Assisted Living Sector Gets Real Estate Exception to Tax Law Limit

- Trade groups, businesses bombarded agency with letters
- Guidance lets them avoid restriction as real estate

By Lydia O'Neal | August 4, 2020 1:41PM ET

The IRS yielded to a lobbying campaign by the assisted living and nursing sector, allowing many of those companies to opt out of a cap on the amount of loan interest payments they can write off their taxes.

But the agency, in recent rules, also left out companies in other industries, such as other types of health care providers or brick-and-mortar businesses, structured in a way that might have otherwise qualified them for the ability to elect out of the limit. The restriction, under tax code Section 163(j), effectively makes debt financing more expensive for large, leveraged companies.

The assisted living and nursing sector "did a good job of lobbying and submitting comment letters and proposing rules," said Andrea Mouw, a partner at Eide Bailly LLP in Minneapolis. "These rules are beneficial to people in that industry but not more broadly."

The 2017 tax code overhaul limited debt interest deductions to 30% of adjusted taxable income, and the third Covid-19 relief law, known as the CARES Act (Public Law 116-136), raised that restriction to 50%. "Real property trades or businesses," a broad term for real estate, can opt out of the restriction, at the cost of writing off certain property expenses more slowly.

The IRS in 2018 proposed creating an anti-abuse rule in an effort to keep businesses from gaming the system by setting up real estate entities and leasing property to non-real estate operating entities to qualify for the opt-out.

The agency backed off the idea in guidance last month, after skilled nursing and assisted living centers and their representatives flooded the agency with close to 20 letters stressing that they were often structured that way already, for legal liability and other reasons. This structure, the groups, businesses, and anonymous critics maintained, should qualify them for the ability to elect out of the restriction, as real estate businesses.

A notice (N-2020-59), released released alongside proposed (REG-107911-18; RIN 1545-BP73) and final rules (T.D. 9905), offers a standard for "residential living facilities" to qualify for the ability to elect out.

These facilities must include rental units that serve as primary residences in which customers reside for at least 90 days, and can include "the provision of supplemental assistive, nursing, or other routine medical services," the guidance said.

Randy Hardock, tax counsel at the American Seniors Housing Association, whose president signed a letter to the IRS on this issue, said it came down to the extent to which a service-oriented business could fit into the scope of real estate.

“Clearly this was not intended to have a restaurant be a real estate business, so you have to somehow draw some lines, and I think the notice tries to do that,” he said. “As long as the services meet these characteristics you’re okay, it’s not too much.”

Ignored Industries

The anti-abuse rule, however, still hits companies in other industries that are broken up into separate real estate and operating entities, however, tax professionals say.

The final rules modify it so that, if a business’s real estate entity is leasing to a separate, commonly-owned entity that also qualifies as real estate, it can opt out of the restriction. Because the notice classified assisted living and nursing facilities this way, they should get this exception even if they’re structured as separate real estate and operating entities, tax professionals said.

“The rule was intended to prevent companies from creating artificial structures to be able to say they had somebody in their entity who was in the leasing business,” said Mark Van Deusen, a principal at Deloitte Tax LLP in Richmond, Va. “If they are both in a real property trade or business, what is the abuse there?”

Some opponents of the rule sought broader exceptions, such as for businesses that have a legitimate reason for separating their operating and real estate entities.

The American Health Care Association/National Center for Assisted Living, which also wrote the IRS and Treasury Department its own letter critical of the 2018 proposed rules, said in a statement emailed to Bloomberg Tax that they “are still reviewing the rule but are pleased that it appears the IRS took our comments into consideration.”

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