

Qualified Improvement Property Needs Improvement
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Client Alert

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The restaurant, retail and hospitality industries, among others, will be negatively affected by the qualified improvement property (QIP) drafting error in the Tax Cuts and Jobs Act (TCJA) (P.L. 115-97). This mistake will unintentionally increase the tax burden of many businesses. To rectify this problem and allow businesses to recover the costs of investing in their businesses, lawmakers must enact a technical correction.

What is Qualified Improvement Property?

As an example, a local hotel has endured substantial wear and tear over the years, and improvements to its dining space would significantly increase business. With the additional revenue, it could provide better services to its customers and increase wages for its employees. But, remodeling is expensive.

Qualified improvement property (QIP) tax treatment allows businesses to immediately write off investments to interior improvements. Normally, these upgrade costs must be deducted over a number of years in accordance with depreciation schedules. Prior to the TCJA, there were various categories of interior building improvements, such as qualified leasehold improvement property, qualified restaurant property and qualified retail improvement property. Under the previous regime, improvements in these areas qualified for a 15-year cost recovery period and 50 percent bonus depreciation.

So, What Went Wrong?

To simplify the law, the TCJA consolidated the various forms of improvement property into one comprehensive QIP category with a 15-year recovery period and such property was eligible for 100 percent expensing. However, not only did Congress fail to create this benefit in the TCJA, the final text of the provision actually made matters worse.

Due to a drafting error, the final text fails to provide a recovery period for QIP and unintentionally makes such improvements ineligible for bonus depreciation. As a result, the new QIP provision, which is in effect now, does not have a clearly defined recovery period, meaning that investments will default to the 39-year period and be ineligible for the 100 percent write-off.

Congressional Intent

This was clearly a drafting error. The TCJA was meant to reduce tax burdens on individuals and businesses, and a central tenet was incentivizing business investment.

In the Joint Explanatory Statement of the Committee of Conference that accompanied the TCJA, the report makes clear that “the conference agreement provides a general 15-year MACRS [Modified Accelerated Cost Recovery System] recovery period for qualified improvement property.”

To reconfirm their legislative intent, a number of lawmakers involved in the drafting and passage of the TCJA have attempted to set the record straight. In addition to numerous rank-and-file members, former and current Senate Finance Committee Chairs Orrin Hatch (R-UT) and Chuck Grassley (R-IA) signed a **letter** with Senate Banking Committee Chair Mike Crapo (R-ID) attempting to provide clarity. In the letter to Treasury Secretary Steven Mnuchin and then-Acting Commissioner of the Internal Revenue Service and current Assistant Secretary for Tax Policy David Kautter, the senators wrote that “congressional intent was to provide a 15-year MACRS recovery period and a 20-year ADS recovery period for qualified improvement property.”

Impact on U.S. Businesses

If businesses are prevented from immediately deducting these costs, they will be forced to recover their

investment over a period of 39 years. As a result, the cost of capital effectively rises, which in turn leads to diminished investment, economic growth and employment.

Countless businesses and their representatives have recognized the damage of this error, and they have expressed their concerns to Congress. In a **letter** to Senate Majority Leader Mitch McConnell (R-KY), Senate Minority Leader Chuck Schumer (D-NY), former Speaker Paul Ryan (R-WI) and current Speaker Nancy Pelosi (D-CA), over 200 companies and their business associations explained that “the delay in correcting this provision has caused economic hardship for numerous businesses, including retailers, restaurants, real estate and construction industries, as well as the manufacturers that supply products to the building trade. The delay in investments has had ripple effects across the economy that impact the communities in which these companies are doing business.”

In another letter to Secretary Mnuchin on the harm imposed by the QIP drafting error, 16 Senate Democrats—all of whom voted against the bill—**wrote** that “improper implementation of this portion of the 2017 law would cause disruption to a wide range of industries, including the nation’s retail, restaurant, and commercial properties industries.”

Unfortunately, some businesses that have already initiated renovations and upgrades are beginning to suffer. Without a solution, these businesses may have to scale back improvement projects, which means fewer jobs and less economic growth. Absent an adequate amendment to the law, this provision will continue to prevent optimal economic expansion.

How Can Congress Fix the Problem?

Congress can enact a technical correction that retroactively applies to Jan. 1, 2018.

In the final days of the 115th Congress, then-Chair of the House Ways and Means Committee Kevin Brady (R-TX) proposed legislation to correct the issue, but lawmakers failed to pass it before the session ended. The Tax Technical and Clerical Corrections Act would have corrected the recovery period for QIP, among other fixes.

There was hope that a technical correction would be able to ride on the partial government funding bill signed into law earlier this year, but it was ultimately left out of the package. Now, almost two months into the new Congress, no legislation to fix the QIP drafting error has been introduced, and the vehicle through which it might pass remains uncertain.

This document is intended to provide you with general information about a drafting error in the Tax Cut and Jobs Act regarding qualified improvement properties and its impact on businesses. The contents of this document are not intended to provide specific legal advice. If you have any questions about the contents of this document or if you need legal advice as to an issue, please contact the attorneys listed or your regular Brownstein Hyatt Farber Schreck, LLP attorney. This communication may be considered advertising in some jurisdictions.

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