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May 31, 2018

Internal Revenue Service
CC:PA:LPD:PR (Notice 2018-28)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Re: Issues Related to Internal Revenue Code¹ Section 163(j) (Notice 2018-28)

Thank you for providing the opportunity to comment on the upcoming proposed regulations with respect to the new section 163(j) limit on the business interest deduction (BID). This letter highlights the need for specific guidance with respect to section 163(j)(7)(A), which provides that a “real property trade or business” is not a trade or business subject to the BID limit. In particular, as discussed more fully below, we request that such guidance include specific confirmation that the construction, management, and operation of seniors housing residences are not excluded from the “real property trade or business” definition merely because the seniors housing also involves the provision of supportive services that are required by its aging residents. In addition, at the end of this letter, we briefly discuss the need for guidance on a number of other issues and questions that affect the broader real estate community.

By way of background, the American Seniors Housing Association (ASHA) is a national organization of over 445 senior living providers involved in the operation, development, investment, and financing of the entire spectrum of seniors housing – independent living, assisted living, memory care, and Continuing Care Retirement Communities (CCRCs). Our members’ communities serve a wide range of seniors, including those who live independently or require varying degrees of assistance with activities of daily living (ADL) such as eating, bathing, and dressing, and those with significant needs associated with Alzheimer’s and related dementia.

SENIORS HOUSING UNDER THE REAL PROPERTY TRADE OR BUSINESS DEFINITION

Background: Section 163(j)(7) provides that, for purposes of the new BID limit, any “electing real property trade or business” will not be treated as a trade or business (and thus will not be subject to the BID limit). Section 163(j)(7)(B) defines an electing real property trade or business as “any trade or business which is described in section 469(c)(7)(C)” which makes an irrevocable election in the manner to be prescribed by the Secretary of the Treasury. Section 469(c)(7)(C) in

¹ All section references herein are to the Internal Revenue Code unless otherwise indicated.

turn defines a real property trade or business broadly as: “any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business.”

Under any reasonable interpretation, we believe that seniors housing ventures would be a “real property trade or business” as defined in section 469(c)(7)(C) (and by cross reference section 163(j)(7)(B)). Significantly, seniors housing businesses provide rental residences for millions of seniors, and the debt and equity financing for seniors housing essentially comes from (and competes for) the same lending sources that fund other types of real estate (including HUD, Fannie Mae, Freddie Mac, and commercial banks). Moreover, seniors housing properties are generally depreciated as residential rental properties. As such, it is important that owners and investors in residential rental property for the elderly, such as an assisted living residential facility, memory care residence, or a CCRC, be provided with guidance that confirms that the provision of necessary services to the property’s residents will not jeopardize the treatment of the enterprise as a real property trade or business for purposes of the application of the BID limit.

This issue was directly addressed during the Senate floor consideration of H.R. 1 in a colloquy between Senator James Lankford and Senate Finance Committee Chairman Orrin Hatch as follows:

Mr. LANKFORD. Mr. President, we commend Senator HATCH for his efforts on this most important bill. We would like to ask for confirmation on a question that will be of considerable importance to millions of seniors housing residents, including those living in assisted living and memory care residences and in continuing care retirement communities, CCRCs.

As you know, capital for seniors housing, including assisted living and memory care residences and CCRCs, essentially comes from the same lending sources that fund other types of real estate. HUD, Fannie Mae, Freddie Mac, and commercial banks finance seniors housing through their respective housing related programs. Seniors housing competes with other real estate based investments for both equity and debt and it is critical that our tax law treat these seniors housing units in a manner that is comparable to other housing.

Provisions relating to the deduction for business interest and to the deduction for depreciation in the bill include rules governing a “real property trade or business,” as that term is currently defined in the tax law. Under these rules, the conferees stated that they intended that a real property operation or a real property management trade or business includes the operation or management of a lodging facility. We would like to ask the distinguished chairman of the Committee on Finance if he agrees with us that the operation or management of residential rental property housing the elderly, such as an assisted living residential facility, memory care residence, or a continuing care retirement community, are not excluded from the definition of a “real property trade or business” merely because they provide necessary supplemental assistive services that meet the needs of aging seniors.

Mr. HATCH. Mr. President, I agree.

[December 19, 2017 CONGRESSIONAL RECORD—SENATE S8109-S8110]

Requested Guidance: The proposed regulations should include a statement consistent with the principles outlined in the colloquy between Senator Lankford and Chairman Hatch, i.e., a specific confirmation that the operation or management of residential rental property housing the elderly, such as an assisted living residential facility, memory care residence, or a continuing care retirement community, is not excluded from the definition of a “real property trade or business” merely because the housing development provides necessary supplemental assistive services that meet the needs of aging seniors.

