



TaxNewsFlash

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Rev. Proc. 2021-28: Real property trade or business, 30-year recovery under alternative depreciation system

The IRS today released an advance version of Rev. Proc. 2021-28 providing guidance for certain electing real property trade or businesses required to use a depreciation recovery period of 30 years under the alternative depreciation system (ADS) for residential rental property placed in service before January 1, 2018.

[Rev. Proc. 2021-28](#) [PDF 165 KB] explains how an electing real property trade or business can change its method of computing depreciation under section 168(g) for residential rental property that was (1) placed in service before 2018, and (2) subject to a change in use in a prior tax year because of the real property trade or business election.

Today's revenue procedure modifies Rev. Proc. 2019-08 related to the depreciation for certain property held by an electing real property trade or business, and also modifies Rev. Proc. 2019-43, which provides the list of automatic changes in methods of accounting, to expand the applicability of the automatic accounting method change procedures for a change in use of residential rental property held by an electing real property trade or business.

Background

The 2017 tax law ("Tax Cuts and Jobs Act" or TCJA) added residential rental property held by an electing real property trade or business—i.e., a real property trade or business that has elected not to apply the interest limitation provisions of section 163(j)—to the list of property for which the use of the ADS is required. The TCJA also changed the ADS recovery period of residential rental property placed in service after December 31, 2017, from 40 years to 30 years.

A provision of the "Taxpayer Certainty and Disaster Tax Relief Act of 2020" enacted on December 27, 2020, as part of the "Consolidated Appropriations Act, 2021" (Pub. L. No. 116-260) added that, in the case of any residential rental property (1) that was placed in service before January 1, 2018, (2) that is held by an electing real property trade or business, and (3) for which section 168(g)(1)(A) through (E) did

not apply prior to January 1, 2018, the TCJA amendments for 30-year recovery period applied to residential rental property for tax years beginning after December 31, 2017.

Electing real property trades or businesses are required to use the ADS for all residential rental, non-residential real, and qualified improvement property placed in service in the year of the election and in subsequent years. They are also required to change the depreciation method for any such property placed in service in years prior to the election to use the ADS. This change in depreciation method is treated as a change in use of the subject property.

Real property trades or businesses that elected out of section 163(j) in a tax year for which the return was filed prior to December 27, 2020, generally have applied the change in use rules to change the depreciation recovery period of residential rental property to 40 years, unless they were already using the ADS for such property. As a result of the December 2020 legislation, these entities were required to change their methods of depreciating these assets in the years since the change in use occurred. Prior to the issuance of today's revenue procedure, there was no guidance on how to effect this change.

Summary

Under today's revenue procedure, an electing real property trade or business that made the election on a previously filed return and that owns residential rental property not previously depreciated using the ADS may change the recovery period of such property from 40 years to 30 years by either filing an automatic accounting method change or one or more amended returns.

A separate revenue procedure—Rev. Proc. 2021-29—provides an alternative process for partnerships to file amended returns in order to apply a recovery period of 30 years under the alternative depreciation system for certain residential rental property when placed in service before January 1, 2018. Read [TaxNewsFlash](#)

Rev. Proc. 2021-28 specifies that the use of 40 years instead of 30 years as the ADS recovery period of residential rental property placed in service prior to 2018 by an electing real property trade or business is an impermissible method of accounting. Generally, impermissible methods of accounting may only be corrected with an accounting method change if they are used on more than one tax return. Impermissible accounting methods used on a single return are generally corrected with an amended return.

Rev. Proc. 2021-28 allows taxpayers to use the automatic accounting method change procedures to correct this impermissible method even if it has been used on only a single tax return. In addition, it allows amended returns to be filed for tax years prior to the immediately preceding tax year so long as the amended return is filed by April 15, 2022.

The revenue procedure also provides rules specific to residential rental property held by an electing real property trade or business and accounted for in a general asset account.

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