

Depreciation Update: New Final and Proposed Bonus Regulations, Changing Bonus Elections, 163(j) ADS Transition

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DEPRECIATION UPDATE: FINAL AND PROPOSED BONUS REGULATIONS

Overview Of Newly Released Final and Proposed Bonus Regulations, Making and Revoking Bonus Elections, and Other Depreciation Considerations

November 14, 2019

With you today



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Agenda

- ▶ Final and Proposed Bonus Regulations Overview
- ▶ Rev. Proc. 2019-33: Making and Changing Bonus Depreciation Elections
- ▶ ADS Depreciation Under Sec. 163(j)
- ▶ Qualified Improvement Property (QIP)
- ▶ Sec. 179 Opportunities
- ▶ Other Depreciation Considerations
- ▶ Questions and Discussion

Final and Proposed Regulations Overview




History of Bonus Depreciation

- ▶ Created by the Job Creation and Worker Assistance Act of 2002 - added Section 168(k)
- ▶ 2017 tax reform bill (known as TCJA) amended Section 168(k) to include “used” property and allowed for full expensing
- ▶ Aug. 2018 - proposed regulations released
- ▶ Sept. 2019 - final and proposed regulations released

History of Bonus Depreciation

Start Date	End Date	Bonus Percentage
9/11/2001	5/4/2003	30%
5/5/2003	12/31/2004	50%
1/1/2005	12/31/2007	0%
1/1/2008	9/8/2010	50%
9/9/2010	12/31/2011	100%
1/1/2012	12/31/2017	50%

Bonus Depreciation under Tax Reform



	Placed in service before 9/28/17	Placed in service between 9/28/17 and 12/31/22	Placed in service in 2023	Placed in service in 2024	Placed in service in 2025	Placed in service in 2026	Placed in service in 2027 and thereafter
Acquired before 9/28/17	50%	100%	80%	60%	40%	20%	0%
Acquired after 9/27/17							

- ▶ Follow current law phase-down schedule for assets acquired before 9/28/2017 and placed in service after 9/27/2017
- ▶ Can elect 50% bonus, rather than 100%, for 1st tax year ending after 9/27/2017
- ▶ Taxpayer can elect out of bonus depreciation (generally irrevocable once election is made)



Eligible Property

Eligible property must meet **all** of the following requirements:

- ▶ The depreciable property must be of a specific type
- ▶ The original use of the depreciable property must commence with the taxpayer or used property must meet the requirements of Section 168(k)(2)(E)(iii)
- ▶ The depreciable property must be placed in service by the taxpayer within a specified time period (or planted or grafted prior to a specified date)
- ▶ The depreciable property must be acquired by the taxpayer after Sept. 27, 2017



Eligible Property

Qualified property (Section 168(k)(2)(A)(i)) includes the following:

- ▶ MACRS property with a recovery period of 20 years or less
- ▶ Computer software under Section 167(f)(1)
- ▶ Water utility property under Section 168(e)(5) and depreciated under MACRS
- ▶ Qualified film or television production as defined under Section 181(d) and for which a deduction would have been allowed under Section 181
- ▶ Qualified live theatrical productions defined in 181(e) and for which a deduction would have been allowed under Section 181
- ▶ Specified plants (i.e., tree or vine which bears fruits or nuts that have a pre-productive period of more than two years)



Eligible Property

- ▶ New property - “Original use” of property begins with the taxpayer
- ▶ Used property must meet the following requirements:
 - Not be used by the taxpayer or a predecessor prior to the acquisition
 - Acquisition of property meets the related party and carryover basis requirements under Section 179(d)(2)(A) (B) and (C) as well as Reg. Section 1.179-4(c)(1)(i), (ii), (iii), and (iv) or Reg. Section 1.179-4(c)(2)
 - Acquisition of property meets the cost requirements of Section 179(d)(3) and Reg. Section 1.179-4(d)



Eligible Property

A predecessor is defined in the final regulations:

