

Qualified Improvement Property

GUIDANCE FOR METHOD CHANGES AND ELECTIONS

Overview

This guidance is applicable to QIP placed in service by the taxpayer after Dec. 31, 2017, in the taxpayer's 2018, 2019, or 2020 taxable year, and to elections under §168(g)(7), (k)(5), (k)(7), or (k)(10). However, a §168(g)(7) election can only be withdrawn by filing an amended return. Amended returns are due by Oct. 15, 2021.

The guidance also allows taxpayers to amend prior year tax returns or to file an accounting method change on Form 3115 to make, revoke, or withdraw an election under sections 168(g)(7), (k)(5), (k)(7), or (k)(10) by October 15, 2021, but not later than the applicable period of limitations on assessment. These changes apply to tax returns that were timely filed before April 17, 2020.

YEAR PLACED IN SERVICE	2018 RETURN FILED	2019 RETURN FILED	OPTION 1	OPTION 2**
2018	Yes	No	Amend 2018 or AAR, as applicable	File 3115 with 2019 return
	Yes	Yes	Amend 2018 and 2019 or AAR, as applicable	File 3115 with amended 2019 or original 2020 return
2019		No	Use correct method	
		Yes	Amend 2019 or AAR, as applicable	File 3115 with original 2020 return

***Section 6.03(4) of Rev. Proc. 2015-13 grants an automatic extension of 6-months from the due date (excluding any extension) of the federal income tax return for the year of change when certain conditions are met. The making and revocation of late elections may only be made with a timely filed original Federal income tax return or Form 1065 for the taxpayer's first or second taxable year following the placed-in-service year, or that is filed after April 16, 2020, and by Oct. 15, 2021.*

Qualified Improvement Property - Procedural Guidance for Method Changes and Elections

The guidance does not apply to QIP that was expensed in the placed-in-service year, such as under section 179, or to make or withdraw an election under sections 163(j)(7)(B) (electing real property trade or business) or 163(j)(7)(C) (electing farming business). A taxpayer that wishes to make or withdraw these elections for the 2018, 2019, or 2020 taxable year must timely file an amended federal income tax return by October 15, 2021, but not later than the applicable period of limitations on assessment, in accordance with Rev. Proc. 2020-22. A change in these elections affects the amount of depreciation allowed for QIP placed-in-service in such years and subsequent taxable years.

Tax Elections

- 168(g)(7) To depreciate under the ADS any class of property placed in service during the taxable year.
- 168(k)(5) To apply the special rules of §168(k)(5) to one or more specified plants that are planted, or grafted to a plant that has already been planted, by a taxpayer in the ordinary course of its farming business.
- 168(k)(7) To not deduct bonus depreciation for any class of property that is qualified property placed in service during the taxable year.
- 168(k)(10) To deduct 50% instead of 100% bonus depreciation for all qualified property acquired after Sept. 27, 2017 and placed in service during the taxable year that includes Sept. 28, 2017.
- 163(j)(7)(B) Electing real property trade or business for purposes of the business interest expense deduction limitation.
- 163(j)(7)(C) Electing farming business for purposes of the business interest expense deduction limitation.

Depreciation Method Changes

Taxpayers may change from an impermissible to a permissible method of determining depreciation for QIP by either:

- (1)** Filing an amended federal income tax return or Form 1065, or an Administrative Adjustment Request (AAR) as applicable, for the placed-in-service year of the QIP by Oct. 15, 2021;
- (2)** Filing Form 3115 with a timely filed original federal income tax return or Form 1065 under the automatic change procedures in Rev. Proc. 2015-13; or
- (3)** Filing Form 3115 with an amended federal income tax return or Form 1065, or an AAR filed within the automatic 6-month extension period under the automatic change procedures in Rev. Proc. 2015-13.

If the time for filing the original federal income tax return or federal Form 1065 hasn't passed (including extensions), then the correct method should be used on an original or superseding tax return.

Late Elections

Taxpayers may make late section 168(g)(7), (k)(5), (k)(7), or (k)(10) elections by either:

- (1) Filing an amended federal income tax return or Form 1065, or an AAR as applicable, for the placed-in-service year of the QIP by Oct. 15, 2021; or
- (2) Filing Form 3115 with a timely filed original federal income tax return or Form 1065 for (a) the taxpayer's first or second taxable year following the placed-in-service year, or (b) that is filed after April 16, 2020, and by Oct. 15, 2021.

