

Relief for Developers and Property Owners

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On November 6, 2009, President Obama gave some much-needed relief to the ailing real estate industry by signing into law the Worker, Homeownership, and Business Assistance Act. It provides support to cash-strapped developers by offering broader tax benefits for businesses with taxable losses, otherwise known as net operating losses (NOLs).

Who Can Take Advantage of This New Provision?

The federal government enacted the NOL provision to help balance out taxable income in industries that experience significant cycles. An NOL is the excess of business deductions over income in any given tax year. You can deduct this loss, through either an NOL carryback or carryover, in another year in which you have income. In general, you can carry back NOLs two years and forward 20 years.

The American Recovery and Reinvestment Act, passed in February 2009, allowed an eligible small-business taxpayer to carry back a 2008 NOL for either three, four, or five years rather than the normal two years. By increasing the carryback period, it allowed real estate developers to use their 2008 NOL and take it back to 2003, 2004, or 2005, which were profitable years for many in the industry. However, only eligible small businesses—those with averages gross receipts of less than \$15 million (including an aggregation of all related entities) for the three-year period that ended with the loss year—were allowed to take advantage of this extended NOL carryback period. This disqualified many home builders and other developers.

The Worker, Homeownership, and Business Assistance Act changes this, making the NOL carryback privilege available to virtually all businesses, regardless of size. Specifically, the new rules allow calendar-year taxpayers to carry back either a 2008 or 2009 NOL (but not both) three, four, or five years.

Home Builder Example

Let's assume that during 2008 a homebuilder forfeited option deposits on a piece of development property totaling \$1 million, resulting in a tax loss in the same amount. The builder was very profitable from 2003 to 2005, but subsequent to the market collapse, absorption rates slowed and sale prices decreased, resulting in no income for 2006 and 2007. Additionally, although the builder wasn't profitable, it did in fact have sales in excess of \$15 million for 2006–2008 and therefore didn't previously qualify as an eligible small business.

Under the old rules, the builder could carry back its \$1 million tax loss to 2007 and 2006. However, in those years there was no income, and therefore the \$1 million loss is carried forward to offset future income.

Under the revised rules, the builder now has the option of going back to 2003, 2004, or 2005, although the ability to use it in 2003 could be limited. If taxable income for 2004 is \$5 million, the \$1 million loss carryback will put cash in the developer's hands in the amount of \$340,000 (assuming a 34 percent federal tax rate).

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The new NOL carryback rules are welcome news and can provide significant refund opportunities. Nonetheless, there are difficult decisions that need to be made, since the extended carryback period is generally available for only a single year, 2008 or 2009.

Moss Adams LLP can help you sort through those decisions and make the best choice for your business. We routinely look for these and other opportunities to provide value to our real estate clients, and we'd be happy to meet with you to answer any questions, review your needs, and help you make the most of the new carryback provision.

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