- ▶ A transferor of an asset to a transferee in a transaction to which Sec. 381(a) applies
- ▶ A transferor of an asset to a transferee in a transaction in which the transferee's basis in the asset is determined by reference to the basis of the asset in the hands of the transferor
- ▶ A partnership that is considered as continuing under Sec. 708(b)(2)
- ▶ The decedent in a case of an asset acquired by an estate
- ▶ A transferor of an asset acquired by an estate



Eligible Property

Restrictions to Bonus:

- ▶ Election out
- ▶ Mandatory use of ADS life:
 - Election out of Section 163(j) limitations - modified by regulations
 - Leased to a non-profit
 - Tax exempt bond financed
 - Foreign use of the asset
 - Certain companies using floor plan interest



Eligible Property

PARTNERSHIPS

- ▶ Final regulations generally adopt the Aug. 2018 Proposed Regulations
- ▶ M & A transactions that permit bonus depreciation:
 - Section 743(b) basis adjustments
 - Deemed asset sale transactions (Section 338(h)(10) and 336(e))
- ▶ M & A transactions that do not permit bonus depreciation:
 - Section 734(b) basis adjustments
 - Section 704(c) remedial allocations
 - Zero basis property
 - Basis determined under Section 732



Eligible Property

▶ Safe Harbor Look-Back

- A safe harbor look-back period of five calendar years immediately prior to taxpayer's placed in service year is provided to determine whether a taxpayer or predecessor had depreciable interest in property prior to acquisition

▶ “Substantially Renovated Property”

- “Substantially renovated property” does not satisfy original use requirement. The property can qualify if cost of reconditioned or rebuilt property is not more than 20% of total cost of renovated property, whether acquired or self-constructed.



Eligible Property

▶ GILTI and FDII Implications

- Property that is required to be depreciated under ADS is not eligible for bonus depreciation
- Using the alternative depreciation system (ADS) to determine the asset basis for GILTI (Sec. 951A(d)(3)) or FDII (Sec. 250(b)(2)(B)) deductions will not make the property ineligible for bonus depreciation.

▶ Additional Guidance

- The regulations provide rules for qualified film, television, and live theatrical productions.



Date of Acquisition

- ▶ The acquisition date for property acquired pursuant to a written binding contract is the latter of:
 - The date on which the contract was entered into.
 - The date on which the contract is enforceable under state law.
 - The date on which all cancellation periods end, if the contract has one or more cancellation periods.
 - The date on which all conditions subject to such clauses are satisfied, if the contract has one or more contingency clauses.



Date of Acquisition

- ▶ Property manufactured, constructed, or produced for the taxpayer by another person under a written binding contract that is entered into prior to the manufacture, construction, or production of the property for use by the taxpayer in its trade or business is not acquired pursuant to a written binding contract, but rather is self-constructed property.
- ▶ The final regulations provide rules similar to those in Sec. 1.168(k)-1(b)(4) which defines when manufacturing, construction, or production begins, including a 10% safe harbor.

Effective Date for Final Regulations

- ▶ Effective for qualified property placed in service during the tax year that includes Sept. 24, 2019
- ▶ Taxpayers may elect to apply the final regulations to qualified property acquired and placed in service after Sept. 27, 2017, or during tax years ending on or after Sept. 28, 2017 if the taxpayer applies the rules in the final regulations in a consistent manner
- ▶ Alternatively, a taxpayer may apply the Aug. 2018 proposed regulations to qualified property acquired and placed in service after Sept. 27, 2017, in a tax year ending on or after Sept. 28, 2017 and before Sept. 24, 2019

Proposed Bonus Regulations

▶ De minimis Rule for Used Property

- Taxpayers acquiring property and then disposing of that property within 90 days of placing that property in service are considered to have no prior depreciable interest in that property
- If this property is reacquired by the taxpayer, then this property would be eligible for bonus depreciation; however, bonus would not be permitted if the taxpayer reacquires the property in the same taxable year in which it was disposed