In addition, we request that the proposed regulations include a specific example addressing seniors housing under the real property trade or business definition, as follows:

Example: A rental assisted living residence that includes a memory care unit for residents with Alzheimer’s or dementia will not be excluded from the definition of a “real property trade or business” merely because the residence provides necessary supplemental assistive services (e.g., meals, transportation, assistance with activities of daily living) that meet the needs of the residents.

KEY GUIDANCE ISSUES RELATED TO THE BID LIMIT AND REAL ESTATE GENERALLY

We appreciate that there are many issues that will need to be addressed in the proposed regulations under section 163(j). Highlighted below are some of those issues that we believe are important for the real estate industry generally, including seniors housing.

Elections by Real Property Trades or Businesses under subparagraph (B) of Section 163(j)(7): Section 163(j)(7)(B) provides, in part, that an “electing real property trade or business” is an entity “which makes an election under this subparagraph. Any such election shall be made at such time and in such manner as the Secretary shall prescribe, and, once made, shall be irrevocable.” We request that guidance confirm the clear reading of the statute, i.e., that the election, once made, is irrevocable, but that an election may be made at any time prospectively.

- *Rules for the Allocation of Interest Expense Among a Taxpayer’s Activities:* The proposed regulations should address appropriate methods for allocating business interest between trades or businesses that are subject to the new BID limit and those that are not (e.g., an electing real property trade or business or a taxpayer that is eligible for the small business exemption of section 163(j)(3)). In this regard, we suggest that the Treasury Department and the Internal Revenue Service clarify that taxpayers may use any reasonable allocation method to deduct business interest attributable to an electing real property trade or business. At a minimum, this reasonable allocation rule should be applied until regulations are finalized prospectively.

In addition, guidance should confirm that interest (other than investment interest) on debt incurred by an owner of an entity that is an electing real property trade or business will be treated as interest that is allocable to that real property trade or business (and thus not subject to the new BID limits), assuming that such debt can be traced to the owner's investment of funds in that real property trade or business.

- *Rules for Aggregation of Activities:* Guidance is also needed with respect to the definition of a “trade or business” – a question that arises under section 163(j) and the new 20 percent deduction for certain pass-through income under section 199A. It is important that those rules address the ability of taxpayers to aggregate or combine qualified business activities. In order to avoid unnecessary and inefficient restructuring activity, we request guidance that enables individuals to aggregate all qualified business activity at the partner level in a manner consistent with the passive loss rules of section 469.²

Depreciation: An electing real property trade or business as defined in section 163(j)(7)(B) is required by section 168(g) to use the alternative depreciation system (ADS). The ADS, as amended, provides that the recovery period for residential rental property is 30 years. However, due to some ambiguity in the effective dates of the various provisions, the statutory language could conceivably be interpreted to require that those residential rental properties that are placed in service prior to the effective date of a real property trade or business's election would have to be depreciated over 40 years instead of 30 years. We do not believe that such a reading with respect to existing residential rental properties was intended by Congress. We urge the Treasury Department and the Internal Revenue Service to use their existing authority under section 168 to make it clear that existing residential rental properties that are subject to the ADS due to an election by a real property trade or business under section 163(j)(7)(B) are depreciated over 30 years. In addition, we request that guidance confirm that when an election is made, the shift to the ADS system will not be treated as an accounting method change.

Also, the recent tax legislation created a new category of “qualified improvement property” which was, according to the conference report, intended to have a 15-year recovery period (and thus be eligible for bonus depreciation). The final language of the legislation is less clear on this point and we understand that technical corrections legislation will address this issue. In the meantime, we request that interim guidance

² We also suggest that the comprehensive review of the somewhat interrelated rules with respect to sections 163(j) and 199A address two technical issues under 199A. First, guidance should make clear that in determining the unadjusted basis of property acquired in a like-kind exchange, the basis should be no less than the unadjusted basis in the property relinquished in the exchange (plus any cash or other consideration provided in the exchange). In addition, guidance should clarify that shareholders that invest in a REIT through a mutual fund should be eligible to fully qualify for the section 199A deduction in the same manner as investors who invest directly in the REIT.

provide confirmation that qualified improvement property is subject to a 15-year recovery period.

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Thank you for your consideration of these comments.

Sincerely,

A handwritten signature in blue ink, appearing to read "David Schless".

David Schless
President
American Seniors Housing Association