FEDERAL POLICY UPDATE

American Seniors Housing ASSOCIATION

SPECIAL FEDERAL TAX UPDATE

January 15, 2021

TOPICS COVERED:

- **IRS FINALIZES GUIDANCE ON BUSINESS INTEREST DEDUCTION**
- **IRS FINALIZES CARRIED INTEREST RULES**
- **TAX PROVISIONS FOR REAL ESTATE AND EMPLOYERS IN COVID-19 RELIEF BILL**
- **MEDICAL EXPENSE DEDUCTION MADE PERMANENT**

ASHA ADVOCACY ON BUSINESS INTEREST DEDUCTION YIELDS RESULTS

Last week, the IRS released a final version of Revenue **Procedure 2021-9** providing guidance on the eligibility of seniors housing communities to be treated as "Real Property Trades or Businesses" (RPTBs) for purposes of electing to be excepted from the limitations on Business Interest Deductions (BIDs) that were added in 2017 tax legislation. The issuance of the final Revenue Procedure marks the successful culmination of over three years of efforts by ASHA to ensure that seniors housing would not be unfairly subjected to the potentially onerous BID limitations.

The final Revenue Procedure follows up on and expands a September 28, 2020 proposed Revenue Procedure (Notice 2020-59) issued by the IRS. That proposal, which was based on legislative history obtained by ASHA, proposed a safe harbor that would ensure that businesses providing assisted living, CCRCs, and other seniors housing residences would be eligible to take advantage of the RPTB exception to the BID limits even though the businesses provided substantial supplemental services to residents.

In short, the safe harbor which was finalized in last week's Revenue Procedure provides that any trade or business that manages or operates a "qualified residential living facility" would be allowed to treat such trade or business as a RPTB for purposes of qualifying to make an election to be exempt from the BID limits. The final Revenue Procedure retains the original proposed relief, and makes it even easier for seniors housing to demonstrate that it qualifies as an RPTB.

A "qualified residential living facility" would be defined as a facility that:

- Has multiple rental dwelling units within one or more buildings that generally serve as primary residences on a permanent or semi-permanent basis to individual customers or patients;
- Provides "supplemental assistive, nursing, or other routine medical services"; and
- Has an average period of customer or patient use of the individual rental dwelling units that is 30 days or more. [Note that the proposed revenue procedure released in September would have required a more stringent 90-day average. For this purpose, the final Revenue Procedure provides detailed rules for determining the average period of customer or patient use, including an option that allows taxpayers to determine the average period by reference to either the number of days paid for by Medicare or Medicaid or the number of days under a rental contract or other formal written lease agreement.]

As under the proposed revenue procedure, "supplemental assistive, nursing, or other routine medical services" are defined as personal and professional services that are customarily and routinely provided to individual residential customers or patients of nursing homes, assisted living facilities, memory care residences, continuing care retirement communities, skilled nursing facilities, or similar facilities, as needed, on a day-to-day basis. Such services generally do not include surgical, radiological, or other intensive or specialized medical services that are usually provided only in emergency or short-term in-patient or out-patient hospital or surgical settings.

The final Revenue Procedure also includes an alternative way of qualifying for the safe harbor, providing that if a taxpayer operates or manages residential living facilities that qualify as residential rental property under Internal Revenue Code (Code) section 168(e)(2)(A), then the facility meets the requirements of the safe harbor.

As clearly provided in the Code, the final Revenue Procedure confirms that, a taxpayer that makes the election to be treated as a RPTB pursuant to this safe harbor must use the alternative depreciation system of section 168(g) of the Code. In addition, the final Revenue Procedure confirms that a RPTB must satisfy the tests to be treated as a qualified residential living facility on an annual basis and includes an anti-abuse rule that denies access to the safe harbor if a principal purpose of an arrangement or transaction is to avoid the BID limitations. As always, these issues should be discussed with your accountants or other tax advisors.

Additionally, the Final Regulations simplify the look through rule for gain from the disposition of partnership interests. The new rule establishes that the holding period of the direct owner of transferred property will determine whether it meets the standard under Section 1061. This change was of interest to the REIT sector.