▶ Components of Self-Constructed Property

- Taxpayers may elect to treat one or more components, acquired or self-constructed after Sept. 27, 2017, of certain larger self-constructed property as eligible for 100% bonus depreciation if the larger self-constructed property was qualified property under Sec. 168(k)(2) prior to the TCJA
- The proposed regulations provide the time and manner of making the election and provide examples reflecting these provisions



Mid-Quarter Convention

- ▶ Mid-Quarter convention applies to all MACRS property placed in service during a tax year (other than MACRS residential rental property, nonresidential real property and railroad grading and tunnel bores) if more than 40 percent of the aggregate bases of such property is placed in service during the last three months of the year even if the tax year is a short tax year (Section 168(d)(3) and Treas. Section 1.168(d)-1)
- ▶ In determining whether the mid-quarter convention applies, the basis of qualified property eligible for bonus depreciation should not be reduced by the allowed or allowable additional first year depreciation in determining whether the mid-quarter convention applies for the taxable year



Proposed Bonus Regulations

OTHER PROVISIONS

- ▶ For property not acquired pursuant to a written binding contract, the acquisition date is deferred until the date that the taxpayer has paid (cash basis) or incurred (accrual basis) more than 10% of the total cost of the property, excluding land and other preliminary costs
- ▶ Members that left a consolidated group of corporations or who change consolidated groups will not be deemed to have used the property in which the former consolidated group had depreciable interest, unless that specific member was the holder of that interest
- ▶ A partner is considered to have a depreciable interest in a portion for property equal to the partner's share of total depreciation deductions allocated to all partners over the total amount of the deductions for the current and prior five tax years



Effective Date

PROPOSED REGULATIONS

- ▶ Until final regulations are published, taxpayers may rely on the proposed regulations for qualified property acquired and placed in service after Sept. 27, 2017, during tax years ending on or after Sept. 28, 2017
- ▶ Until final regulations are published, taxpayers may rely on the proposed regulations for qualified property self-constructed after Sept. 27, 2017
- ▶ Taxpayers must apply the proposed regulations in a consistent manner

Rev. Proc. 2019-33 - Elections

Rev. Proc. 2019-33

MAKING / CHANGING BONUS ELECTIONS

- ▶ Rev. Proc. 2019-33 provides additional time for taxpayers to make a late election out of 100% bonus or to revoke an election out of bonus for property for tax years that include Sept. 28, 2017
- ▶ Proposed regulations were released so close to the tax return filing date
- ▶ Generally a taxpayer that wants to make a late election out of bonus or to revoke a previously filed election would need to file a letter ruling or seek Section 9100 relief
- ▶ How to claim relief:
 - File an amended return for the tax year that includes Sept. 27, 2017, (expires once the taxpayer has filed a return for the tax year that follows the tax year that includes Sept. 27, 2017), or
 - File an accounting method change within the first three tax years that follow the tax year that includes Sept. 27, 2017

ADS Depreciation Under Section 163(j)



ADS Depreciation under Sec. 163(j)

REGULATED PUBLIC UTILITIES AND FLOOR PLAN FINANCING

- ▶ Under tax reform Sec. 168(k)(9), assets used in certain trades or businesses (i.e., regulated public utilities and businesses that use floor plan indebtedness financing) that are placed in service in 2018 and later years are not qualified property for bonus purposes

ADS Depreciation under Sec. 163(j)

REGULATED PUBLIC UTILITIES AND FLOOR PLAN FINANCING

- ▶ The proposed regulations provide additional clarity:
 - Lessors of property to taxpayers engaged in a trade or business described in Sec. 168(k)(9) are eligible to claim bonus depreciation on qualified property in 2018 and later years
 - Taxpayers may claim bonus depreciation on assets used in trades or businesses described in Sec. 168(k)(9) that are acquired or self-constructed prior to Sept. 28, 2017 under Sec. 168(k)(2) prior to the TCJA
 - Guidance is provided that taxpayers may use to determine whether property is primarily used by a regulated public utility under Sec. 168(k)(9)(A)
 - Taxpayers with floor plan financing interest will only be prohibited from claiming bonus depreciation if the special rule under Sec. 163(j) permitting floor plan financing to be deducted is used. If the business interest for that year is less than the Sec. 163(j) interest expense limitation, then bonus depreciation would be permitted. This is an annual test.



