

Resources

IRS Allows Higher Deductible Interest Expense and Accelerated Depreciation for Real Property Trade & Farming Businesses

April 13, 2020

On April 10, 2020, the Internal Revenue Service (the “IRS”) issued Revenue Procedure 2020-22 to provide guidance related to business interest expense limitations and elections available for certain real property trade and farming businesses under Section 163(j)(7) of the Internal Revenue Code (the “Code”). Pursuant to this Revenue Procedure, electing property trade and farming businesses are allowed to withdraw an election, or to make a late election on an amended Federal income tax return, in order to take advantage of the benefits available under the Coronavirus Aid, Relief, and Economic Security Act, Pub. L. No. 116-136 (the “CARES Act”).

For taxable years before 2018, business interest expense was generally deductible in the year in which it was incurred. For taxable years beginning after December 31, 2017, the Tax Cuts and Jobs Act of 2017 (“TCJA”) imposed a limitation on the deductibility of business interest expenses under Code Section 163(j) generally equal to 30 percent of the taxpayer’s adjusted taxable income (“ATI”) for the taxable year (the “163(j) limitation”). As a general rule, for taxable years beginning after 2017 and ending before January 1, 2022, ATI is based on a taxpayer’s earnings before interest, taxes, depreciation and amortization (“EBITDA”), and for taxable years beginning after December 31, 2021, the calculation of ATI is adjusted to EBIT. This limitation applies to all taxpayers other than certain exempt small businesses with annual average gross receipts for the three prior taxable years of less than \$25 million on certain excepted trades or businesses. Code Section 163(j)(7) allows a real property trade or farming business to elect out of the 163(j) limitation (“electing business”), but the election is irrevocable. If so elected, an electing business is required to use an alternative depreciation system (“ADS”) for depreciating any of its non-residential, residential rental and qualified improvement property (“QIP”). In addition, an electing business is not eligible for the bonus depreciation deduction under Code Section 163(k).

The CARES Act temporarily increases the business interest expense limitation to 50 percent of ATI for taxable years beginning in 2019 and 2020 in order to provide relief for businesses affected by the COVID-19 pandemic. In addition, a taxpayer may elect to use its 2019 ATI for computing its 2020 business interest limitation, which may allow the taxpayer a bigger deduction in light of the economic downturn in 2020. The CARES Act also implemented a technical correction to TCJA allowing certain QIP assets to become eligible for bonus depreciation. While the CARES Act provided for the temporary increase in business interest expense limitation on a retroactive basis, many taxpayers were precluded from filing amended returns without additional guidance from the IRS.

Revenue Procedure 2020-22 provides additional guidance with respect to the 163(j) limitation and allows electing businesses to amend their tax returns for taxable years 2018, 2019, and 2020 to make a section 163(j)(7) election or to withdraw their previous section 163(j)(7) election, which would allow taxpayers to take advantage of the increased 163(j) limitation, to accelerate depreciation and expensing of assets and to claim bonus depreciation for QIP assets. The Revenue Procedure also provides additional guidance on procedures for electing out of the 50 percent ATI limitation, including a consent to revoke the election, an election to use 2019 ATI in the 2020 taxable year, and an election out of the 50 percent excess business interest expense for partners in a partnership.

In order to make a section 163(j)(7) election for taxable years 2018, 2019, or 2020, a taxpayer must file an amended Federal income tax return, amended Form 1065 (partnership return) or Administrative Adjustment Request (“AAR”) on or before October 15, 2021, but not later than the applicable period of limitations on assessment for the taxable year for which the return is being filed (different rules may apply to partnerships, for more information, see our e-alert “Partnerships Are Eligible for Relief”). An electing business must attach to the timely filed return an election statement as provided under proposed Treasury Regulation §1.163(j)-9 and under the Revenue Procedure. The amended return must include any adjustments for the amount of depreciation allowed or allowable and the amount of taxable income or tax liability in the applicable tax year.

In order to withdraw a previous election for taxable years 2018, 2019, or 2020, a taxpayer must timely file an amended Federal income tax return, amended Form 1065 or AAR with an election withdrawal statement, as provided under the Revenue Procedure, on or before October 15, 2021, but not later than the applicable period of limitations on assessment for the taxable year for which the return is being filed (different rules may apply to partnerships—see above). The amended return must include all adjustments to taxable income arising from the withdrawal of the election. A taxpayer must also file amended returns with subsequent adjustments for any affected succeeding taxable year.

If you have any questions about the information in this alert, please contact Michael Cumming (248-203-0740 or MCumming@dykema.com), Scott Kocienski (248-203-0868 or SKocienski@dykema.com), Asel Lindsey (210-554-5298 or ALindsey@dykema.com), Nardeen Dalli (248-203-0793 or NDalli@dykema.com), or your Dykema relationship attorney.

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