

IRS Releases Rev. Proc. 2020-25: Qualified Improvement Property (QIP) Guidance

April 30, 2020

Summary

Revenue Procedure 2020-25, issued on April 17, 2020, clarifies the process by which taxpayers are able to claim depreciation deductions including 100% “bonus depreciation” for the cost of certain leasehold and other improvements to existing buildings (“qualified improvement property” or “**QIP**”). Significantly, the Procedure provides a method for taxpayers to expense QIP placed in service in 2018 or 2019, or change the depreciation method without filing amended returns for those years, by filing Form 3115, application to change accounting method.

Revenue Procedure 2020-25 also provides for the manner in which taxpayers can make or revoke certain elections related to depreciation methods.

Revenue Procedure 2020-25

Qualified Improvement Property

The CARES Act includes a technical correction to the 2017 Tax Cuts and Jobs Act related to the manner in which the cost of certain improvements to an existing building is recovered. Generally, QIP includes interior non-structural improvements made to existing nonresidential real property (e.g., retail or office leasehold improvements). The Act provides that QIP that is placed in service prior to 2023 is generally eligible for an immediate 100% write-off, with the write-off phasing down for property that is placed in service in 2023 or subsequent years. In addition, taxpayers that elect to forgo the immediate write-off can generally depreciate QIP over a generous 15-year recovery period that is much shorter than the normal 39-year recovery period for nonresidential building improvements.

In order to claim the 100% bonus depreciation or the special 15-year recovery period on QIP that was placed in service in a prior year for which the taxpayer’s returns have already been filed, Revenue Procedure 2020-25 provides taxpayers with three different options, including filing an amended return (which option is available even for partnerships that would normally be required to file an Administrative Adjustment Request (AAR) - as described in our recent Client Alert: [IRS Provides Additional Relief for Taxpayers, Partnerships](#) - filing an AAR (relevant to partnerships subject to the special audit rules of the Balanced Budget Act of 2015), or filing Form 3115 to change their account method on a prospective basis.

Revenue Procedure 2020-25 further provides that a taxpayer changing the depreciation method of QIP, and/or claiming the first-year bonus depreciation deduction for QIP is changing from an “impermissible method of accounting” to a “permissible method of accounting”. As such, the

change to the depreciation will generally be able to be reported as an accounting method change. This is true even in the case of property that was placed in service in a preceding year.

To effect the change of accounting, a taxpayer is allowed to submit Form 3115, attached to a timely filed federal income tax return under the automatic change procedures described in Revenue Procedure 2015-13 (with modifications in Revenue Procedure 2020-25). A taxpayer using this procedure is eligible to claim a deduction in 2020 for the additional depreciation that the taxpayer was entitled to claim in the prior year when the property was placed in service. This deduction is obtained through a negative Code section 481(a) adjustment in the current year to which the taxpayer is entitled because of the accounting method change. This puts the taxpayer in roughly the same position they would be in by filing an amended return, but without the need to file the amended return

Note that if a taxpayer has been depreciating QIP on a 39-year depreciation schedule in 2018 or 2019, the taxpayer is required to change its depreciation method using one of the three options in Revenue Procedure 2020-25, as that would constitute "impermissible method of accounting" based on the changes above.

Extension of Time to Make or Revoke Certain Elections under Code Section 168

The Revenue Procedure 2020-25 specifically grants taxpayers an extension of time to make or revoke certain elections with respect to property placed in service on a 2018, 2019, or 2020 tax return that was filed on or before April 17, 2020. Taxpayers may rely on this extension for the election to:

1. Use the alternative depreciation system (ADS) under Code section 168(g)(7)
2. Claim additional depreciation plants placed in service in connection with a farming business under Code section 168(k)(5)
3. Elect out of the additional first-year depreciation under Code section 168(k)(7), or
4. Elect to use 50% first-year additional depreciation instead of 100% under Code section 168(k)(10)

Taxpayers may make any of the above elections by filing an amended return, an AAR, or Form 3115 with a timely filed tax return.

Similarly, a taxpayer who has previously made one of the above elections may revoke/withdraw such election in accordance with the Revenue Procedure 2020-25. The revocation of elections under Code sections 168(k)(5), (7), and (10) may be made on an amended tax return, an AAR or on a completed Form 3115. The withdrawal of the ADS election under Code section 168(g)(7), however, may only be made by filing an amended return or an AAR.

Revoking the RPT Election

Revenue Procedure 2020-25 does not address the revocation of a Code section 163(j)(7) real property trade or business election to opt-out of the Code section 163(j) interest deductibility limitation ("**RPT Election**"). However, the previously issued Revenue Procedure 2020-22 provides ways to revoke the RPT Election by way of amended return or an AAR.

Taxpayers who have made the RPT Election are required to depreciate QIP under the ADS over 20 years and are not able to immediately expense such improvements. However, in order to enable taxpayers to take advantage of the new bonus depreciation provision, Revenue Procedure 2020-22 allows taxpayers who made the RPT Election for 2018, 2019 or 2020 to withdraw the election on an amended tax return to allow them to claim bonus depreciation (but become subject to the section 163(j) interest deductibility limitation, which was increased by the Cares Act to 50% from 30%).

See our previous update on Revenue Procedure 2020-22: [IRS Provides Additional Relief for Taxpayers, Partnerships](#)

Click here to access the revenue procedure: <https://www.irs.gov/pub/irs-drop/rp-20-25.pdf>