2020 WOLTERS KLUWER US MASTER DEPRECIATION GUIDE

CARES ACT UPDATE

**15-year recovery period for qualified improvement property**. A 15-year recovery period is retroactively assigned to qualified improvement property (QIP) ([Code Sec. 168(e)(3)(E)(vii)](javascript:void(0)), as added by the Coronavirus Aid, Relief, and Economic Security (CARES) Act ([P.L. 116-136](javascript:void(0))) (March 27, 2020)). Thus, QIP placed in service after December 31, 2017, is depreciated over 15 years. Alternatively, the property qualifies for 100 percent bonus depreciation if all bonus requirements are met. Lower bonus rates apply to qualified improvement property if it was acquired before September 28, 2017 (i.e., construction began before that date) and it was placed in service in 2018 or 2019.

IRS guidance in Rev. Proc. 2020-25 provides that a taxpayer who has filed two or more returns using a 39-year recovery period for QIP placed in service after 2017 is using an incorrect accounting method may either file amended returns or an automatic consent to change to the correct method on [Form 3115](javascript:void(0)) using the procedures described in Sec. 6.01 of [Rev. Proc. 2019-43](javascript:void(0)). Taxpayers who only filed one return using a 39-year recovery period (e.g., a calendar-year taxpayer who placed improvement property in service in 2018 and has not filed a 2019 return) may file an amended return to correct the recovery period or may also file [Form 3115](javascript:void(0)) with their current year return. The Form 3115 or amended return will generally be filed taking into account the adjustments required if the taxpayer had originally claimed 100 percent bonus depreciation.

See ¶127D (item 1A) of 2020 US Master Depreciation Guide (electronic version).

**Improvement must be made by taxpayer**. An additional technical correction clarifies that the 15-year recovery period and bonus depreciation only apply to improvements made by the taxpayer ([Code Sec. 168(e)(6)(A)](javascript:void(0)), as amended by the CARES Act). Since the improvement must be made by the taxpayer, the 15-year recovery period and bonus depreciation do not apply to a taxpayer that purchases a building that includes qualified improvement property that is depreciated by the seller over 15 years.

**Certain late elections and revocations allowed**. The IRS guidance (Rev. Proc.2020-25) allows a taxpayer to make or revoke the following elections for property placed in service in tax years ending in 2018, 2019, or 2020:

1. Election out of bonus depreciation
2. Election to claim bonus depreciation in year of planting or grafting
3. Election to use the alternative depreciation system (ADS) for a class of property.

In addition, a taxpayer may make a late election or revoke an election to claim 50 percent bonus depreciation in lieu of the 100 percent rate for property acquired and placed in service after September 27, 2017 in a tax year that includes September 28, 2017.

A taxpayer may make or revoke any of these elections even if no qualified improvement property was placed in service in the tax year for which the late election is made or election revoked.

These rules only apply to a taxpayer that filed a timely federal income tax return or Form 1065 on or before April 17, 2020 for the tax year that the property relating to the election was placed in service. For example, a calendar-year taxpayer that filed an income tax return or Form 1065 for the 2019 tax year after April 17, 2020 may not make or revoke an election for property placed in service in 2019.

See ¶127D (item 1A) of 2020 US Master Depreciation Guide (electronic version) for bonus elections.

See ¶152 of 2020 US Master Depreciation Guide (electronic version) for ADS election.

**Interest deduction limitation---farming business and real property trade or business**. IRS guidance in Rev. Proc. 2020-22 allows a farming business or real property trade or business to make a late election out of the business interest deduction limitations (Code Sec. 163(j)) or withdrew a prior election out, for a tax year beginning in 2018, 2019, or 2020. A farming business that elects out of the interest deduction limitation is required to depreciation all property with a recovery period of ten years or more using ADS. An electing real property trade or business must depreciate nonresidential real property, residential rental property, and qualified improvement property using ADS. The guidance requires a taxpayer making a late election or withdrawing an election to file an amended return by October 15, 2021 to change depreciation periods to conform to these rules.

See ¶152 of the 2020 US Master Depreciation Guide (electronic version).

**Revocation of farmer’s election not to capitalize preproductive period expenses**. IRS guidance in Rev. Proc. 2020-23 allows farmers who are exempt from the uniform capitalization rules by reason of having average annual gross receipts of $25 million or less (Code Sec. 263A(i)) to revoke a prior election not to capitalize preproductive expenses (Code Sec. 263A(d)(3)) and switch from the ADS method of depreciation to the GDS system using the change in use rules of Reg. §1.168(i)-4(d). The election may be revoked retroactively for the 2018 tax year when the $25 million exemption went into effect. In addition, the guidance allows a farmer who is exempt from the UNICAP rules under the $25 million average annual gross receipts exception to make the election not to capitalize preproductive period expenses in the tax year that the exception no longer applies.

See ¶152 of the 2020 US Master Depreciation Guide (electronic version).