Depreciation and Deductions for Fixed Assets

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Notice

The following information is not intended to be “written advice concerning one or more Federal tax matters” subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230.

The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

Overview of Select Deductions for Business Fixed Assets

— **What is new in the Tax Cuts and Jobs act (TCJA)**

- Section 179 Deductions
- Bonus Depreciation (100% expensing)
- Automobile Depreciation
- Change in use rules when for real property trades or businesses electing out of the Section 163(j) interest expense limitations
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What’s New

Dollar Limitation:

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Bonus Depreciation

The Act provides 100% bonus depreciation for qualified property acquired and placed in service after September 27, 2017, and before January 1, 2023.

Qualified Property is

— **Property of a specified type:**
  - Tangible property with a MACRS recovery period of 20 years or less
  - Computer software
  - Water utility property
  - Qualified film, television, and live production property ⬅ ***New***

— **Property that is either:**
  - Original-use property to the taxpayer, OR
  - Used property acquired by purchase from an unrelated party (so long as taxpayer has not previously used the property) ⬅ ***New***

— **Property that is not required to use the ADS method of depreciation, including:**
  - Foreign-use property
  - Property leased to a tax exempt entity
  - Certain building property owned by an "electing real property trade or business" or "electing farming business" as defined in section 163(j) ⬅ ***New***

Bonus Depreciation

— **Property is acquired no later than the date a written binding contract for the acquisition is entered into**

— **Reduced percentages apply for property placed in service after 2022 as follows:**
  - 80% in 2023,
  - 60% in 2024,
  - 40% in 2025, and
  - 20% in 2026.

— **Property used in a business excluded from section 163(j) interest limitation is not bonus eligible**
  - Regulated utility property
  - Floor plan financing property

— **Election out of bonus depreciation**
  - Made by recovery class and by entity

— **Election to use 50% in lieu of 100%**
  - Available only for first tax year ending after 9/27/2017
  - Applies to all qualified property for which taxpayer has not made a valid election out

Bonus depreciation percentages

Placed in Service Year[500]	Bonus Depreciation Percentage	
	Qualified Property in General/Specified Plants	Longer Production Period Property and Certain Aircraft
Portion of Basis of Qualified Property Acquired before Sept. 28, 2017		
Sept. 28, 2017 – Dec. 31, 2017	50 percent	50 percent
2018	40 percent	50 percent
2019	30 percent	40 percent
2020	None	30 percent[501]
2021 and thereafter	None	None
Portion of Basis of Qualified Property Acquired after Sept. 27, 2017		
Sept. 28, 2017 – Dec. 31, 2022	100 percent	100 percent
2023	80 percent	100 percent
2024	60 percent	80 percent
2025	40 percent	60 percent
2026	20 percent	40 percent
2027	None	20 percent[502]
2028 and thereafter	None	None

Source: Conference Report to Accompany H.R. 1, Pub. L. 115-97, 115th Cong. 1st Sess., p. 192. (2017).

Automobiles

Annaul depreciation limitations for listed property (Section 280F), generally referred to as the passenger cars or light duty trucks, are increased as follows:

- $10,000 for the year in which the vehicle is placed in service,
- $16,000 for the second year,
- $9,600 for the third year, and $5,760 for the fourth and later years in the recovery period

The limitation are indexed for inflation for automobiles placed in service after 2018.

The TCJA retains the **$8,000** limit for additional first year (100% bonus) depreciation for passenger automobiles and light trucks now applies to used as well and new qualified property. The additional first year limit plus the $10,000 first limitation provides **$18,000** as the maximum deductible amount for 2018.

Computers and peripheral equipment placed in service after 2017 is not longer consider "listed property", and thus not required to be depreciated using the straight-line method if the business use falls below 50%.

SUVs and Larger Vehicles

Gross vehicle weight rating above 6,000 lbs..

- are not subject to depreciation limits , however
- are limited to a $25,000 Section 179 deduction limit

No depreciation or Section 179 limits apply to SUVs with a GVW more than 14,000 lbs..

Trucks and vans with a GVW rating above 6,000 lbs., but not more than 14,000 lbs.. generally have the same limits, however, are not subject to the Section 179 $25,000 limit if special capacity and configurations exceptions apply.

Although SUVs and larger vehicles purchased after September 27, 2017, remain subject to the $25,000 Section179 limit, they are eligible for 100% bonus depreciation if they are above 6,000 lbs.. This is true for both new and used vehicles.

Examples

Example 1

Taxpayer 1 acquired and placed into service a $45,000 8,000 lbs. SUV (new or used) in January 2018 that is used 100% for business.

Taxpayer 1 is able to depreciate the entire amount in 2017 using 100 percent bonus depreciation.

If electing out of bonus then the taxpayer can take $25,000 maximum Section 179 deduction and regular MACRS deprecation on the remaining $20,000 over 5 years.

Example 2

Taxpayer 2 acquired and placed into service (new or used) light-duty pickup truck for $16,000 in March 2018.

Purchase is eligible for bonus depreciation, and taxpayer 2 is able to deduct her entire purchase since the 2018 Section 280F first-year limitation is $18,000, more than the purchase amount purchase.

Effective as of 2018 ADS depreciation on <u>building property</u> is <u>mandatory</u> for real property trades or business electing out of the 163(j) interest limitation.

