A WELCOMED CHANGE INVOLVING REAL ESTATE DEPRECIATION

Submitted by: Martin H. Abo, CPA/ABV/CVA/CFF July 25, 2020

We tax practitioners and certain taxpayers have been waiting for Congress to fix a key technical glitch in the 2017 Tax Cuts & Jobs Act (TCJA) rushed through in the waning days of 2017. The concern was over permitted depreciation for retail, restaurant, hospitality and leasehold remodeling lumped together and called "Qualified Improvement Property" (QIP). Republicans in Congress meant to give QIP a fifteen-year life for depreciation and make it eligible for the very favorable 100% bonus depreciation. Instead, it inadvertently gave it a 39-year life and precluded bonus depreciation. While nothing really to do with the pandemic, The Coronavirus Aid, Relief and Economic Security Act (CARES Act) passed March 27th, fixed this omission retroactive back to 2018. This change may well provide significant tax-reduction opportunities. The faux pas has been called the retail glitch". While beneficial to a broad base of taxpayers, the incentive was a meaningful boon to the retail, restaurant and hospitality industries because of the rate at which these businesses open and renovate locations.

QIP is defined as improvements to an interior portion of a nonresidential building. It must be placed in service by the taxpayer after the building was first placed in service and can include no improvements for the enlargement of the building, for elevators or escalators, or for the internal structural framework of the building. While there is no change in the definition of QIP, again, the change is effective for tax years that begin subsequent to December 31, 2017.

Taxpayers who put such Qualified Improvement Property in service during 2019 but have not yet filed their returns, should so explore this opportunity. Those who filed returns where they placed such QIP into service during 2018 and 2019, may wish to look into filing amended returns to take advantage of the changes which could be material. If they treated the assets as bonus-ineligible 39-year property, they should amend those returns to treat such assets as bonus-eligible.

The TCJA eliminated a taxpayer's ability to carry back an NOL, only to be carried forward (indefinitely) and, even then, limited to 80% of income. For tax years beginning before 1/1/2021, the CARES Act will now allow net operating losses to be carried BACK to offset 100% of income for the prior 5 years (i.e. 2013 thru 2017).

C corporations can file an amended return to claim the bonus depreciation. Such may generate a NOL that can be carried back five years under the new NOL provisions of the CARES Act to tax years before 2018. Imagine using such losses carried back to a time when rates were 35%, even though these losses were generated in years with a tax rate of 21%. Tax refunds may be generated which can bring welcome relief to mitigate the negative impact of the pandemic.

Current and contemplated projects involving significant costs for improvements should be evaluated by taxpayers who want to take advantage of deducting the cost of these improvements. They will need to segregate interior improvements from exterior improvements and items specifically excluded from QIP. Cost segregation studies

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are essential tools in identifying eligible costs so it would appear wise to have cost segregation professionals involved. While not my field, I'm sure the experts at WCRE can put you in touch with credible teams they work with.

FOR MORE INFORMATION:

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