

Qualified Improvement Property (QIP) Opportunities

July 15, 2020



The new QIP guidance issued by the CARES act provides a wide range of flexibility and options for building owners. See below for more information on the various QIP opportunities and helpful hints to maximizing your tax relief:

Amend or Supersede Tax Returns

If the 2019 tax return was already filed but has a valid extension, or if the return

qualifies for an automatic extension through July 15, 2020, the taxpayer can file a superseding return so these changes are reflected on the 2019 return. A superseding return just replaces the return already filed with the IRS.

Taxpayers who placed QIP in service in 2018, have filed their 2019 tax return and continued depreciation of 2018 QIP over a 39-year period, have established an accounting method. Under Revenue Procedure 2020-25, the IRS is now allowing taxpayers (other than certain partnerships subject to CPAR – see below) to file amended tax returns for 2018 and 2019 to revise their treatment of QIP on or before October 15th, 2021.

Under Revenue Procedure 2020-23, partnerships subject to CPAR can file amended returns for tax years 2018 and 2019 before September 30th, 2020.

Amending tax returns provides a more immediate benefit to a taxpayer from a cash flow perspective, but may not be practical in tiered partnership structures and where there are many partners and possibly partners with minor shares of ownership. Real estate owners need to carefully evaluate how best to maximize the value of any additional depreciation deductions.

Change in Accounting Method (Form 3115)

The automatic method change available to change a taxpayer's depreciation method for QIP is available for both taxpayers who adopted a method for QIP (used an impermissible method for at least two consecutive taxable years), and taxpayers who have not adopted a method for QIP.

Taxpayers can choose to file Form 3115 and deduct a "catch-up" adjustment instead of filing an Administrative Adjustment Request (AAR) or amending a tax return. Filing Form 3115 is not as complicated as filing an AAR or amending returns.

Please keep in mind that if the partnership ownership has changed, only partners in the year of the adjustment (most likely 2019 or 2020) will benefit from the additional deduction, not the partners in the year the property was placed in service.

Administrative Adjustment Request (AAR)

A partnership may choose to file an AAR related to their 2018 or 2019 income tax returns. This option does not generally require the individual partners to amend their returns, but will delay any potential benefit until the year the AAR is filed. The benefit of the additional deductions is allocated to the partners in the year the property was placed in service (compare to filing a Form 3115 above).

The potential tax benefit will be delayed until the year the AAR is filed, and if the partners do not have other tax liabilities in the later year, the benefit may be lost. The benefit will not be refundable or carried forward in this situation.

Late Elections and Revocations

For a limited time, taxpayers may make a late election or revoke a prior election that was made for depreciable property placed in service in 2018, 2019, or 2020. One of those elections is the ability to elect out of bonus depreciation.

Taxpayers may make or revoke these elections by filing an amended return, AAR or Form 3115.

Business Interest Limitation Relief

As you may recall, the Tax Cuts and Jobs Act of 2017 (TCJA), limited the business interest deduction to 30% of Adjusted Taxable Income (ATI). For 2019 and 2020, the CARES Act increases the business interest limitation to 50% of the taxpayer's ATI.

For partnerships, this increase will not apply to tax years beginning in 2019. Instead, 50% of the excess business interest expense from 2019 can be deducted by partners in their taxable year beginning in 2020, and the remaining 50% will be subject to the normal rules established by the TCJA.

Taxpayers may elect not to apply the 50% limitation. In addition, the CARES Act permits taxpayers to elect to use their 2019 ATI for 2020. Assuming the taxpayer's ATI for 2020 would be lower than that of 2019, electing to use 2019 would result in a higher interest deduction.

The Takeaway

The CARES Act statute and guidance issued by the IRS present many opportunities for taxpayers. In order to maximize benefits, you will need to analyze the interaction of QIP with other provisions in the relief package, especially NOL and interest limitations.