ADS Depreciation under Sec. 163(j)

REAL PROPERTY TRADE OR BUSINESS ELECTION

- ▶ Effective beginning Jan. 1, 2018
- ▶ If taxpayer elects out of interest deduction cap, taxpayer must use ADS for non-residential real property, residential rental property, and QIP
 - ADS life for non-residential real property is 40 years
 - ADS life for residential rental property is 30 years
 - ADS life for QIP is 40 years (**Note** - Was to be 20 years, but QIP issue intervened)

ADS Depreciation under Sec. 163(j)

REAL PROPERTY TRADE OR BUSINESS ELECTION

- ▶ Electing taxpayer may still use normal MACRS lives and claim bonus for all other classes of property
- ▶ Electing taxpayer must use ADS for all non-residential real property, residential rental property, and QIP placed in service in prior years. IRS Chief Counsel's office has stated that future guidance will provide that taxpayers will not need to file accounting method change, but instead may make the switch per the change in use rules.
- ▶ Election is irrevocable - if QIP becomes shorter-lived and bonus eligible under technical correction at a later date, bonus will not be permitted for electing taxpayer.

Qualified Improvement Property (QIP)

Qualified Improvement Property

- ▶ Beginning in 2016, Sec. 1250 improvements to interior portion of existing buildings that are non-residential real property are qualified improvement property (QIP). Examples include:
 - Electrical and lighting
 - Plumbing
 - HVAC (interior components)
 - Drywall and ceilings

Recovery Periods and Bonus Eligibility - 2016 and 2017 (pre-TCJA)

- ▶ QIP is 15-year property (SL) if qualified leasehold improvement property, qualified restaurant property (improvements to existing restaurants), or qualified retail improvement property
- ▶ QIP is 39-year property if interior improvements do not qualify as 15-year property
- ▶ QIP is bonus eligible and appropriate bonus rate is 50% (15-year and 39-year)

Qualified Improvement Property

QIP AND TCJA

- ▶ Sept. 28 through Dec. 31, 2017
 - Recovery periods remain the same as above
 - Bonus rate is 100% if acquired and placed in service after Sept. 27, 2017
- ▶ 2018 Onward - the intent
 - Three 15-year classes of qualified real property (leasehold improvement, restaurant, retail improvement) are eliminated as of Dec. 31, 2017
 - QIP to be 15-year property beginning on Jan. 1, 2018, and thus eligible for bonus depreciation
- ▶ 2018 Onward - what actually happened (the “Retail Glitch”)
 - QIP was not defined as “15-year” due to drafting error
 - 39-year property and not eligible for bonus depreciation
- ▶ Final Treasury Bonus Regulations affirm that QIP is 39-year property and ineligible for bonus depreciation. A legislative amendment is required to rectify the error.

Qualified Improvement Property

Acquired before 9/28/17
And PIS after 9/27/17

Acquired after 9/27/17
And PIS on or before
12/31/17

Acquired after 9/27/17
And PIS after 12/31/17

50% bonus if PIS on or before
12/31/17; no bonus if PIS
after 12/31/17

100% bonus

No bonus

Recovery period is 39 years,
unless improvements are PIS
on or before 12/31/17 and
also satisfy the QLIP, QRIP, or
QRP requirements, in which
the case is 15 years

Recovery period is 39 years,
unless improvements also
satisfy the QLIP, QRIP or
QRP requirements, in which
case the recovery period is
15 years

Recovery period is 39 years,
unless a technical corrections
bill is passed, in which case
the recovery is 15 years

Qualified Improvement Property

Opportunities for taxpayers until technical correction is made (or if not made):

