

FEDERAL TAX REFORM

How Will the New Federal Tax Laws Impact You?



Rules Eased for Bonus Depreciation, Code Sec. 179 Expensing and Regular Depreciation

The Tax Cuts and Jobs Act (TCJA) has effectively lowered the cost of acquiring capital assets by making substantial changes to the income tax rules for bonus depreciation and other “cost recovery.” There’s a lot to discuss, but please bear with us. There’s a good chance that one or more of these changes will change your tax bill.

Bonus depreciation

Before the TCJA, taxpayers were allowed to deduct 50% of the cost of most new tangible property (other than buildings and some building improvements) and most new computer software in the year placed in service (with adjustment of the regular depreciation deductions allowed in that year and later years). The “50% bonus depreciation” was to be phased down to 40% for property placed in service in calendar year 2018, 40% in 2019 and 0% in 2020 and afterward.

But for property placed in service and acquired after Sept. 27, 2017 (with no written binding contract for acquisition in effect on Sept. 27, 2017), the TCJA raised the 50% rate to 100%. (Appropriately, 100% bonus depreciation is also called “full expensing” or “100% expensing”).

Additionally, the post-Sept. 27, 2017 property eligible for bonus depreciation can be new or used. Also, certain film, television and live theatrical productions are now eligible.

On the other hand, the TCJA repealed the eligibility of “qualified improvement property” (certain improvements to buildings other than residential rental buildings). And the TCJA excluded from bonus depreciation public utility property and property owned by certain vehicle dealerships.

The 2018/2019/2020 phase down (above) doesn’t apply to post-Sept 27, 2017 property. Instead, 100% depreciation is decreased to 80% for property placed in service in calendar year 2023, 60% in 2024, 40% in 2025, 20% in 2026 and 0% in 2027 and afterward.

Code Sec. 179 expensing

Before the TCJA, most smaller taxpayers could immediately deduct the entire cost of section 179 property up to an annual limit of \$500,000 adjusted for inflation. For property placed in service in tax years that begin in 2018, the inflation adjusted limit was scheduled to be \$520,000. The annual limit was reduced by one dollar for every dollar that the cost of

all section 179 property placed in service by the taxpayer during the tax year exceeded a \$2 million threshold adjusted for inflation. For property placed in service in tax years that begin in 2018, the threshold was scheduled to be \$2,070,000. But for tax years beginning after 2017, the TCJA substitutes as the annual dollar limit \$1 million (inflation-adjusted for tax years beginning after 2018) and \$2.5 million as the phase down threshold (similarly inflation adjusted).

Before the TCJA, section 179 property included most tangible personal property as well non-customized (“off-the-shelf”) computer software. Generally, the only buildings or other land improvements that qualified were restaurant buildings and certain improvements to leased space, retail space or restaurant space that were treated as section 179 property under an election. The TCJA, for tax years beginning after 2017, eliminated these categories and substituted as an elective category the much broader qualified improvement property category (that is no longer eligible for bonus depreciation, see above). Also, taxpayers can, for buildings other than rental real estate buildings, elect to treat as section 179 property previously ineligible building components that are roofs, heating, ventilation and air conditioning property, fire protection and alarm systems, or security systems.

And items (for example refrigerators) used in connection with residential buildings (though not the buildings themselves) are eligible to be section 179 property.

Other rules for real property depreciation

If placed in service after 2017, qualified improvement property, in addition to no longer qualifying for bonus depreciation and being newly eligible as section 179 property, has a 15-year depreciation period (rather than the usual 39 year period for non-residential buildings).

Apartment buildings and other residential rental buildings placed in service after 2017 generally continue to be depreciated over a 27.5 period, but should the alternative depreciation system (ADS) apply to a building either under an election or because the building is subject to one of the conditions (for example, tax-exempt financing) that make ADS mandatory, the ADS depreciation period is 30 years instead of the pre-TCJA 40 years.

For tax years beginning after 2017, if a taxpayer in a real property trade or business “elects out” of the TCJA’s limits on business interest deductions, the taxpayer must depreciate all buildings and qualified improvement property under the ADS.

Vehicles

The TCJA triples the annual dollar caps on depreciation (and Code Sec. 179 expensing) of passenger automobiles and small vans and trucks. Also, because of the extension of bonus depreciation, the increase, allowed only to vehicles allowed bonus depreciation, of \$8,000 in the otherwise-applicable first year cap is extended through 2026 (with no phase-down).

Computers and peripheral equipment

Under the TCJA, computer or peripheral equipment placed in service after 2017 isn’t treated as “listed property” whether or not used in a business establishment (or home office) and whether or not an employee’s use is for employer convenience. So, an item doesn’t have to pass a more-than-50%-qualified-business-use test to be eligible for Code Sec. 179 expensing and to avoid mandatory use of the ADS.

Farm property

For items placed in service after 2017, the TCJA shortens the depreciation period for most farming equipment and machinery from seven years to five and allows many types of farm property to be depreciated under the 200% (instead of 150%) declining balance method.

If a taxpayer elects to not have a farming business be subject to the TCJA’s limits on business interest deductions, the taxpayer must depreciate under the ADS the business’s buildings and other assets property that have a depreciation period of 10 years or more.

Elective rules that sometimes make it easier for fruit-or-nut-bearing trees and vines to qualify for bonus depreciation continue to apply.

Alternative minimum tax

Property eligible for bonus depreciation continues to be exempt from the unfavorable depreciation adjustments that apply under the AMT. However, the corporate AMT has been repealed; accordingly, the election that corporations could make to give up bonus and other accelerated depreciation for bonus-depreciation-eligible property in exchange for a refund of otherwise-deferred AMT credits was eliminated.

Questions?

Please contact a member of the Bowles Rice Tax Team to talk about the above changes and other changes made by the TCJA that may affect planning for your business and personal affairs.

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