KBKG Tax Insight: New 2016 Qualified Improvement Property Criteria

The new Qualified Improvement Property category put into effect in 2016 by the PATH Act will have a broad impact on almost all real estate owners for the near future by increasing the likelihood real property capital expenditures are eligible for bonus depreciation.

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. Although Qualified Improvement Property is depreciated over a 39-year recovery period, it was specifically identified as eligible for bonus depreciation and expensing under Section 179.

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 any 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:** 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.

Interaction with other Qualified Property
Improvements that meet the criteria for QIP can also meet the criteria for Qualified Leasehold Improvement and Qualified Retail Improvement Property. The PATH Act removed the exclusion of Qualified Retail Improvement Property from bonus eligibility starting in 2016, so these taxpayers get bonus depreciation and 15-year recovery period. For Qualified Restaurant Property however, bonus depreciation is limited to only those improvements that also meet the definition of QIP.

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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. Qualified Retail Improvement Property placed in service after 2015 is now eligible for bonus depreciation while Qualified Restaurant Property generally is not eligible.

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 KBKG's Qualified Improvements Quick Reference Chart for an easy-to-use resource reflecting all the new and historical changes. For the complete text of the bill, read the PATH Act of 2015.

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