



March 2018

Follow @Paul_Hastings



Depreciation of Tenant Improvements After Tax Reform: Confusion Reigns

By [Douglas Schaaf](#) & [Amy Lawrence](#)

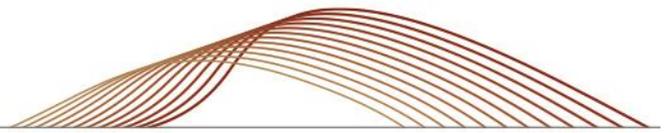
On December 22, 2017, the President signed into law tax legislation commonly referred to as the Tax Cuts and Jobs Act (the “New Act”). The New Act was rushed through Congress in record time, the result of which is that dozens of drafting errors, oversights, and disconnects have been discovered in the few months following its general effective date of January 1, 2018.

One of the most glaring errors relates to the period over which various tenant improvements can be depreciated under the New Act. Prior to the enactment of the New Act, qualifying tenant improvements could be depreciated over a period of 15 years. In what was intended to be a simplification of the depreciation rules, various forms of tenant improvements were combined in the New Act into a single category of “qualified improvement property” or “QIP,” which was intended to be eligible for a 15-year depreciation life. However, due to what appears to be a drafting oversight, the New Act was drafted without the language necessary to include QIP among property eligible for a 15-year depreciation life, and thus it remains subject to a 39-year depreciation life. This also means that QIP is not eligible for 100% bonus depreciation under the New Act, which is only available for property with a depreciable life of 20 years or shorter.

The New Act

Prior to the New Act, the following types of tenant improvements were depreciable over a 15-year life (regardless of the term of the lease and regardless of which party “owned” the improvements): (i) qualified leasehold improvements, (ii) qualified retail improvement property, and (iii) qualified restaurant property. Each of these assets was defined in old Section 168(e)(6), (7) and (8) of the Internal Revenue Code as it existed prior to the New Act. Each of these categories of improvements was eliminated in the New Act. The only remaining category of tenant improvements is “qualified improvement property,” defined in new Code Section 168(e)(6). The only requirements for this category of improvements are: (i) an improvement made to the interior portion of a nonresidential building, and (ii) placement in service after the date the building is first placed in service.

While it is clear that the intent of Congress was a simplification of the various tenant improvement categories into a single category of qualified improvement property that would continue to be eligible for depreciation over 15 years, the actual language of the statute does not achieve the intended result—the link that would have allowed qualified improvement property to be depreciated over 15 years was overlooked and never inserted into the New Act. The result is that QIP remains depreciable over 39 years.



One might think this omission of minor relevance in light of the new 100 percent bonus depreciation rules available under the New Act for certain depreciable property. Unfortunately, this 100 percent bonus depreciation is only available for assets with a recovery period of 20 years or less, and thus it appears qualified improvement property is not eligible for bonus depreciation under the New Act.

How Does This Problem Get Fixed?

There are ongoing discussions in Washington concerning a technical corrections bill to correct the various errors that have been discovered in the New Act. Unfortunately, it is likely that any such legislation will require 60 votes in the Senate in order to find its way to the President's desk. Despite the significant hurdles associated with the passage of such a technical corrections bill, the tax community and the many constituents impacted by the "tenant improvements glitch" (and many other errors) remain hopeful that a technical corrections bill will be passed soon to eliminate the many unintended consequences of the New Act.



If you have any questions concerning these developing issues, please do not hesitate to contact either of the following Paul Hastings lawyers:

Los Angeles

Amy L. Lawrence
1.213.683.6139

amylawrence@paulhastings.com

Orange County

Douglas A. Schaaf
1.714.668.6221

dougschaaf@paulhastings.com

Paul Hastings LLP

Stay Current is published solely for the interests of friends and clients of Paul Hastings LLP and should in no way be relied upon or construed as legal advice. The views expressed in this publication reflect those of the authors and not necessarily the views of Paul Hastings. For specific information on recent developments or particular factual situations, the opinion of legal counsel should be sought. These materials may be considered ATTORNEY ADVERTISING in some jurisdictions. Paul Hastings is a limited liability partnership. Copyright © 2018 Paul Hastings LLP.