

TECHNICAL CORRECTION TO QUALIFIED IMPROVEMENT PROPERTY

SUMMARY On April 17, 2020, the IRS published Revenue Procedure 2020-25, supplementing Revenue Procedure 2020-23, which provides procedural guidance on the various options a taxpayer can use to change its depreciation under Section 168 for qualified improvement property placed into service after December 31, 2017.

BACKGROUND The CARES Act included a highly anticipated technical correction to qualified improvement property (QIP). 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 and as a result QIP did not meet the requirements for bonus depreciation.

The CARES Act addresses this error and allows taxpayers to apply the 100% bonus depreciation rules to QIP retroactive to January 1, 2018.

WHAT IS QIP? QIP is defined as any improvement made by the taxpayer to an interior portion of a building that is nonresidential real property, if such improvement is placed in service after the date the building was first placed in service. This does not include any improvement expenditures for the enlargement of the building, any elevator or escalator, or the internal structural framework of the building.

Common Scenarios (still must meet the definition of QIP as stated above):

- The CARES Act QIP changes do not affect new building construction not previously placed in service
- Taxpayers who purchase real estate may not treat acquired improvements previously made as QIP
- Improvements made by the landlord are considered QIP
- Tenant improvement allowances may be considered QIP
- The improvements do not need to be made to an area under lease (example – common area improvement)

SPECIFIC PROCEDURES The recent guidance published by the IRS allows for three ways for taxpayers to adjust for the retroactive changes made to QIP. (See chart at the end of this article.)

1. File Form 3115 – “Application for Change in Accounting Method”
2. File amended income tax returns for tax years affected
3. File Form 8082/1065-X – “Administrative Adjustment Request (AAR)”

Form 3115 – Application for Change in Account Method

The taxpayer may file Form 3115 – “Application for Change in Accounting Method” with its next timely filed income tax return (2019 if not yet filed or 2020 tax return). This option only applies to tax years 2019 and 2020. This allows the taxpayer to claim the additional depreciation from the QIP technical correction, which would have been allowed on previously filed tax returns, as a Section 481(a) adjustment on the current reporting year’s tax return. In the case of a partnership, the partnership will file Form 3115. Pass-through entities and their corresponding owners will not have to file amended returns. All deductions will be claimed on the next timely filed income tax return of the pass-through entities and their corresponding owners.

Form 3115 may not be used to make or revoke a Real Property Trade or Business Election (RPTOB). However, it may be filed to make or revoke an election to depreciate assets using ADS (Alternative Depreciation System) or an election out of bonus depreciation.

Amended Returns

The taxpayer may file amended returns for tax years 2018 and/or 2019 to reflect the technical correction to QIP. This includes partnerships that are subject to the Bipartisan Budget Act of 2015 (BBA). The amended returns may take into account tax changes brought about by the CARES Act as well as any other tax attributes to which the entity is entitled by law.

A partnership that is subject to the new centralized partnership audit regime is known as a BBA partnership. All partnerships with tax years beginning after 2017 are BBA partnerships unless they made a valid election out of the centralized partnership audit regime.

BBA partnerships that filed a Form 1065 may file amended partnership returns and furnish corresponding amended Schedule K-1s on or before September 30, 2020. All other entities must file on or before October 15, 2021. Owners of pass-through entities will have to file amended returns to reflect any changes passed through to them on a Schedule K-1. A BBA partnership that is currently under audit for tax years 2018 or 2019 must notify the IRS agent coordinating the audit in writing before filing the amended return.

Form 8082/1065-X – Administrative Adjustment Request (AAR)

BBA Partnerships may file Form 8082/1065-X – “Administrative Adjustment Request” (AAR) with their next timely filed partnership income tax return (2019 if not yet filed or 2020 tax return). The AAR may take into account tax changes brought about by the CARES Act as well as any other tax attributes to which the entity is entitled by law. The AAR must be filed on or before October 15, 2021.

The partnership will supply each partner with their share of adjustments. The partner will then calculate the decrease in tax for each year identified and report that amount as a nonrefundable

credit on the their current year tax return. Please note a nonrefundable credit can decrease the partner's reporting year tax to zero but it cannot generate a refund. Under current legislation, there is no ability to carry forward or back the portion of the decrease in tax that is unused on the reporting year return.

If any partner in the partnership is another pass-through entity, they can elect to file Form 8985 and Form 8986 to further pass through the adjustments to their partners.

CONNECTION WITH CARES ACT SECTION 163(j) CHANGES A taxpayer who previously made a Real Property Trade or Business election (RPTOB) or an Electing Farming Business election is not eligible to use Form 3115 to revoke this election and claim the additional depreciation from the technical correction to QIP. They must revoke the election and claim the additional deprecation from the QIP technical correction by filing an amended return or an AAR. The Form 3115 filing option also does not apply to any QIP for which the taxpayer already deducted the cost as an expense.

Updated May 19, 2020

OPTION	WHO IS ELIGIBLE	CHANGES THAT CAN BE MADE	DUE DATE	PROS	CONS
Form 3115	All Entities	<ul style="list-style-type: none"> - Change QIP life and/or take 100% bonus on QIP - Make or revoke ADS or election out of bonus 	October 15, 2021	<ul style="list-style-type: none"> - No requirement for PTEs or partners to file amended returns - Can make or revoke ADS or election out of bonus - Efficient way to get the benefits from CARES Act changes - Changes for all assets can be done on Form 3115 	<ul style="list-style-type: none"> - Cannot revoke a RPTOB election - Cannot amend for other issues - If 2019 return already filed, have to wait to file with 2020 returns
Amended	All Entities	<ul style="list-style-type: none"> - Change QIP life and/or take 100% bonus on QIP - Make or revoke RPTOB election - Make or revoke ADS or election out of bonus - Any other tax attributes to which the entity is entitled by law 	BBA Partnerships - September 30, 2020 All other entities - October 15, 2021	<ul style="list-style-type: none"> - Can revoke RPTOB election - Can amend for non-CARES Act changes as well - Can file currently, do not have to wait to file with next return - Can file and get the benefit currently 	<ul style="list-style-type: none"> - Requires partners to file amended returns - Must file by September 30, 2020 - If 2019 return already filed, may have to amend multiple years - Amended returns could take time to process

AAR	Partnerships (Non-BBAs are not eligible)	<ul style="list-style-type: none"> - Change QIP life and/or take 100% bonus on QIP - Make or revoke RPTOB election - Make or revoke ADS or election out of bonus - Any other tax attributes to which the entity is entitled by law 	October 15, 2021	<ul style="list-style-type: none"> - No requirement for PTEs or partners to file amended returns - Can revoke RPTOB election - Have until October 15, 2021 to file - Can adjust for non-CARES Act changes as well 	<ul style="list-style-type: none"> - Burdensome filing process for partnership and partners - Decrease in tax is a nonrefundable credit - Partners that are PTEs will have to further pass-through adjustments - If 2019 return already filed, have to wait to file with 2020 returns
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