

CARES Act Updates Tax Act's Depreciation Period – Act Fast

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Before the enactment of the 2017 Tax Cuts and Jobs Act (TCJA), qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property had a 15-year recovery period for depreciation purposes. For property placed in service after December 31, 2017, the TCJA eliminated the separate definitions of qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property and replaced them with a new category called qualified improvement property. Qualified improvement property is any improvement to an interior portion of a building that is classified as nonresidential real property if the improvement is placed in service after the date the building was first placed in service. Qualified improvement property does not include the enlargement of the building, any elevator or escalator, or the internal structural framework of the building.

The Tax Act was supposed to provide for a general 15-year recovery period for qualified improvement property. Due to a drafting error, however, the necessary change adding qualified improvement property to the definition of 15-year recovery property was not made. As a result, under the TCJA as enacted, qualified improvement property, by default, is subject to the general 39-year recovery period that applies to nonresidential real property. Although this problem was recognized immediately after passage of TCJA, Congress failed to make the anticipated correction until this year.

The CARES Act finally makes a technical correction to the TCJA that retroactively treats qualified improvement property as 15-year recovery property for depreciation purposes. As a result of the retroactive effect of the technical correction, all qualified improvement property placed in service on or after January 1, 2018, likely is being depreciated using a now impermissible depreciation method (a 39-year recovery period rather than a 15-year recover period).

To address the use of an impermissible depreciation method, IRS released [Revenue Procedure 2020-25](#) on April 17, 2020, which provides guidance allowing taxpayers to change the depreciation of qualified improvement property placed in service by the taxpayer in a tax year ending in 2018, 2019, or 2020. Taxpayers that placed qualified investment property in service in their 2018, 2019, or 2020 tax year (and did not make an election pursuant to IRC §163(j) for a longer recovery period in order to deduct certain business interest) have the option under Revenue Procedure 2020-25 to **file IRS Form 3115, Application for Change in Accounting Method**, with their timely-filed current-year return to claim the missed depreciation; to **file an amended return**; or, in the case of a BBA partnership (discussed below), to **file an administrative adjustment request (AAR)** for the year the qualified improvement property was placed in service and any affected succeeding tax years. No matter the approach, taxpayers must ensure that current year returns are timely filed and any amended returns are filed within the statute of limitations period for filing amended returns.

Additional rules apply to partnerships subject to the partnership audit regime enacted as part of the Bipartisan Budget Act of 2015 (BBA partnerships). Before the IRS released [Revenue Procedure 2020-23](#) on April 8, 2020, BBA partnerships that already filed their partnership tax returns for an affected year were unable to take advantage of the CARES Act relief applicable to that year except by filing one or more AARs. Revenue Procedure 2020-23 allows a BBA partnership to file amended partnership returns, and issue amended Schedule K-1s, for taxable years beginning in 2018 and 2019. Such amended returns, however, must be filed on or before September 29, 2020, and only for a taxable year for which it already filed a partnership return and issued Schedule K-1s before to April 10, 2020.

Revenue Procedure 2020-25 expands the relief provided to BBA partnerships. Under it, a BBA partnership will have the option to (1) file an amended return for each affected prior year on or before September 29, 2020 (the deadline under Revenue Procedure 2020-23), (2) file an AAR for the year(s) in which the qualified improvement property was placed in service, generally no later than October 15, 2021, or (3) account for the retroactive change in law by filing IRS Form 3115 with the next timely-filed partnership return.

Many taxpayers may find filing IRS Form 3115 with their current-year tax return to be preferable to filing an amended return or AAR. Filing IRS Form 3115 for the 2019 tax year, for example, allows the taxpayer to claim in that return the depreciation that should have been claimed in the earlier years but was not claimed due to the use of a 39-year recover period. **Most federal tax filing and payment deadlines are postponed to July 15, 2020**, because of the COVID-19 pandemic. (Most states have extended the time to file tax returns, but taxpayer's must check their state's filing extensions, which may differ from the federal extension.) While there is still time to file IRS Form 3115 with a 2019 tax return, taxpayers must be mindful of the time limit. Revenue Procedures 2020-23 and 2020-25 are detailed, and taxpayers should consult their tax advisors to ensure proper compliance with the revenue procedures' requirements.

Please reach out to one of the authors or any member of McGlinchey's Corporate and Tax teams for help or questions.

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