

KBKG TAX INSIGHT: FORM 3115 MAY BE USED FOR CHANGING TO ADS DEPRECIATION FOR RESIDENTIAL RENTAL PROPERTY

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Under Revenue Procedure 2021-28, an RPTOB that owns residential rental property not depreciated using ADS and made a Section 163(j) election on a prior tax return may change the recovery period to 30-year ADS.

The IRS on June 17, 2021 issued Revenue Procedure 2021-28, which provides procedures for taxpayers to change to the alternative depreciation system ("ADS") for certain residential rental property placed in service prior to January 1, 2018, held by an electing Real Property Trade or Business (RPTOB).

KBKG INSIGHT

A RPTOB that made the election under Section 163(j) to avoid interest expense limitations for residential rental property is required to depreciate real property under ADS. Revenue Procedure 2021-28 clarifies that a Form 3115, change of accounting method, may be used to change the recovery period of residential real property placed in service prior to January 1, 2018 to 30-years

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under ADS. The appropriate Designated Change Number (DCN) is 88.

BACKGROUND

The Tax Cuts and Jobs Act (“TCJA”) provided that RPTOBs could elect not to apply the interest limitation provision of Section 163(j) for residential rental property. As an offset, Revenue Procedure 2019-08 provided that those RPTOB making this election are required to depreciate applicable real property under ADS. However, Revenue Procedure 2019-08 also provided that the conversion to ADS should be based on the ADS rules applicable to the year the property was placed in service, not the year in which the property was converted to ADS. RPTOBs were required to change the depreciation method for any applicable real property placed in service in years prior to the election to use ADS.

This required residential rental property placed in service prior to January 1, 2018 to convert to a 40-year ADS life rather than the 30-year ADS life established by the TCJA for residential rental property placed in service after December 31, 2017.

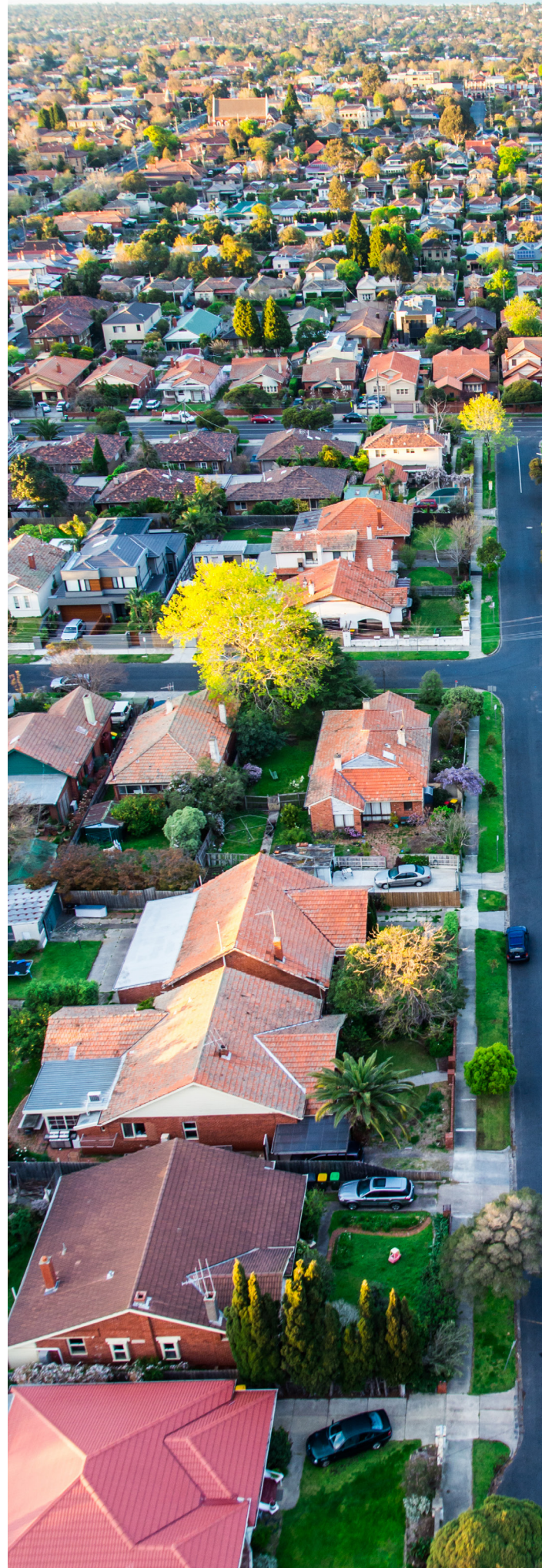
In 2021, the Consolidated Appropriations Act retroactively provided that electing RPTOBs are required to use a 30-year ADS recovery period for residential rental property placed in service prior to January 1, 2018. However, prior to the issuance of Revenue Procedure 2021-28 there was no guidance provided on how Taxpayers were to effectuate this change.

GUIDANCE

Under Revenue Procedure 2021-28, an RPTOB that owns residential rental property not depreciated using ADS and made a Section 163(j) election on a prior tax return may change the recovery period to 30-year ADS.

The Revenue Procedure provides that the use of 40-year ADS for a RPTOB that made the 163(j) election is an impermissible method of accounting, which typically may only be corrected with an accounting method change if the method was used on more than one filed tax return. However, Revenue Procedure 2021-28 allows:

- Taxpayers to use automatic method change procedures to correct this impermissible method (even if method





was used only on one tax return).

- i. Automatic Change pursuant to Section 6.05 of Rev. Proc 2019-43 (“Change in method of accounting for depreciation due to change in use of MACRS property”)
- ii. Designated Automatic Change Number: 88
- Allows amended returns to be filed to account for this change.
Note: A separate Revenue Procedure (2021-29) provides an option for partnerships to file amended returns to apply a 30-year ADS recovery period for residential rental property placed in service prior to January 1, 2018.
- Allows an administrative adjustment request (“AAR”) under Section 6227 to account for this change.

Reference: <https://www.irs.gov/pub/irs-drop/rp-21-28.pdf>

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Amar spent 14 years at PwC and one year at Centiv, LLC, focusing on various specialty tax products including Cost Recovery Solutions and [Research & Development Tax Credits](#). In the past 15 years of practice, Amar has become an expert in [cost segregation](#) and large fixed asset depreciation reviews for purposes of identifying federal, state, and property tax benefits. » [Full Bio](#)