

Notice 2020-59

SECTION 1. PURPOSE

This notice contains a proposed revenue procedure providing a safe harbor for a trade or business that manages or operates a qualified residential living facility, as defined in section 3.01 of the proposed revenue procedure, to be treated as a real property trade or business solely for purposes of qualifying as an electing real property trade or business under section 163(j)(7)(B) of the Internal Revenue Code (Code).

SECTION 2. BACKGROUND

On December 22, 2017, section 163(j) of the Code was revised by § 13301(a) of Public Law No. 115-97, 131 Stat. 2054, commonly referred to as the Tax Cuts and Jobs Act (TCJA), effective for tax years beginning after December 31, 2017. On March 27, 2020, section 163(j) was further amended by § 2306 of the Coronavirus Aid, Relief, and Economic Security Act, Public Law No. 116-136, 134 Stat. 281 (CARES Act), to provide special rules for applying section 163(j) to taxable years beginning in 2019 or 2020.

Section 163(j) generally limits the amount of a taxpayer's business interest expense that can be deducted in the current taxable year. The deduction limitation is calculated as the sum of: (1) the taxpayer's business interest income, as defined in section 163(j)(6), for the taxable year; (2) 30 percent of the taxpayer's adjusted taxable income, as defined in section 163(j)(8), for the taxable year, or 50 percent of the taxpayer's adjusted taxable income (if applicable, as provided in section 163(j)(10)); and (3) the taxpayer's floor plan financing interest, as defined in section 163(j)(9), for the taxable year.

The term "business interest" means any interest that is properly allocable to a

trade or business. For purposes of section 163(j), the term “trade or business” does not include certain trades or businesses listed in section 163(j)(7). Section 163(j)(7)(A)(ii) provides that, for purposes of the limitation on the deduction for business interest, the term “trade or business” does not include an “electing real property trade or business.” Section 163(j)(7)(B) defines an electing real property trade or business as a trade or business defined in section 469(c)(7)(C) that makes a proper election. Taxpayers that make an election under section 163(j)(7)(B) must use the alternative depreciation system under section 168, and cannot claim bonus depreciation. See section 163(j)(11)(A).

Section 1.163(j)-9 of the Income Tax Regulations provides the rules and procedures for making an election under section 163(j)(7)(B) to be an electing real property trade or business. In addition, the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) released Rev. Proc. 2020-22, 2020-18 I.R.B. 745, (April 27, 2020) to provide the time and manner of making a late election, or withdrawing an election under section 163(j)(7)(B) to be an electing real property trade or business for taxable years beginning in 2018, 2019, or 2020. Rev. Proc. 2020-22 also provides the time and manner of making or revoking elections provided by the CARES Act under section 163(j)(10) for taxable years beginning in 2019 or 2020. See Rev. Proc. 2020-22 for more information regarding the time and manner of making, revoking, or withdrawing elections under section 163(j)(7) and section 163(j)(10).

The Treasury Department and the IRS are aware that taxpayers have uncertainty about whether residential living facilities that include the provision of supplemental

assistive, nursing, or routine medical services qualify as electing real property trades or businesses under section 163(j)(7)(B).

To mitigate this uncertainty, the proposed revenue procedure in section 6 of this notice provides a safe harbor under which a qualified residential living facility, as defined in section 3.01 of the proposed revenue procedure, is treated as eligible to be an electing real property trade or business under section 163(j)(7)(B).

SECTION 3. REQUEST FOR COMMENTS

The Treasury Department and the IRS request comments on the proposed revenue procedure set forth in section 6 of this notice. Interested parties are invited to submit comments on this notice by September 28, 2020. The Treasury Department and the IRS will publish for public availability any comment received to its public docket, whether submitted electronically or in hard copy.

WHERE TO SEND COMMENTS

Commenters are strongly encouraged to submit public comments electronically. Persons may submit comments electronically via the Federal eRulemaking Portal at www.regulations.gov (indicate IRS and NOT-126369-19). Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn.

Send hard copy submissions to: CC:PA:LPD:PR (NOT-126369-19), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044.

The IRS expects to have limited personnel available to process public comments that are submitted on paper through mail. Until further notice, any comments submitted on paper will be considered to the extent practicable.

SECTION 4. APPLICABILITY AND IMMEDIATE RELIANCE

The proposed revenue procedure is proposed to apply to taxable years beginning after December 31, 2017.

