

US IRS gives relief to taxpayers making Section 163(j) elections

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In [Revenue Procedure 2020-22](#), the United States (US) Internal Revenue Service (IRS) granted relief for real estate and farming businesses that want to withdraw or make late Internal Revenue Code Section¹ 163(j) elections based on provisions of the *Coronavirus Aid, Relief, and Economic Security Act* (CARES Act).

The CARES Act added new Section 163(j)(10), which increases the amount of business interest expense that may be deducted for the 2019 and 2020 tax years. Revenue Procedure 2020-22 allows real estate and farming businesses to change their elections if doing so would be advantageous following the changes made by the CARES Act.

Increased business deductions

Under the *Tax Cuts and Jobs Act*, Section 163(j) was amended to reduce business interest expense deductions to the sum of (1) the taxpayer's business interest income, (2) 30% of the taxpayer's adjusted taxable income (ATI), and (3) the taxpayer's floor plan financing interest. Real estate and farming businesses could elect out of this new limitation, but then had to use the alternative depreciation system (ADS) on residential and nonresidential real property and qualified improvement property (QIP). The elections had to be made on a timely filed original return and were irrevocable.

The changes made to Section 163(j)(10) by the CARES Act allow taxpayers to: (1) increase the 30%-of-ATI limitation to 50% of ATI for any tax year beginning in 2019 (except for partnerships) or 2020; (2) use their 2019 ATI in calculating their 2020 Section 163(j) limitation; and (3) treat 50% of any excess business interest expense (EBIE) allocated to partners from a partnership in tax year 2019 as automatically paid or accrued to them in the partner's 2020 tax year, without further Section 163(j) limitations at the partner level.

In addition, the CARES Act amended Section 168(e)(3)(E) to retroactively include QIP as property to which a 15-year recovery period applies and for which bonus depreciation may be claimed.

Taxpayers can revoke prior elections

Taxpayers that had elected to be real estate and farming businesses excepted from the business expense limitations may now want to withdraw their election so they can use the new CARES Act provisions, particularly if they have significant QIP in 2018 or 2019 that is now retroactively eligible for bonus depreciation following the CARES Act.

The revenue procedure allows an electing real property trade or businesses to withdraw an election under Section 163(j)(7) for tax years 2018 and 2019.

To withdraw the election, taxpayers must file an election withdrawal statement with an amended federal income tax return, amended Form 1065 or administrative adjustment request, as applicable, for the tax year in which the election was made. This must be done on or earlier of 15 October 2021, or the applicable period of limitations on assessment for the tax year for which the amended return is being filed (with an exception for amended *Bipartisan Budget Act of 2015* (BBA) 2018 and 2019 tax returns under Revenue Procedure 2020-23).

The election withdrawal statement should be titled, "Revenue Procedure 2020-22 Section 163(j)(7) Election Withdrawal," and must contain the taxpayer's name, address, SSN or EIN, and state that, "pursuant to Revenue Procedure 2020-22, the taxpayer is withdrawing its election under" Section 163(j)(7)(B) or 163(j)(7)(C), as applicable.

Taxpayers can make late elections

The revenue procedure also allows taxpayers to make a late real property trade or business election for the 2018, 2019, or 2020 tax year by filing an amended federal income tax return, amended Form 1065 or administrative adjustment request, as applicable. This would exempt taxpayers from the Section 163(j) business interest limitations including, for this purpose, the new limitation (50%) applicable for 2019 and 2020 but would require them to use ADS on residential and nonresidential real property and QIP.

Other CARES Act provisions

Under Revenue Procedure 2020-22, no formal statements are required for the following actions so long as the taxpayer properly files the amended federal income tax return, amended Form 1065 or administrative adjustment request, as applicable:

- ▶ Electing or revoking the application of the 50% ATI limitation for a 2019 or 2020 tax year (partnerships can make this election only for a 2020 tax year because partnerships cannot use the 50% ATI limitation for a 2019 tax year)
- ▶ Electing to use the taxpayer's 2019 ATI for the 2020 tax year (subject to modifications for short tax years)
- ▶ Electing or revoking application of the 50% EBIE rule

Implications

Before issuance of this Revenue Procedure, taxpayers that did not elect to be excepted from Section 163(j) on their original timely-filed tax returns were precluded from so electing on an amended return. After making the election, taxpayers could not revoke it.

The CARES Act includes many provisions intended to retroactively provide relief to taxpayers. Revenue Procedure 2020-22 creates a procedural mechanism for taxpayers to avail themselves of the provisions in the CARES Act.

In determining whether to make the election or withdraw an existing limitation, taxpayers would be well advised to consider the impact of the Section 163(j) business interest limitations or the election to be excepted from its limitations, in light of the many changes in the CARES Act.

Endnote

1. All "Section" references are to the Internal Revenue Code of 1986, and the regulations promulgated thereunder.

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EYG no. 002153-20Gbl

1508-1600216 NY
ED None

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