The enactment date will be as of the date that the final rules are published in the Federal Register. The IRS is continuing to study and solicit comments on certain areas. The final regulations will apply to tax years beginning on or after the date final regulations are published. For funds with a calendar tax year, the rules will be effective for tax year 2022.

It should be noted that with the beginning of a new Administration there is the potential of a tax package later this year. Carried interest is likely to be a topic of interest for those discussions.

IRS RELEASES FINAL RULES ON TAX TREATMENT OF CARRIED INTEREST

On January 7, 2021, the Internal Revenue Service released final regulations on the tax treatment of carried interests under **Section 1061**. Section 1061 was adopted as part of the 2017 Tax Cuts and Jobs Act with the purpose of increasing the holding period required to receive long term capital gain treatment from one year to three years for the gain related to applicable partnership interests for services provided.

The intention of the Section 1061 language sponsors was to distinguish between "money managers" and those who actively work to improve an asset such as real estate partnerships. At the time, then House Ways and Means Chairman Kevin Brady (R-TX), said that it would "make sure you don't have the giant hedge funds spinning in and out" of investments and would reward "those who put skin in the game and then work to make the skin in the game better." Brady highlighted "traditional real estate partnerships" as the types of partnerships that would continue to qualify for long-term capital gains treatment.

As stated, Section 1061 increases the holding period required to receive long term capital gain treatment from one year to three years for the gain related to applicable partnership interests. The Final Regulations includes "real estate held for rental or investment" in the definition of specified asset. Investing or disposing of specified assets is considered a substantial service provided in an applicable trade or business. This clarification was requested by the real estate industry.

REAL ESTATE TAX PROVISIONS IN YEAR END COVID-19 RELIEF BILL

» Electing Real Property Trade or Business Depreciation Glitch Fix. This change corrects a drafting error in the 2017 tax reform bill. The general rule is that a multifamily property is fully depreciated over a 30-year period for "real property trades or businesses" (RPTBs) that elect to fully deduct business interest and over a 27.5-year period for firms which elect to abide by limits on interest deductibility (or are exempted by having average annual gross receipts under $25 million). Due to a drafting glitch, an electing RPTB that elected out of the business interest deduction limitations was required to depreciate over 40 years with respect to real property that was placed in service prior to 2018. The year-end Covid bill corrects that glitch and allows those properties be depreciated over 30 years for electing RPTBs. This change applies retroactively. There will be some implementation issues next year, e.g., re: change of accounting method and how to claim additional deductions for past years.

» Minimum low-income housing tax credit rate. This provision establishes a 4% rate floor for calculating credits related to acquisitions and housing bond-financed developments for purposes of the low-income housing tax credit.

EMPLOYER TAX ISSUES

Extended and Enhanced Employee Retention Tax Credit (ERTC)

- **Prospective Changes.** Changes to the CARES Act's ERTC provisions that would apply to calendar quarters beginning after December 31, 2020 include the following:

- **Extension of credit.** The bill would extend the ERTC to apply to wages paid during the first 6 months of 2021 (i.e., before July 1, 2021, instead of January 1, 2021).

- **Increased credit percentage.** The bill would increase the credit percentage from 50% to 70% of applicable wages.

- **Increased credit dollar amount.** The bill would increase the per-employee limitation on applicable wages from $10,000 total to $10,000 per calendar quarter. In combination with the increase in the credit percentage, this would increase the maximum credit per employee from $5,000 total to $7,000 per quarter (up to a total of $14,000 for the first two quarters in 2021 when the increased credit percentage and limitation is in effect).

- **Expanded eligibility based on reduction in gross receipts.** For employers with a reduction in revenues, the bill would make the ERTC available if the business experienced a decline of at least 20% in gross receipts as compared to the same calendar quarter in the prior year (instead of a 50% decline, that applied in 2020). The bill would also give employers the option of measuring the reduction in gross receipts based on the immediately preceding calendar quarter.

- **Threshold for treatment as small employer.** The bill would modify the more generous small employer definition of qualified wages to apply to employers that have 500 or fewer employees (instead of 100 of fewer employees).

- **Retroactive Changes.** The following changes would generally take effect as if included in the CARES Act:

- **Coordination with PPP loans.** Under the CARES Act, the ERTC is not available if an eligible employer receives a covered loan under the SBA's Paycheck Protection Program (PPP). The bill would repeal the provision denying the ERTC to employers receiving a PPP loan. Instead, mechanisms would be created to prevent the same wages from being used for both PPP loan forgiveness and the ERTC.

