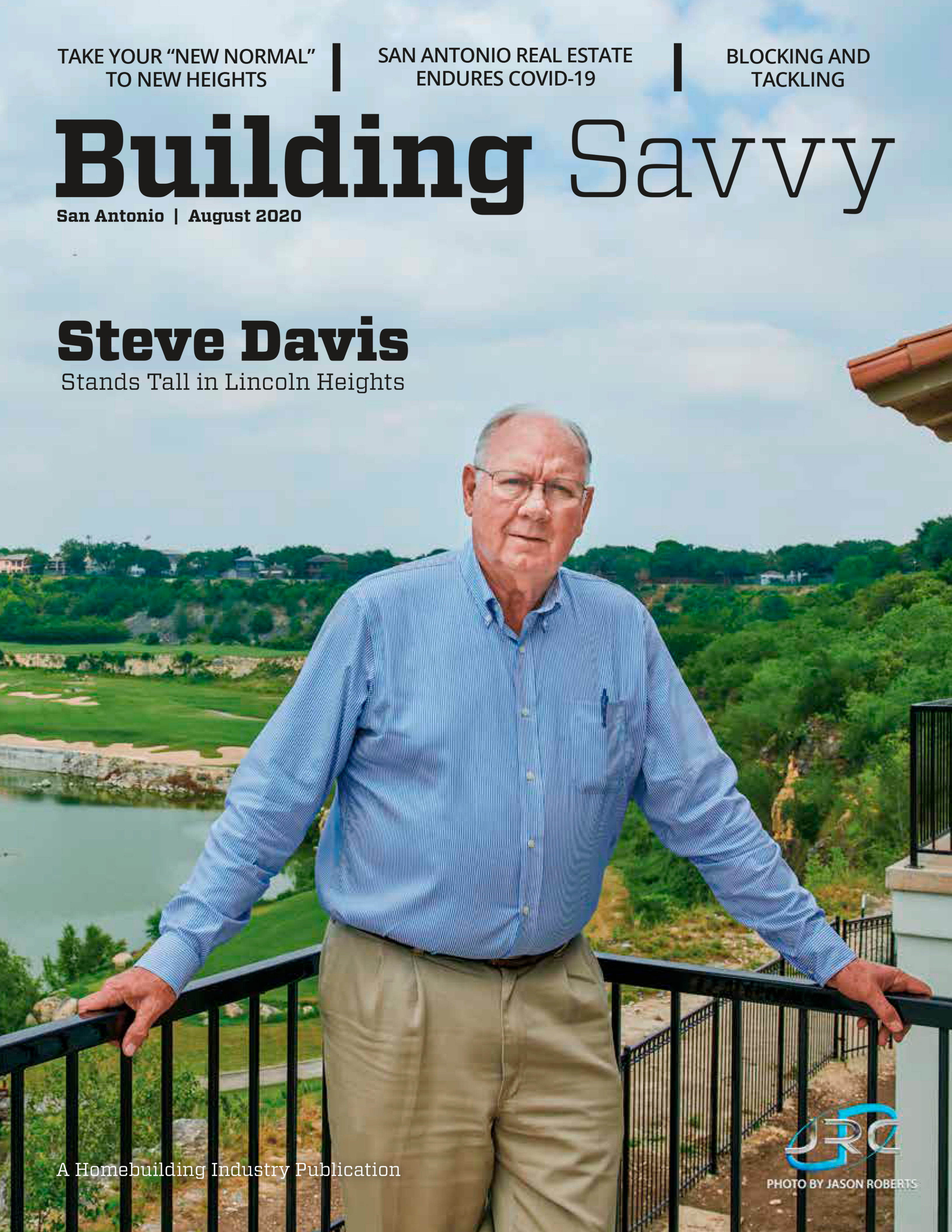

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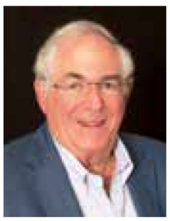
TAX CHANGES for Property Improvements and Business Losses

By Steven Bankler, CPA



Some long-awaited great news for commercial property and business owners: The CARES Act that was passed in response to the COVID-19 pandemic includes technical corrections and additional modifications to the 2017 Tax Cuts and Jobs Act. If you've made commercial property improvements or have experienced passive activity losses or net operating losses, take a close look at how it affects your taxes. Some of these changes are retroactive to previous tax years as well.

One-Hundred Percent Bonus Depreciation Is Back

Yes, the federal government makes mistakes. And it made a glaring one in 2017 when qualified improvement property (QIP) was unintentionally classified as nonresidential real property. A QIP is any improvement to an interior portion of a nonresidential property. The improvement must be made after the building is first placed in service, can't include enlarging or changing the internal structure of the building, and can't involve adding elevators or escalators.

Suddenly these QIP's that should have qualified for 100-percent bonus depreciation as 15-year property were subject to a 39-year depreciation schedule. It was called the retail glitch because, while the definition was meant to give retail, restaurant, and commercial real estate property owners a valuable tax break for making interior improvements to their spaces, it didn't. All because a specific reference to QIP's was left out of the list of property eligible for the bonus.

The CARES Act remedies this glitch and gives 100-percent bonus depreciation power back to QIP activities. The change is retroactive to cover assets placed into service in 2018. If you already filed your taxes for 2018 or 2019 and included QIPs at the 39-year depreciation schedule, you can amend your return to take advantage of the 100-percent bonus depreciation.

Other Important Changes

Recent IRS guidance allows taxpayers to take a late election, revoke an election, or withdraw an election for the 2018, 2019, or 2020 tax years regarding the depreciable property. Taxpayers can now choose to (a) elect 100-percent bonus depreciation, (b) elect to deduct these qualified expenditures under Section 179 ("expensing") or (c) depreciate these assets over a 15-year life. There are various advantages and disadvantages for each method and taxpayers need to review their specific situation.

Other significant changes relate to business losses. The CARES Act removes excess business loss limits for taxable years beginning in 2018. Under the TCJA, business owners who made a passive or investment income of $500,000 per married couple ($250,000 for single filers) were restricted in the amount of net losses their pass-through entities could claim. There are currently no limitations (although they're set to return in 2021), and additional provisions include how capital gains and losses can help determine the excess business loss.

Net operating losses (NOL) are also temporarily affected (for election in tax years 2019 and 2020). Businesses or business owners that need to increase cash flow and liquidity may be able to apply NOLs generated in prior years to offset taxable income by 100 percent. This can be done by carrying back losses for up to five years, but be aware that it might trigger an alternative minimum tax (AMT) in those previous years and carry-backs to offset Section 965 income aren't allowed.

As with any election that allows you to carry back or spread out tax liabilities from year to year, considerations unique only to you and your business can help determine the best course of action. But if you've made commercial property improvements or have excess business or net operating losses over the past couple of years, you may be due a tax refund – perhaps over several years. It's money on the table you'd be wise to pick up.

Steven Bankler has more than 43 years of experience in the accounting industry. Steven's expertise lies in consulting, planning, tax, and asset protection, as well as exit strategy services for closely held businesses. He also provides litigation support (both as a testifying expert witness and a consulting expert), business negotiations and estate planning. Visit www.bankler.com for additional tax strategy tips and to learn more about Steven Bankler, CPA, Ltd.