Until the date on which the proposed revenue procedure is published as a revenue procedure in the Internal Revenue Bulletin, taxpayers may rely on the safe harbor described in the proposed revenue procedure for purposes of determining whether a qualified residential living facility, as defined in section 3.01 of the proposed revenue procedure, is eligible to be an electing real property trade or business solely for purposes of section 163(j).

SECTION 5. DRAFTING INFORMATION

The principal authors of this notice are Susie Bird, Charles Gorham, and Justin Grill of the Office of Associate Chief Counsel (Income Tax & Accounting) and Adrienne Mikolashek and William Kostak of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Mr. Grill at (202) 317-7003, or Mr. Kostak at (202) 317-5279 (not toll-free calls).

SECTION 6. FORM OF PROPOSED REVENUE PROCEDURE

Set forth below is the form of the proposed revenue procedure that is proposed in this notice:

FORM OF PROPOSED REVENUE PROCEDURE

26 CFR 601.601. Rules and regulations.
(Also Part I, §163(j).)

Rev. Proc. 2020-[]

SECTION 1. PURPOSE

This revenue procedure provides a safe harbor that allows a trade or business that manages or operates a qualified residential living facility, as defined in section 3.01 of this revenue procedure, to be treated as a real property trade or business, solely for purposes of qualifying as an electing real property trade or business under section 163(j)(7)(B) of the Internal Revenue Code (Code).

SECTION 2. BACKGROUND

.01 On December 22, 2017, section 163(j) of the Code was amended by § 13301 of Public Law No. 115-97, 131 Stat. 2054, commonly referred to as the Tax Cuts and Jobs Act (TCJA). Section 163(j), as amended by the TCJA, provides rules limiting the amount of business interest expense that can be deducted for taxable years beginning after December 31, 2017. See TCJA § 13301(a).

.02 On March 27, 2020, section 163(j) of the Code was further amended by § 2306 of the Coronavirus Aid, Relief, and Economic Security Act, Public Law No. 116-136, 134

Stat. 281 (CARES Act), to provide special rules for applying section 163(j) to taxable years beginning in 2019 or 2020.

.03 Under section 163(j)(1) of the Code, the amount allowed as a deduction for business interest expense is limited to the sum of: (1) the taxpayer's business interest income, as defined in section 163(j)(6), for the taxable year; (2) 30 percent of the taxpayer's adjusted taxable income, as defined in section 163(j)(8), for such taxable year, or 50 percent of the taxpayer's adjusted taxable income (if applicable, as provided in section 163(j)(10)); and (3) the taxpayer's floor plan financing interest, as defined in section 163(j)(9), for such taxable year.

.04 The limitation under section 163(j) of the Code on the deductibility of business interest expense applies to all taxpayers with business interest, as defined in section 163(j)(5), except for taxpayers, other than tax shelters under section 448(a)(3), that meet the gross receipts test in section 448(c).

.05 Section 163(j)(5) of the Code generally provides that the term "business interest" means any interest properly allocable to a trade or business. Section 163(j)(7)(A)(ii) provides that, for purposes of the limitation on the deduction for business interest, the term "trade or business" does not include an "electing real property trade or business." Thus, interest expense that is properly allocable to an electing real property trade or business is not properly allocable to a trade or business for purposes of section 163(j), and is not business interest expense that is subject to section 163(j)(1).

.06 The term "electing real property trade or business" under section 163(j)(7)(B) of the Code means any trade or business that is described in section 469(c)(7)(C) that makes an election to be an electing real property trade or business.

.07 Section 168(g)(1)(F) of the Code provides that an electing real property trade or business within the meaning of section 163(j)(7)(B) must use the alternative depreciation system for property described in section 168(g)(8). See section 163(j)(11)(A).

.08 The Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) published (1) proposed regulations under section 163(j) of the Code in a notice of proposed rulemaking (REG-106089-18) (proposed regulations) in the Federal Register (83 FR 67490) on December 28, 2018, (2) final regulations on **[INSERT DATE OF PUBLICATION OF TD 9905 IN FEDERAL REGISTER]** (final regulations) in the Federal Register (___ FR ____), and (3) concurrently with the publication of the final regulations, a notice of proposed rulemaking providing additional proposed regulations under section 163(j) (REG-107911-18) (___ FR ____).

