

KBKG Tax Insight: New Qualified Improvement Property Category in 2016

Many tax professionals are still unclear about the newest classification of building improvements eligible for bonus depreciation when placed in service on or after January 1, 2016. That's understandable considering there has been over a dozen additions or changes to rules relating to various qualified real property improvements since bonus depreciation was enacted. This newest category significantly increases the likelihood real property capital expenditures are eligible for bonus depreciation. In this post, we clarify the new applications of Qualified Improvement Property.

Qualified Improvement Property (QIP) is defined as any improvement to an interior portion of a building that is nonresidential real property as long as that improvement is placed in service after the building was first placed in service by any taxpayer (Section 168(k)(3)). The QIP provisions are effective for property placed in service after December 31, 2015. Similar to Qualified Leasehold Improvements, QIP specifically excludes expenditures for (1) the enlargement of a building, (2) elevators or escalators, or (3) the internal structural framework of a building. Qualified Improvement Property is not eligible for Section 179 unless it also meets the definition of a Qualified Leasehold Improvement, Qualified Retail Improvement, or Qualified Restaurant Property.

Differences with Qualified Leasehold Improvements

The QIP definition is similar to that of Qualified Leasehold Improvements; however, there are subtle but distinct differences to note. For one, Qualified Improvement Property does not have the Qualified Leasehold Improvements requirement that a building must have been placed in service at least three years prior to the expenditure. Further, QIP is not restricted to expenditures pursuant to a lease between non-related parties.

KBKG Insight: Interior components such as common area improvements in multi-tenant buildings, interior improvements in an owner occupied building, or tenant improvements in a building less than three-years old may be eligible for bonus depreciation as QIP even though they have 39-year recovery periods.

Interaction with other Qualified Property

Improvements that meet the criteria for QIP can also meet the criteria for Qualified Leasehold Improvements and Qualified Retail Improvement Property. Since the PATH Act removed the exclusion of Qualified Retail Improvement Property from bonus eligibility, it is more advantageous to use the 15 year recovery period offered by this category. For Qualified Restaurant Property however, bonus depreciation is limited to only those improvements that also meet the definition of QIP.

KBKG Insight: New restaurant improvements to the exterior of a building, such as HVAC units, windows, façade work, or roofing, are still excluded from bonus depreciation. Therefore, for restaurant improvements, taxpayers should consider engaging a cost segregation study to separate 15-year improvements eligible for bonus depreciation from 15-year improvements that are not eligible.

Bonus Depreciation Considerations

Bonus depreciation has been extended through 2019, but with the following phase-out rate changes: 50% bonus depreciation through the end of 2017; 40% in 2018; and 30% in 2019. Additionally, Qualified Retail Property placed in service after 2015 is now eligible for bonus depreciation while Qualified Restaurant Property is not.

Section 179

The PATH Act permanently restored Section 179 expensing. The limit for 2016 is \$500,000 and will be adjusted for inflation going forward. QIP, Qualified Leasehold Improvements, Qualified Restaurant Property, and Qualified Retail Improvement Property may be eligible for Section 179 expensing subject to certain limitations. The rules for each category of qualified improvements have changed several times over the last decade making it difficult for tax professionals to keep track. You can download our Qualified Improvements Quick Reference Chart for an easy-to-use resource reflecting these new changes: <http://www.kbkg.com/handouts/KBKG-Qualified-Improvement.pdf>. For the complete text of the bill, read the PATH Act of 2015: <http://www.kbkg.com/docs/PATH-2015.pdf>.

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