



FREED MAXICK COVID-19 RESOURCE CENTER

# Qualified Improvement Property IRS Guidance for Method Changes and Tax Elections

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**The IRS issued guidance in Rev. Proc. 2020-25 for taxpayers to retroactively change their depreciation method for Qualified Improvement Property (QIP) and to make or revoke tax elections impacting bonus depreciation, effective for tax years ending in 2018, 2019, or 2020.**

This guidance is needed as a result of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) “technical amendments” to the Tax Cuts and Jobs Act (TCJA) retroactively changing the classification of QIP from 39-year to 15-year property, for property placed in service after Dec. 31, 2017. As a result, QIP may be eligible for 100% bonus depreciation.

The classification of QIP placed in service after Dec. 31, 2017 as nonresidential real property is an impermissible method of accounting. Therefore, taxpayers are required to change their depreciation method for QIP placed in service after Dec. 31, 2017 and to claim bonus depreciation for eligible property. The guidance allows taxpayers to amend prior year tax returns or file Form 3115 to change the depreciation method and to claim bonus depreciation for eligible property for tax years ending in 2018, 2019, and 2020.

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.

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.

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## Qualified Improvement Property

The Tax Cuts and Jobs Act (TCJA) removed QIP as a separate class of property eligible for bonus depreciation, effective for QIP placed in service after Dec. 31, 2017. Before this change, QIP was potentially eligible for either 50% or 100% bonus depreciation depending on the date of acquisition. However, as a result of a technical error, QIP wasn't assigned to a 15-year MACRS asset class. As a result, QIP was classified as nonresidential real property ineligible for bonus depreciation.

The CARES Act "technical amendments" assigned QIP to the 15-year MACRS asset class (20-years under the alternative depreciation system (ADS)) retroactively for property placed in service after Dec. 31, 2017. As a result, QIP placed in service after Dec. 31, 2017 may be eligible for bonus depreciation.

## Tax Elections

The tax elections referred to above are as follows:

1. Election to use MACRS ADS (Code Sec. 168(g)(7)).
2. Election to claim bonus depreciation on specified plants in the year of planting or grafting (Code Sec. 168(k)(5)).
3. Election out of bonus depreciation for a class of property (Code Sec. 168(k)(7)).
4. Election to claim bonus depreciation at a 50% rate instead of a 100% rate for all qualified property acquired after Sept. 27, 2017 and placed in service in a tax year that includes Sept. 28, 2017 (Code Sec. 168(k)(10)).
5. Election by a real property trade or business to use ADS to depreciate nonresidential real, residential rental, and QIP and not limit business interest expense (Code Sec. 163(j)(7)(B)).
6. Election by a farming business to use ADS to depreciate certain property used in farming and not limit business interest expense (Code Sec. 163(j)(7)(C)).

## 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 as applicable, within the automatic 6-month extension period under 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.

### 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 an AAR as applicable, 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 procedures for automatic consent accounting method changes are provided in Rev. Proc. 2019-43 as amended by Rev. Proc. 2020-25 adding new sections 6.19, Qualified improvement property placed in service after December 31, 2017, and 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.

## 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.

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 for the placed-in-service year of the QIP 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.

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## Summing it Up

When considered in combination with other CARES Act changes (e.g., the temporary suspension of the business loss limitations for the 2018, 2019, and 2020 tax years, the temporary increase in the limitation on deductibility of business interest expense for the 2019 and 2020 tax years, the technical amendment to QIP retroactive for property placed in service after Dec. 31, 2017, the ability to change bonus depreciation and business interest expense elections retroactively for the 2018 and 2019 tax years, the ability to claim COVID-related 2020 losses in 2019, the five-year carry back provision for net operating losses (NOLs) arising in tax years beginning after Dec. 31, 2017 and before Jan. 1, 2021, and the removal of the 80% limitation on the use of NOLs for tax years beginning before Jan. 1, 2021), taxpayers have a unique opportunity to minimize their Federal income tax liability over multiple years by working with their tax advisors to create an overall tax minimization strategy.

**Contact us for more information by calling 716.847.2651 or:**