Revocation or Withdrawal of Elections

Taxpayers may revoke or withdraw section 168(g)(7), (k)(5), (k)(7), or (k)(10) elections by either:

- (1) Filing an amended federal income tax return or Form 1065, or an AAR as applicable, for the placed-in-service year of the QIP by Oct. 15, 2021; or
- (2) Filing Form 3115 with the taxpayer's timely filed original federal income tax return or Form 1065 (a) for the taxpayer's first or second taxable year following the taxable year placed-in-service year, or (b) that is filed on or after April 17, 2020, and on or before Oct. 15, 2021. However, a Form 3115 may not be used to withdraw a section 168(g)(7) election.

The extension of time to make, revoke, or withdraw these elections is applicable to tax returns filed on or before April 17, 2020.

BBA Partnerships

The centralized partnership audit procedures enacted by the Bipartisan Budget Act (BBA) of 2015 apply to all partnerships, unless the partnership makes a valid election under section 6221(b) not to have those procedures apply.

The IRS issued guidance in Rev. Proc. 2020-23 that allow a BBA partnership to file amended returns for a limited time when certain conditions are met. BBA partnerships that already filed their forms 1065 for the 2018 and 2019 tax years generally are unable to take advantage of the CARES Act relief for partnerships except by filing an AAR pursuant to section 6227. Filing an AAR would result in the partners' only being able to receive any benefits from that relief on the current taxable year's federal income tax return. Therefore, if an AAR were filed, the partners generally would not be able to take advantage of CARES Act benefits from an AAR until they file their current year returns which may be in 2021.

BBA partnerships that filed a Form 1065 and furnished all required Schedules K-1 for the taxable years beginning in 2018 or 2019 prior to **April 8, 2020**, may file amended partnership returns and furnish corresponding K-1's **before Sept. 30, 2020**. The amended returns may take into account CARES Act relief including the technical amendments to QIP. The BBA partnership writes "FILED PURSUANT TO REV PROC 2020-23" at the top of the amended return and attaches a statement to each Schedule K-1 with the same notation.

If a BBA partnership chooses not to file an amended Form 1065 under Rev. Proc. 2020-23 or the placed-in-service year of the QIP is not within the scope of Rev. Proc. 2020-23, then the BBA partnership may file an AAR for the placed-in-service year by **Oct. 15, 2021**.

A BBA partnership has the following options in connection with method changes under Rev. Proc. 2020-25:

- (1) Form 3115.** File Form 3115 with a timely filed or superseded federal Form 1065, or with an AAR filed within 6-months of the due date for filing Form 1065 (excluding extensions). Under this option, the partners report their allocable share of the adjustment to taxable income or loss on their current year tax returns.
- (2) Amended Return.** For 2018 and 2019 Forms 1065 timely filed before April 8, 2020, file an amended Form 1065 under Rev. Proc. 2020-23 before Sept. 30, 2020. Under this option, the partners report their allocable share of the adjustment to taxable income or loss on their amended tax returns.
- (3) AAR.** File an AAR to "push-out" the adjustment to the partners in the placed-in-service year. The partners report their allocable share of the adjustment to taxable income or loss on their current year tax returns.

Method Change Procedures

Generally, when an impermissible method of accounting has been used for at least two tax years, the taxpayer has established a method of accounting and may not file an amended return to change the method. However, Rev. Proc. 2020-25 allows taxpayers to file amended tax returns for the placed-in-service year for a limited time.

Form 3115 is filed under the automatic change procedures in Rev. Proc. 2015-13 with a timely filed original federal tax return (including a superseding return). In addition, Form 3115 may be filed with an amended income tax return or Form 1065, or AAR as applicable, filed within 6-months of the original due date for filing the original tax return, excluding extensions. However, the elections discussed above are made or revoked with a timely filed original federal income tax return or Form 1065.

The following sections were added to Rev. Proc. 2019-43 (automatic method change procedures):

- 6.19 Qualified improvement property placed in service after December 31, 2017.
- 6.20 Late elections under §168(g)(7), (k)(5), (k)(7), and (k)(10) or revocation of elections under §§168(k)(5), (k)(7), and (k)(10).

In addition, changes are permitted in the final year of the trade or business and when the taxpayer has made or requested a change for the same item within the five taxable years ending with the year of change.

State Conformity

State conformity with the CARES Act provisions will vary. For example, New York chose to decouple the New York State and City corporate income taxes from the CARES Act changes to business interest limitations for the 2019 and 2020 tax years. In addition, New York chose to decouple the New York State and City personal income tax from all federal law changes enacted after March 1, 2020, for tax years beginning before Jan. 1, 2022. As a result, the technical amendments to QIP apply to New York State and City corporate taxpayers but do not apply to New York State and City personal income taxpayers. Also, New York State and City do not conform to federal bonus depreciation.