.09 Section 1.163(j)-9 of the Income Tax Regulations provides the rules and procedures for making an election under section 163(j)(7)(B) of the Code to be an electing real property trade or business. In addition, the Treasury Department and the IRS released Rev. Proc. 2020-22, 2020-18 I.R.B. 745, (April 27, 2020) to provide the time and manner of making a late election, or withdrawing an election under section 163(j)(7)(B) to be an electing real property trade or business for taxable years beginning in 2018, 2019, or 2020. Rev. Proc. 2020-22 also provides the time and manner of making or revoking elections provided by the CARES Act under section 163(j)(10) for taxable years beginning in 2019 or 2020. See Rev. Proc. 2020-22 for more information regarding the time and manner of making, revoking, or withdrawing elections under section 163(j)(7) and section 163(j)(10).

.10 Section 469(c)(7)(C) of the Code defines a real property trade or business as any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business.

.11 In response to the proposed regulations, commenters expressed concern as to whether a trade or business that manages or operates a residential living facility and also provides supplemental assistive, nursing or routine medical services to its customers or patients is eligible to make the election to be an electing real property trade or business under section 163(j)(7)(B) of the Code.

.12 In light of these comments in the context of section 163(j) of the Code, this revenue procedure provides a safe harbor that allows a taxpayer engaged in a trade or business that manages or operates a qualified residential living facility, as defined in section 3.01 of this revenue procedure, to treat the trade or business as a real property trade or business solely for purposes of qualifying to make an election to be an electing real property trade or business under sections 163(j)(7)(B) and 168(g)(1)(F) (residential living facility safe harbor).

SECTION 3. DEFINITIONS FOR RESIDENTIAL LIVING FACILITY SAFE HARBOR

The following definitions apply for purposes of this revenue procedure:

.01 Qualified Residential Living Facility. A qualified residential living facility is a facility that:

(1) Consists of multiple rental dwelling units within one or more buildings or structures that generally serve as primary residences on a permanent or semi-permanent basis to individual customers or patients;

(2) Includes the provision of supplemental assistive, nursing, or other routine

medical services; and

(3) Has an average period of customer or patient use of the individual rental dwelling units that is 90 days or more.

.02 Average period of customer or patient use.

(1) In general. The average period of customer or patient use is determined by dividing (i) the sum of the total number of days in the taxable year that each customer or patient resides in a rental dwelling unit of the residential living facility (which may be determined by reference to a rental contract or other formal written lease agreement); by (ii) the total number of individual residential customers or patients that reside in all of the rental dwelling units of the facility for the taxable year. For this purpose, a married couple residing in a single rental dwelling unit of the residential living facility will be counted as one individual customer or patient, unless each spouse is separately properly treated as an individual customer or patient of the residential living facility that receives supplemental assistive, nursing, or other routine medical services from or on behalf of the residential living facility.

(2) Example. Facility has 100 rental dwelling units. Of the 100 units, 60 units are occupied by the same customer or patient for the entire year, 25 units are occupied by each customer or patient for three months (90 days) of the year, and 15 units are occupied for only 10 months (300 days) of the year (for a total of 100 customers for the year). Of the 15 units occupied for only 10 months of the year, 10 units are occupied by customers or patients for 5 months (150 days) each (for a total of 20 customers for the 10-month period). For the remaining 5 of 15 units that are occupied for only 10 months of the year, 5 customers or patients occupy the units for 8 months (240 days) of the

year, and 5 other customers or patients occupy the units for 2 months (60 days) of the year. The average period of customer or patient use is determined by dividing the sum of the total number of days in the taxable year that each customer resides in a rental dwelling unit, by the total number of individual residential customers or patients that reside in all of the rental dwelling units for the taxable year. The total number of days in the taxable year that the customers or patients reside in the rental dwelling unit is 35,400 days [21,900 days (60 units that are occupied for the entire year x 365 days per year) + 9,000 days (25 units that are occupied for 90 days each x 90 days x 4 90-day periods in a year) + 4,500 days (15 units that are occupied for only 10 months x 300 days)]. The total number of individual residential customers or patients is 190 [60 customers or patients occupying a unit for the entire year + 100 (25 customers or patients occupying units for 90 days each x 4 90-day periods in a year) + 20 customers or patients that occupy a unit for a 5-month period + 5 customers or patients that occupy a unit for a 8-month period + 5 customers or patients that occupy a unit for a 2-month period]. Accordingly, the average period of customer or patient use is approximately 186 days (35,400/190).

.03 Supplemental assistive, nursing, or other routine medical services.

Supplemental assistive, nursing, or other routine medical services are 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

only provided in emergency or short-term in-patient or out-patient hospital or surgical settings.

