



## CARES ACT 2020 QIP AND IMMEDIATE RENOVATIONS

# Q

If a taxpayer buys a building and immediately renovates it, would the improvements qualify as Qualified Improvement Property (QIP) eligible for bonus depreciation?

# A

For bonus depreciation purposes, if a taxpayer buys a building and immediately renovates it, any improvements that qualify as QIP are eligible for bonus depreciation. If the improvements were acquired and placed in service after 9/27/17 and before 1/1/2023, they would qualify for 100% bonus depreciation. If the improvements were acquired before 9/28/17, but were placed in service after 9/27/17, then they would qualify for 50% bonus depreciation if placed in service in 2017, 40% if placed in service in 2018, and 30% if placed in service in 2019.

The bigger issue concerns whether the improvements will satisfy all the requirements for QIP. In general, interior improvements made after the acquisition of a building will be QIP. However, under §168(e)(6)(B)(i), any improvement for which the expenditure is attributable to the enlargement of the building does not qualify. This could be an issue for the taxpayer if they bought a building that had never been completely finished before they made the improvements (for instance, a developer builds a shell, and then the taxpayer buys it and completes the interior improvements). We believe that the first set of interior improvements to a space are related to the enlargement (or creation) of the building, and therefore will not qualify under §168(e)(6)(B)(i).

While the definition for what constitutes an “enlargement,” found at Treas. Reg. §1.48-12(c)(10)(i), provides that a building is enlarged to the extent that its total volume is increased, our position is that the creation of a building is substantively equivalent to the enlargement of a building, and there is no substantive economic difference between the two.

However, there are some commentators that believe that under the following example found in Rev. Proc. 2017-33 at Sec. 4.02(5)(d), such improvements would qualify as QIP. We believe that example only addressed the in-service date requirement and assumed away the requirement that the improvements cannot relate to the enlargement of the building (see highlighted text in the example).

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## Example

Qualified improvement property. D is engaged in the commercial building rental business. In March 2015, D enters into a written contract with Z to construct a multi-story building. Pursuant to this contract, Z constructs a completely finished exterior of the building and a minimally finished interior of the building with only elevators, heating, ventilation, and air conditioning systems, plumbing, restrooms, and concrete floors. In December 2015, D and E entered into a lease agreement providing that E will lease one floor of the new building and E will install on that floor drop ceilings, lighting, interior walls, electrical outlets, carpeting, and trade fixtures necessary for the operation of E's trade or business (collectively referred to as a build-out). On February 8, 2016, D places in service the new building. On June 4, 2016, E places in service the build-out. Because the building is first placed in service on February 8, 2016, and the build-out is placed in service after that date, the assets of the build-out that are § 1250 property are qualified improvement property, **assuming all other requirements in § 168(k)(3) [now 168(e)(6)] and § 1.168(k)-1(c) [now 1.168(b)-1(a)(5)], taking into account section 4.02(3) of this revenue procedure, are met.**

As you can see, the example provides that the improvements would satisfy the requirement that the improvements were placed in service by the taxpayer after the date the building was first placed in service, but does not address whether they relate to the enlargement of the building. It should also be noted that the example involves a landlord/tenant relationship. If the building owner was an owner/operator, it is questionable that the IRS would have considered the building structure to have been placed in service prior to the completion of the interior improvements. See AOD 2017-02.

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