Qualified Improvement Property Depreciation Guide

PLACED IN SERVICE YEAR	BONUS DEPRECIATION PERCENTAGE		DEPRECIATION	
	BONUS %	LONG PRODUCTION PERIOD BONUS %	GDS	ADS
Portion of Basis of QIP Acquired before September 28, 2017				
2015 - 2017	50%	50%	39-Years S/L	40-Years S/L
2018	40%	50%	15 Year S/L	20 Year S/L
2019	30%	40%	15 Year S/L	20 Year S/L
2020	0%	30%	15 Year S/L	20 Year S/L
Portion of Basis of QIP Acquired after September 27, 2017				
Sept. 28 - Dec. 31, 2017	100% (50% election)	100% (50% election)	39-Years S/L	40-Years S/L
2018 - 2022	100%	100%	15 Year S/L	20 Year S/L
2023	80%	100%	15 Year S/L	20 Year S/L
2024	60%	80%	15 Year S/L	20 Year S/L
2025	40%	60%	15 Year S/L	20 Year S/L
2026	20%	40%	15 Year S/L	20 Year S/L
2027	0%	20%	15 Year S/L	20 Year S/L
2028 and thereafter	0%	0%	15 Year S/L	20 Year S/L

NOTES:

A transition rule provides that, for a taxpayer's first taxable year ending after Sept. 27, 2017, the taxpayer may elect to apply a 50% allowance instead of the 100% allowance.

In the case of longer production period property described in section 168(k)(2)(B) and placed in service in 2020, 30% applies to the adjusted basis attributable to manufacture, construction, or production before Jan. 1, 2020, and the remaining adjusted basis does not qualify for bonus depreciation.

Longer production period property is property with an estimated production period exceeding 2 years, or an estimated production period exceeding 1 year and a cost exceeding \$1 million.

Bonus depreciation is not applicable when use of ADS (Alternative Depreciation System) is required (excluding any election to use ADS).



Glossary of Key Terms

Acquisition Date

Property is treated as acquired no later than the date in which a written binding contract is entered into for the acquisition of the property, or the date on which construction begins in the case of self-constructed property.

ADS (Alternative Depreciation System)

Use of ADS is required for the following property:

1. Tangible property used predominately outside the U.S.
2. Tax-exempt use property
3. Tax-exempt bond financed property
4. Imported property covered by an executive order of the President of the U.S.
5. Property used in the trade or business of selling or leasing motor vehicles when floor plan financing interest is taken into account under Code Sec. 163(j)(1)(C).
6. Property used predominately in a farming business and placed in service during any tax year in which an election under Code Sec. 263A(d)(3) to not have the uniform capitalization rules of 263A apply.
7. Any non-residential real property, residential rental property, or QIP property held by an electing real property trade or business.
8. Any property that has a recovery period of 10 years or more that is held by an electing farming business.

Bonus Depreciation

An additional first-year depreciation (i.e., bonus) may be claimed for the placed-in-service year for tangible property with a recovery period of 20 years or less. The amount is based on the acquisition date and place-in-service year. Under the Tax Cuts and Jobs Act, bonus depreciation increased from 50% to 100% for eligible property acquired and placed in service after Sept. 27, 2017, and previously used property acquired after this date was added. However, previously used property is not applicable to QIP.

Electing Farming Business

A farming business, as defined in Code Sec. 263A(e)(4), that makes an election under Code Sec. 163(j) to avoid the business interest limitation under Code Sec. 163(j); or a trade or business of a specified agricultural or horticultural cooperative, as defined in Code Sec. 199A(g)(2), for which the cooperative makes an election under Code Sec. 163(j)(7)(C) as an exception to the business interest limitation under Code Sec. 163(j). Once made, the election is irrevocable and requires the farming business to use ADS to depreciate any property used in the farming business with a recovery period of ten years or more (including property placed in service in tax years preceding the election year). Refer to Rev. Proc. 2020-22 for the procedure to withdraw this election.

Glossary of Key Terms, continued.

Electing Real Property Trade or Business

Any trade or business that is described in Code Sec. 469(c)(7) and makes an election under Code Sec. 163(j)(7)(B) as an exception to the business interest limitation under Code Sec. 163(j). Once made, the election is irrevocable and requires the business to use ADS to depreciate any of its non-residential real property, residential rental property, and QIP (including property placed in service in tax years preceding the election year). Refer to Rev. Proc. 2020-22 for the procedure to withdraw this election.

