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Can you use losses to benefit your corp.?



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Every day we hear of more businesses failing. Unfortunately, that in turn means that vacancy rates are rising and that owners of commercial real estate are sustaining losses from their rental activities. Planning for such losses is critical. Often, partners in partnerships, members of limited liability companies as well as shareholders in S corporations discover at tax time that they cannot deduct losses flowing through to them from a losing rental activity because of a myriad of applicable tax rules. More specifically, before S corporation shareholders, partners in partnerships and members of LLCs may deduct losses that flow through to them they must overcome basis limitation rules, the at-risk rules and the passive activity loss limitation rules.

A taxpayer must have basis and be considered at risk in order to deduct losses currently. Amounts contributed to an activity as well as amounts borrowed in connection with the activity may increase a taxpayer's basis as well as the amount at risk. Importantly, debt is treated differently for partners and S corp. shareholders. For example, while a partner will obtain basis for his share of partnership-level debt, an S corp. shareholder generally only obtains basis for indebtedness running directly from the corporation to the shareholder. A shareholder guarantee of corporate debt may not create basis. Further, even if a taxpayer is considered to be at risk as a result of a personal guarantee, such guarantee may not create basis for an S corporation shareholder. Thus, depending on the circumstances a personal guarantee may not overcome loss limitation rules applicable to S corp. shareholders.

Subject to certain exceptions, the passive activity loss rules may also limit availability of current losses unless the taxpayer has rental income from other sources.

With proper planning, owners of rental activities may be able to overcome these loss limitation rules and generate current loss deductions that would be available to offset other income.