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QIP Glitch Fixed, but Only for New Build-Outs

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In this article, Dexter reviews changes the Coronavirus Aid, Relief, and Economic Security Act made to the definition of qualified improvement property.

It may have taken a global pandemic, but taxpayers finally have their long-awaited legislative solution to the QIP quagmire. Or do they? QIP, short for qualified improvement property, generally refers to any improvement to a building's interior other than elevators, escalators, enlargements, and structural work.[1]

When Congress passed the Tax Cuts and Jobs Act, its intent, set forth in black and white in the legislative history, was to provide QIP with a shorter recovery period of 15 years and extend its eligibility for the bonus depreciation deduction beyond 2017.[2] But when the dust settled, QIP was missing from the statutory list of 15-year property because of an apparent error in the statutory language.[3] QIP therefore arguably remained recoverable over 39 years under the general depreciation system (GDS), rather than the intended 15 years.[4] What's more, QIP placed in service after 2017 appeared ineligible for the bonus depreciation deduction, which for qualified property placed in service before 2023 is 100 percent of cost.[5]

With the recent passage of the Coronavirus Aid, Relief, and Economic Security (CARES) Act (P.L. 116-136), Congress fixed the glitch, retroactive to QIP placed in service after 2017.[6] QIP placed in service after 2017 is now generally depreciable over 15 years and is eligible for the bonus depreciation deduction.[7] But it appears that what Congress giveth, at least to some extent, it also has managed to taketh away. Namely, under the CARES Act, Congress also retroactively changed the definition of QIP — for QIP placed in service after 2017, the shorter 15-year life and bonus depreciation deduction are available only if the QIP is made by the taxpayer.[8]

For example, if a building is purchased after 2017, any existing QIP is not considered QIP in the buyer's hands.[9] Instead, the buyer is left to recover the cost of those improvements over 39 years under GDS. And worse, because the cost of acquiring used improvements, unlike their newly constructed counterparts, was not given a recovery period of 20 years or less, the bonus depreciation deduction is not available to the buyer, either.[10]

If, in aligning the statutory recovery period with the original intent of the TCJA, Congress had stuck with the same definition of QIP that has been in place since the term first appeared in the code in 2016 — which until now has never included the phrase "made by the taxpayer" — any QIP acquired after 2017, whether new or used, would have been eligible for the bonus

[1] Section 168(e)(6).

[2] H.R. Rep. No. 115-466, at 366-367 and 366 n.567 (2017) (Conf. Rep.); Joint Committee on Taxation, "General Explanation of Public Law 115-97," JCS-1-18, at 138, 138 n.632 (Dec. 20, 2018); section 168(k)(2)(A)(i)(IV), (k)(3) (2017); TCJA section 13204(a)(4), (b).

[3] Section 168(e)(3)(E) (2018); JCS-1-18 at 138 n.632.

[4] Section 168(c) (nonresidential real property is generally depreciable over 39 years); section 168(e)(6)(A) (by definition, QIP is nonresidential real property).

[5] Section 168(k)(2)(A)(i)(I), (k)(6)(A)(i).

[6] CARES Act section 2307.

[7] Section 168(e)(3)(E)(vii), (k)(2)(A)(i)(I).

[8] CARES Act; *compare* section 168(e)(6)(A), *with* section 168(e)(6)(A) (2019).

[9] JCT, "Description of the Tax Provisions of Public Law 116-136, the Coronavirus Aid, Relief, and Economic Security (CARES) Act," JCX-12R-20, at 70-71 (Apr. 23, 2020).

[10] Section 168(k)(2)(A)(i)(I).

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depreciation deduction.[11] This would have been an efficient, elegant solution. It also would have done what Congress seemingly sought to do with the TCJA — make the bonus depreciation deduction available for acquisitions of used QIP, the same as any other qualified property.[12] For example, before the TCJA relocated the pre-CARES Act definition of QIP from section 168(k)(3) to section 168(e)(6), but after the TCJA expanded the availability of the bonus depreciation deduction to include used property, both new and used QIP acquired after September 27, 2017, and placed in service before 2018 qualified for the bonus depreciation deduction — that is, regardless of whether the improvements were made by the taxpayer.[13]

So by rewinding the clock to 2018 and changing the definition of QIP to include this novel language, and therefore limiting the bonus depreciation deduction to new QIP, the CARES Act seemingly goes well beyond giving post-2017 QIP a 15-year life as was inadvertently omitted by the TCJA.[14] Nevertheless, this change now means that going back to 2018, and proceeding from there, taxpayers are required to recover the cost of building improvements differently based on whether they are new (15 years under GDS or immediately if the 100 percent bonus depreciation deduction is taken) or used (39 years under GDS and no bonus depreciation deduction).