Elevator or Escalator

The term “elevator” means a cage or platform and its hoisting machinery for conveying persons or freight to or from different levels and functionally related equipment which is essential to its operation. The term includes, for example, guide rails and cables, motors and controllers, control panels and landing buttons, and elevator gates and doors, which are essential to the operation of the elevator. The term “elevator” does not, however, include a structure which is considered a building for purposes of the investment credit. The term “escalator” means a moving staircase and functionally related equipment which is essential to its operation. For purposes of determining qualified investment under section 46(c) and §1.46-3, the basis of an elevator or escalator does not include the cost of any structural alterations to the building, such as the cost of constructing a shaft or of making alterations to the floor, walls, or ceiling, even though such alterations may be necessary in order to install or modernize the elevator or escalator.

Enlargement

A building is enlarged to the extent that the total volume of the building is increased. An increase in floor space resulting from interior remodeling is not considered an enlargement. The total volume of a building is generally equal to the product of the floor area of the base of the building and the height from the underside of the lowest floor (including the basement) to the average height of the finished roof (as it exists or existed). For this purpose, floor area is measured from the exterior faces of external walls (other than shared walls that are external walls) and from the centerline of shared walls that are external walls.

Internal Structural Framework

The term “internal structural framework” includes all load-bearing internal walls and any other internal structural supports, including columns, girders, beams, trusses, spandrels, and all other members that are essential to the stability of the building.

Glossary of Key Terms, continued.

Qualified Improvement Property

Qualified Improvement Property (QIP) means any improvement made by the taxpayer to an interior portion of a building which is nonresidential real property if such improvement is placed in service after the date such building was first placed in service. Such term does not include:

- (A) The enlargement of the building as defined in §1.48-12(c)(10);
- (B) Any elevator or escalator, as defined in §1.48-1(m)(2); or
- (C) The internal structural framework of the building as defined in §1.48-12(b)(3)(iii).

Qualified Real Property

For tax years beginning after 2017, qualified real property means qualified improvement property and any of the following improvements to non-residential real property placed in service after the date the property was first placed in service: roofs, HVAC, fire protection and alarm systems, and security systems. For tax years beginning before 2018, qualified real property means qualified leasehold, restaurant, and retail property.

Sale or Lease of Motor Vehicles

The term “motor vehicle” means any self-propelled vehicle designed for transporting persons or property on a public street, highway, or road, a boat, and farm machinery or equipment. The interest that is paid or accrued on indebtedness used to finance the acquisition of motor vehicles held for sale or lease and secured by the inventory is floor plan financing interest. Property used in a trade or business that has floor plan financing indebtedness is excluded from 100% bonus depreciation if the related floor plan financing interest is taken into account under Code Sec. 163(j)(1)(C).

Section 179 Property

An election can be made to expense certain “qualified real property”. For taxpayers other than a corporation, this election does not apply to any section 179 property leased to others unless:

- (1) the lessor manufactured or produced the property; or
- (2) The term of the lease (including options to renew) are less than 50% of the class life of the property, and during the 12 months after the property’s transfer to the lessee, the lessor’s deductions with respect to the property under section 162 (other than rents and reimbursements) must total more than 15% of rental income produced.

Glossary of Key Terms, continued.

Self Constructed Property

Property that is manufactured, constructed, or produced for the taxpayer by another person under a written binding contract that is entered into prior to the manufacture, construction, or production of the property for use by the taxpayer in its trade or business or for its production of income is considered to be self-constructed property.

Construction of property begins when physical work of a significant nature begins. Physical work does not include preliminary activities such as planning or designing, securing financing, exploring, or researching. For example, physical work begins when excavating for footings, pouring the pads or the driving of foundation pilings into the ground begins. Preliminary work such as clearing a site, test drilling to determine soil condition, or excavation to change the contour of the land (as distinguished from excavation for footings) does not constitute the beginning of construction. However, assembly of modular units manufactured off-site and delivered to the site, manufacturing begins when physical work of a significant nature commences at the off-site location.

Under a safe harbor method, physical work of a significant nature will be considered to begin at the time the taxpayer incurs (in the case of an accrual basis taxpayer) or pays (in the case of a cash basis taxpayer) more than 10 percent of the total cost of the property, excluding the cost of any land and preliminary activities such as planning or designing, securing financing, exploring, or researching.

Special rules apply to components of self-constructed property.

Structural Modification Safe Harbor

A modification of a building is not treated as a demolition of the building if:

- (1) 75% or more of the existing external walls of the building are retained in place as internal or external walls;
- (2) 75% or more of the existing internal structural framework of the building is retained in place.