

January 14, 2021

New Stimulus Allows Faster Depreciation of Certain Residential Rental Property Held by Electing Real Property Trades or Businesses



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The stimulus package passed last month may help certain Electing Real Property Businesses by including a provision that allows a shorter depreciation period for residential rental property acquired prior to January 1, 2018.

Background

The Tax Cuts and Jobs Act (TCJA), enacted on December 22, 2017, permitted certain businesses that are electing real property trades or businesses under the Internal Revenue Code to make an election not to be subject to the business interest expense limitation rules under Code Section 163(j). This election is a one-time irrevocable election made by attaching an election statement to a timely filed original federal income tax return, including extensions. Those electing real property businesses that made the election (or who make the election for 2020 or later years) to not have the limitations in Section 163(j) apply (an "Electing Residential Rental Property Owner"), are required to apply the alternative depreciation system (ADS) recovery period for its nonresidential real property, residential rental property, and qualified improvement property.

The TCJA changed the ADS recovery period for residential rental property owned by Electing Residential Rental Property Owners from 40 years to 30 years for property placed into service after December 31, 2017. A business that holds residential rental property that did not elect not to be subject to the business interest expense limitation rules under Code Section 163(j) is required to use the modified accelerated cost recovery system (MACRS) recovery period for its residential rental property, which is 27.5 years.

The New Rules

The Taxpayer Certainty and Disaster Tax Relief Act of 2020, enacted on December 21, 2020, provides that an Electing Residential Rental Property Owner may use the 30-year recovery period under the ADS – instead of the 40-year recovery period – for all residential rental property, including residential rental property placed into service before January 1, 2018.

As a result of this change, residential rental property placed into service at any time (before or after January 1, 2018), held by an Electing Residential Rental Property Owner, may be depreciated over 30 years as opposed to 40 years.

For a business holding residential rental property that did not elect out of business interest expense limitation rules under Code Section 163(j), because, for example, it acquired its residential rental property before January 1, 2018 and it determined that the benefits of electing out of Code Section 163(j) with a 40-year recovery period was outweighed by the 163(j) business interest expense limitations with depreciation over a 27.5-year period, may now want to reconsider that decision.

In similar contexts, the IRS has provided procedures for taxpayers to make late elections when there have been changes to the depreciation tax rules or Code Section 163(j). While such procedures have not yet been issued for this late election, when such relief

is provided by the IRS, taxpayers who did not previously make the election and desire to have the election under Code Section 163(j) apply for previous years may be provided an opportunity to do so, as long as they use the 30-year ADS recovery period.

For additional questions or information about these tax law changes, please contact a member of Gould & Ratner's [Tax Planning and Compliance Practice](#).