Aside from this generally taxpayer-unfavorable result, the lack of consistency between the recovery periods for new and used improvements, coupled with a lack of fanfare surrounding the passage of this change to the definition of QIP, is likely to result in increased controversies and burden on taxpayers, practitioners, and IRS exam teams.[15]

But this change also creates incentives for taxpayers and opportunities for advisers. For example, if the statute had merely been fixed, with all else remaining the same, the demand for more extensive cost segregation studies after a building purchase might have decreased. That is, other than determining the purchase price allocable to the building and its structural components, much of the balance of the purchase price — whether allocable to interior improvements or to furniture, fixtures, and equipment — would have been eligible for the 100 percent bonus depreciation deduction.

So there probably would have been less need to distinguish between types of property with different recovery periods if the buyer could write off the entire cost in full regardless. Now, however, because the buyer cannot claim the bonus depreciation deduction for existing QIP, it may have a greater incentive to undertake a detailed cost segregation study to determine the portion of its capital investment that it can recover through expensing or more accelerated depreciation.

Time will tell.[16] ■

[11] Section 168(k)(3) (2016); Protecting Americans From Tax Hikes Act of 2015, P.L. 114-113, Div. Q, section 143(b)(2), 129 Stat. 2242, 3060 (2015); JCT, "Technical Explanation of the Protecting Americans From Tax Hikes Act of 2015, House Amendment #2 to the Senate Amendment to H.R. 2029," JCX-144-15, at 65 (Dec. 17, 2015); section 168(k)(3) (2017); section 168(e)(6) (2018); section 168(e)(3)(E)(vii), (k)(2)(A)(i)(I), (k)(2)(A)(ii); TCJA section 13204(a)(4)(B), (b); Conf. Rep. at 348-349, 356-357, 363-364 and 364 n.546, 366-367, and 366 n.567; reg. section 1.168(b)-1(a)(5).

[12] Congress had not expressed an intent to restrict the shorter 15-year life and bonus depreciation deduction to QIP made by the taxpayer. Conf. Rep. at 356-357, 363-364, and 364 n.546, 366-367, and 366 n.567; "Reconciliation Recommendations Pursuant to H. Con. Res. 71," S. Prt. 115-20, at 149, 152-153, and 153 n.452 (2017); letter from Senate Finance Committee majority members to Steven T. Mnuchin, secretary of Treasury, and David J. Kautter, assistant secretary of Treasury for tax policy and acting commissioner of the IRS (Aug. 16, 2018); letter from Senate minority members to Mnuchin (Sept. 24, 2018); letter from House majority members to Paul D. Ryan, House speaker, and Kevin Brady, chair of House Ways and Means Committee (Oct. 2, 2018). *Contra* JCS-1-18, at 138 and 138 n.633 (the phrase "made by the taxpayer" is used to describe QIP); *but see United States v. Woods*, 571 U.S. 31, 47-48 (2013) (Bluebooks are "written after passage of the legislation and therefore d[o] not inform the decisions of the members of Congress who vot[e] in favor of the [law].") (quoting *Flood v. United States*, 33 F.3d 1174, 1178 (9th Cir. 1994)).

[13] Reg. section 1.168(k)-2(b)(2)(i)(D).

[14] Regrettably, the CARES Act has no contemporaneous legislative history to supply the legislative purpose behind adding a "made by the taxpayer" requirement to QIP acquired after 2017, even though the TCJA removed the old "original use" requirement and therefore allows the bonus depreciation deduction for new and used property. Section 168(k)(2)(A)(ii); Conf. Rep. at 356-357.

[15] In the Senate Finance Committee's explanation of its changes to QIP in the TCJA — which other than the length of the recovery period were followed in the final bill — the committee no less than admitted that in the "interests of simplicity and administrability, a uniform definition and period for the recovery of [QIP] is desirable." S. Prt. 115-20 at 152.

[16] The information in this article is not intended to be written advice concerning one or more federal tax matters subject to the requirements of reg. section 10.37(a)(2) of Treasury Circular 230 because the content is issued for general informational purposes only. The information in this article is of a general nature and based on authorities that are subject to change. Its applicability to specific situations should be determined through consultation with your tax adviser. This article represents the views of the authors only and does not necessarily represent the views or professional advice of KPMG.

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