.04 Permanent or semi-permanent basis. The rental dwelling units of a residential living facility serve as primary residences on a permanent or semi-permanent basis to customers or patients whose use of the units is generally long-term (more than 90 days) in nature, even though some customers or patients may arrive at the residential living facility with significantly shortened life expectancies due to advanced age or terminal medical conditions, and some customers or patients otherwise may be expected to periodically reside away from the residential living facility (such as at the primary residence of a spouse or other relative) for short periods or durations of time.

SECTION 4. RESIDENTIAL LIVING FACILITY SAFE HARBOR

.01 Safe harbor for certain residential living facility trades or businesses. A taxpayer engaged in a trade or business that manages or operates a qualified residential living facility, as defined in section 3.01 of this revenue procedure, may treat such trade or business as a real property trade or business solely for purposes of the election to be an electing real property trade or business under sections 163(j)(7)(B) and 168(g)(1)(F) of the Code. Satisfying the requirements of the safe harbor is not a determination that the taxpayer is engaged in a real property trade or business under section 469 of the Code.

.02 Effect of election and how to make the election. If a taxpayer makes the election pursuant to this safe harbor, the provisions in § 1.163(j)-9 of the regulations apply, and the taxpayer must use the alternative depreciation system of section 168(g) of the Code to depreciate the property described in section 168(g)(8). The taxpayer makes the

election at the time, and in the manner prescribed by § 1.163(j)-9(d). See also Rev. Proc. 2020-22.

.03 Substantiation. A trade or business that manages or operates a residential living facility to which this revenue procedure applies must retain books and records to substantiate that all the requirements of this section 4 have been met in accordance with section 6001 of the Code.

.04 Anti-abuse. Arrangements entered into with a principal purpose of avoiding the rules of section 163(j) of the Code or the regulations under section 163(j) may be disregarded or recharacterized by the Commissioner of Internal Revenue to the extent necessary to carry out the purposes of section 163(j). See § 1.163(j)-2(j).

SECTION 5. APPLICABILITY

This revenue procedure applies to taxable years beginning after December 31, 2017.

SECTION 6. PAPERWORK REDUCTION ACT

.01 This revenue procedure does not impose any additional information collection requirements in the form of reporting, recordkeeping requirements or third-party disclosure requirements to the burden that is accounted for in the final regulations. However, this revenue procedure provides that qualified residential living facilities, as defined in section 3.01 of this revenue procedure, may be treated as real property trades or businesses, within the meaning of section 469(c)(7)(C) of the Code, solely for purposes of qualifying as an electing real property trade or business under section 163(j)(7)(B). Taxpayers taking advantage of this revenue procedure must file a statement with their return under the procedures set forth in and containing the information required by § 1.163(j)-9 of the regulations and Rev. Proc. 2020-22, if

applicable. That collection of information has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–0123.

.02 This information is required to be collected and retained for compliance purposes, namely, to determine whether the taxpayer has made an election for one of its trades or businesses to be an electing real property trade or business.

.03 The Treasury Department and the IRS estimate that approximately 30,210 respondents are likely. This number was determined by examining, for the 2017 tax year, Form 1120, Form 1120-S, Form 1065, and Form 1120-REIT filers with NAICS codes of 623110 (nursing care facilities (skilled nursing facilities)), 623311 (continuing care retirement communities), 623312 (assisted living facilities for the elderly) and 623990 (other residential care facilities) with gross receipts of at least \$10 million.

.04 The estimated number of respondents is 30,210. The estimated annual burden per respondent/recordkeeper varies from 0 to 30 minutes, depending on individual circumstances, with an estimated average of 15 minutes. The estimated total annual reporting and/or recordkeeping burden is 7,552.5 hours (30,210 respondents x 15 minutes). The estimated annual cost burden to respondents is \$95 per hour. Accordingly, we expect the total annual cost burden for the election statements to be \$717,487.50 (30,210 * .25 * \$95). The estimated annual frequency of responses is once because the statements only have to be filed once.

SECTION 7. DRAFTING INFORMATION

The principal authors of this revenue procedure are Susie Bird, Charles Gorham, and Justin Grill of the Office of Associate Chief Counsel (Income Tax & Accounting) and

Adrienne Mikolashek and William Kostak of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue procedure, contact Mr. Grill at (202) 317-7003, or Mr. Kostak at (202) 317-5279 (not toll-free calls).