- — Building property includes: non-residential real (39 year), residential rental (27.5 year) and QIP (15 or 39 year, includes assets that were QLHI, QRP or QRIP).
- — ADS applies to all building property currently and previously placed into service at the time of election. And buildion. ld

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Qualified Improvement Property (QIP)

Effective for assets placed in service AFTER 2017, the Act removed:

- — 15-year recovery classifications for Qualified Leasehold Improvement Property (QLHI); Qualified Restaurant Property (QRP) and Qualified Retail Improvement Property (QRIP)

- — Qualified Improvement Property (QIP) from the list of property that is qualified for bonus depreciation

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Qualified improvement property (QIP)

The Act intended:

— To create a new 15-year recovery classification for QIP

— Would have included all assets that would have been QLHI or QRIP and certain assets that would have QRP or non-residential real property

— As 15-year property, QIP would have been bonus eligible as MACRS property with a recovery period of less than 20 years

Due to a drafting error, the intended QIP classification was not included in the Act. Consequently, QIP placed in service after 2017 is 39 year property, and, if acquired after 9/27/17 is not bonus eligible. A technical correction is required to fix this issue.

What’s not changed but still relevant

The Tangible Property Regulations (TPR)

The Final Regulations apply to costs incurred throughout the entire life cycle

De Minimis Costs

Taxpayers with audited financial statements can expense up to $5,000 under a de minimis safe hai-cbor7 C axo qu s fr the aospanr 15.33isust havup -cb9(a w-cbor)1141(ed)7.8

Materials and Supplies Overview

Materials and supplies as tangible property used or consumed in the taxpayer's operations that does not qualify as inventory and that:

Is a component acquired to maintain, repair, or improve a Unit of Property ("UOP") owned, leased, or serviced by the taxpayer and that is not acquired as part of any single unit of tangible property;

— Consists of fuel, lubricants, water, and similar items, reasonably expected to be consumed in 12 months or less, beginning when used in the taxpayer's operations;

— Is a UOP that has an economic useful life of 12 months or less, beginning when the property is used or consumed in the taxpayer's operations;

— Is a UOP that has an acquisition or production cost of $200 or less; OR

— Is identified in published guidance in the Federal Register or in the Internal Revenue Bulletin as materials and supplies for which treatment is permitted under this section.

Types of Materials and Supplies

Incidental Materials and Supplies

— Incidental material and supplies include items that are carried on hand and for which no record of consumption is kept or of which physical inventories are not taken.

— Amounts paid to acquire or produce incidental materials and supplies are deductible in the taxable year in which they are paid/acquired.

Non-incidental Materials and Supplies

— Non-incidental supplies include items for which a record of consumption is kept or a physical inventory is taken.

— Amounts paid to acquire or produce incidental materials and supplies are deductible in the taxable year in which they are used or consumed in the taxpayer's operations.

Small Taxpayer Safe Harbor for Improvement Expensing

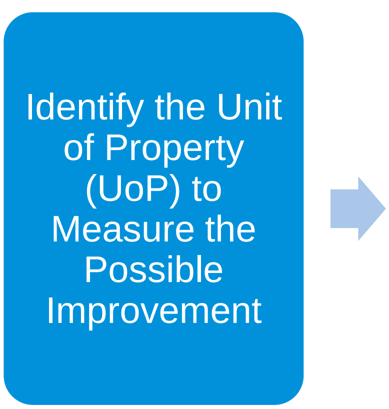
You are not required to capitalize as an improvement, and therefore may be permitted to deduct, the costs of work performed on owned or leased buildings, e.g., repairs, maintenance, improvements or similar costs, that fall into the safe harbor election for small taxpayers. The requirements of the safe harbor election for small taxpayers are:

— Average annual gross receipts of $10 million or less; and

— Owns or leases building property with an unadjusted basis of less than $1 million or less; and

— The total amount paid during the taxable year for repairs, maintenance,

Deductible Repairs and Maintenance Expenditures



Betterment Examples

Not a Betterment	Betterment
Building refreshes (e.g. repainting, patching holes in walls, repairing damaged ceiling tiles)	Building remodels (e.g. installation of more efficient lighting, replacement of existing plumbing fixtures with fixtures that conserve water and energy)
Replacement of HVAC parts resulting in 10% increased efficiency	Addition of insulation to building to reduce energy and power costs by 50%

Routine Maintenance Safe Harbor

You are not required to capitalize as an improvement, and therefore may deduct, amounts that meet all of the following criteria:

— Amounts paid for recurring activities that you expect to perform;

— As a result of your use of the property in your trade or business;

— To keep the property in its ordinarily efficient operating condition; and

— You reasonably expect, at the time the property is placed in service, to perform the activities:

For building structures and building systems, more than once during the 10-year period beginning when placed in service, or For property other than buildings, more than once during the class life of the unit of property.

Considerations in practice

Office Remodel Example A:

Sec 179	5 & 7 Year Personal Property w/	

Office Remodel Example B:

Facts & Circumstances:

- **$9,000,000 office remodel: all interior except for roof and HVAC RTUs**
- **$1,000,000 additional office furniture**
- **Sec. 179 limit reduced to $0 since Sec. 179 property investment is more than $3,500,000**
- **Construction started after 9/27/17 and completed before 12/31/18**

Best Way to Treat $10,000,000?

- **Use a cost segregation study to find eligible personal property and QIP**

Income Tax Filing Guideline