RELIEF TO WITHDRAW A REAL PROPERTY TRADE OR BUSINESS ELECTION

SUMMARY On April 10, 2020, the IRS published Revenue Procedure 2020-22, which provides procedural guidance allowing a taxpayer to make a late election or withdraw a prior election under IRC Section 163(j)(7)(B) to be an electing real property trade or business.

BACKGROUND Under the Tax Cuts and Jobs Act (TCJA), IRC Section 163(j) generally allows a taxpayer to deduct business interest expense up to 30% of the taxpayer's adjusted taxable income (ATI) for the tax year.

A taxpayer is not subject to this limitation to the extent they meet the definition of a real property trade or business and make an irrevocable election under IRC Section 163(j) to not have the limitations apply. The election requires a taxpayer to use the alternative depreciation system (ADS) to depreciate nonresidential real property, residential rental property and qualified improvement property (QIP). ADS does not permit bonus depreciation and requires straight-line depreciation over longer useful lives.

As part of the CARES Act passed on March 27, 2020, Congress retroactively made a technical correction to qualified improvement property. Prior to this, the TCJA intended to classify improvements to the interior portion of nonresidential buildings as 15-year depreciable property eligible for 100% bonus depreciation. Due to drafting errors, the TCJA omitted language to classify QIP as 15-year property eligible for bonus depreciation.

As a result, there are taxpayers who made an irrevocable election out of the IRC Section 163(j) business interest expense limitation in 2018 or 2019 when QIP was not bonus eligible. Such taxpayers may now want to undo the election to take advantage of the technical correction to QIP. Rev. Proc 2020-22 provides guidance to taxpayers impacted by the changes made in the CARES Act and addresses how taxpayers can withdraw their election.

SPECIFIC PROCEDURES The Bipartisan Budget Act of 2015 (BBA) replaced the existing rules for auditing large partnerships with a new set of rules that took effect January 1, 2018. Small partnerships (100 or fewer partners) that meet the eligibility requirements can elect out of the new BBA rules under IRC Section 6221(b). If a small partnership elects out of the BBA rules, the assessment of tax will be determined separately for each partner instead of at the partnership level.

In order to withdraw the real property trade or business election made pursuant to IRC Section 163(j)(7)(B), generally a taxpayer may do the following:

1. File an amended tax return by September 30, 2020 (BBA partnerships) or October 15, 2021 (Non-BBA partnerships)

2. File an administrative adjustment return (AAR) in the case of a BBA partnership by October 15, 2021

Note that the withdrawal of the election cannot be done by filing a Form 3115.

GUIDANCE ON ELECTIONS RELATED TO BUSINESS INTEREST EXPENSE LIMITATIONS UNDER IRC SECTION 163(J)

SUMMARY For taxpayers other than partnerships, the CARES Act temporarily modifies the 30% business interest expense limitation and increases the deductibility to 50% of adjusted taxable income (ATI) for tax years 2019 and 2020. Additionally, businesses may elect to use their 2019 adjusted taxable income rather than their 2020 income for purposes of applying the 50% limitation.

In 2020, partners of partnerships subject to the business interest expense limitation rules will be able to fully deduct 50% of any excess business interest expense (EBIE) that was allocated to them in 2019. The remaining 50% would remain suspended until the partnership allocates excess taxable income to the partners.

ELECTION OUT OF 50% ADJUSTED TAXABLE INCOME RULE Rev. Proc. 2020-22 provides that a taxpayer may compute the Section 163(j) limitation based on 30% of the taxpayer's ATI instead of applying the new 50% limitation rules. This election can be made by timely filing Form 1065, an amended tax return or an AAR by computing the limitation based on 30% of the taxpayer's ATI.

ELECTION TO USE 2019 ADJUSTED TAXABLE INCOME IN 2020 Rev. Proc. 2020-22 provides a taxpayer may elect to apply the taxpayer's 2019 ATI to compute the taxpayer's 2020 business interest expense limitation by timely filing Form 1065, an amended tax return or an AAR by computing the limitation based on the taxpayer's 2019 ATI.

ELECTION OUT OF 50% EBIE RULE (PARTNERS OF PARTNERSHIPS) Rev. Proc. 2020-22 provides a taxpayer may elect not to apply the 50% EBIE rule by timely filing a 2020 tax return, an amended return or an AAR without deducting the EBIE.

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