- **Treatment of health plan expenses.** The bill would clarify that certain group health plan expenses are treated as wages and thus may be considered qualified wages for purposes of the ERTC, even if no other wages are paid to the employee. Although this is consistent with revised and current IRS guidance, the language of the CARES Act could be read as providing that an employer would not be eligible for the ERTC if it continued providing group health plan coverage but did not otherwise pay wages to an employee.

- **Tax-exempt organizations.** Today, ERTC eligibility can be based on a reduction in gross receipts. The bill would clarify that, in the case of a tax-exempt organization, any reference in section 2301 of the CARES Act to "gross receipts" is treated as gross receipts within the meaning of Code section 6033 (returns of exempt organizations).

EXTENSION OF TAX CREDITS FOR CERTAIN COVID-RELATED PAID SICK AND FAMILY LEAVE

- **Three Month Extension.** Extends the paid sick and family leave 100% tax credits against employment taxes enacted in the Families First Coronavirus Response Act (FFCRA), which were due to expire on December 31, 2020, for three additional months to March 31, 2021.

- **Not Mandated.** Does not extend the FFCRA's mandate to provide this paid sick leave or paid family and medical leave beyond December 31, 2020.

OTHER EXTENSIONS OF EXPIRING PROVISIONS

- Energy efficient commercial buildings deduction made permanent. The current provisions (Code section 179D) allowing an increased deduction for buildings that meet above-industry standards of energy efficiency in the year they are placed in service are made permanent. The energy efficiency standards would be updated periodically, and the deduction rate is indexed to inflation.

- 5-Year Extensions. Expiring tax provisions that are extended for five years include the following:

- New Markets Tax Credit. (Code section 45D)

- Work Opportunity Tax Credit. (Code section 51)

- Principal Residence Indebtedness. Exclusion from gross income of discharge of qualified principal residence indebtedness (Code section 108)
- Empowerment Zone Tax Incentives (Code sections 1391 & 1397)
- General Family and Medical Leave Tax Credit. The voluntary employer tax credit (Code section 45S) for paid family and medical leave which was enacted as part of the 2017 tax reform legislation.
- Student Loan Repayments. The CARES Act provision allowing employers to make tax-free student loan repayments for employees (up to an overall annual cap on educational assistance of $5,250) (Code section 127)

OTHER EMPLOYEE BENEFIT CHANGES

- Business Meals Deduction. The provision provides a 100-percent deduction for business meal food and beverage expenses provided by a restaurant that are paid or incurred in 2021 and 2022. Currently, the deduction is available for only 50 percent of such expenses.
- Flexible Spending and Dependent Care Arrangements. The following changes are included:
- Employers would be allowed to allow employees to rollover unused amounts in their health and dependent care flexible spending arrangements from 2020 to 2021 and from 2021 to 2022.
- Employers may also extend the grace period for a plan year ending in 2020 or 2021 to 12 months after the end of such plan year, with respect to unused benefits or contributions remaining in a health flexible spending arrangement or a dependent care flexible arrangement.
- Also, an employee who ceases participation in the plan during calendar year 2020 or 2021 may be allowed to continue to receive reimbursements from unused benefits or contributions through the end of the plan year in which such participation ceased, plus the additional grace period.
- Finally, this provision also permits employers to allow employees to make a 2021 mid-year prospective change in contribution amounts.

MEDICAL EXPENSE DEDUCTION

The COVID-19 Relief Bill makes permanent the 7.5% income threshold after which all eligible medical expenses can be deducted. This is an issue ASHA has championed for several years and commissioned an academic study to quantify the impact of decreasing this benefit for seniors which we shared with Congress and advocates. This tax benefit was at risk due to a scheduled increase to raise the income threshold to 10%, which would essentially be a tax increase for seniors who can use this deduction to help defray the costs of senior living and long-term care insurance premiums among other eligible expenses. ASHA recently joined AARP and 51 industry groups in a **letter** to congressional leaders seeking this permanent fix in the final COVID-19 relief bill.

For further information on any of the topics in this *Federal Policy Update*, please contact:

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