- ▶ Perform cost segregation study to identify 5-year and 7-year property which are eligible for bonus depreciation (100% through 2022)
- ▶ Cost segregation study should also identify QIP even though it's 39-year property
 - If technical correction is made later with retroactivity, QIP is already identified
 - QIP is eligible for Sec. 179 expensing under TCJA of 2017 if taxpayer can utilize
- ▶ Taxpayers who conduct activities within NAICS codes 44, 45 or 722 (with exceptions such as gas stations, auto dealers, and caterers) may take advantage of Retailer and Restaurant Remodel-Refresh Safe Harbor (Rev. Proc. 2015-56)
 - Immediate deduction of 75% of qualifying restaurant/retail store remodeling expenditures and most interior remodeling costs qualify
 - Remaining 25% is capitalized and depreciated over time (some may be eligible for bonus)

Section 179 Opportunities

Sec. 179 Expensing

- ▶ Amounts and effective date
 - Max. Sec. 179 is increased to \$1 million
 - Phase-out threshold is increased to \$2.5 million
 - Effective for tax years beginning on or after Jan. 1, 2018
- ▶ Eligible assets
 - Sec. 1245 property (new and used)
 - Sec. 1245 property used in lodging (this is a new provision)
 - Qualified real property
- ▶ Qualified real property
 - Qualified improvement property (QIP) described in Sec. 168(k)(6)
 - Certain improvements to **existing** buildings that are non-residential real property: roofing, HVAC systems, fire protection and alarm systems, and security systems

Accounting Method Change

Accounting Method Review Opportunities

FIXED ASSETS / DEPRECIATION

Items to consider:

- ▶ Many assets associated with your property are potentially eligible for proper classification. From heating, ventilation and air conditioning modifications... to parking lots and sidewalks... to architectural fees and builder's overhead and profit - everything and maybe even the kitchen sink - may qualify for shorter depreciable lives (i.e. Cost Segregation)
- ▶ Improper classification under Rev. Proc. 87-56 or §168(e)(3)
- ▶ Missed bonus depreciation
- ▶ TPs may have failed to analyze tax fixed assets that have been acquired via a transaction. If acquired in a stock deal, carryover basis applies yet taxpayers can still modify depreciable lives. If acquired in an asset deal, the assets are reflected with a new basis and depreciable life.
 - Generally automatic Form 3115 change



Accounting Method Review Opportunities

FIXED ASSETS / DEPRECIATION

What to look for?

- ▶ Tax Fixed Asset schedules
- ▶ Proper classification of recovery periods
- ▶ Assets that are currently treated as nondepreciable or nonamortizable
- ▶ Bonus depreciation not claimed on eligible property (no election out statement)
- ▶ Inquire about the methodologies that are utilized by the company in assigning tax fixed asset depreciation methods
- ▶ Any prior accounting method changes or depreciation elections (i.e. ADS, “opt-out” off bonus, S/L, etc.)

Accounting Method Review Opportunities

TANGIBLE PROPERTY REGULATIONS

Items to consider:

- ▶ De Minimis Expensing Rule Safe Harbor Election (§1.263(a)-1(f))
 - Revenue Procedure 2015-82 (Increased Amount for Taxpayers without applicable FS)
- ▶ Materials & Supplies - definitional change in Regulations
- ▶ Unit of Property - definitional change in Regulations
- ▶ Change to deduct repair expenses vs. change to capitalize improvement costs
- ▶ Routine Maintenance Safe Harbor
- ▶ Small Taxpayer Safe Harbor Election
- ▶ Remodel Safe Harbor for Restaurants and Retailers (Rev. Proc. 2015-56)
- ▶ Dispositions - specific identification versus partial dispositions



Accounting Method Review Opportunities

TANGIBLE PROPERTY REGULATIONS

What to look for?

- ▶ Determine if any method changes attached to the 2014 return
- ▶ Fixed Asset Schedules - review for opportunities (i.e. repair type assets currently being capitalized that could potentially be expensed)
- ▶ Repairs & Maintenance detailed sub-ledger
- ▶ Materials and Supplies detailed sub-ledger
- ▶ Capitalization Policy in place at beginning of each year

Other Depreciation Considerations



Tax Reform 2017

- ▶ Real Property Recovery Periods
 - No changes to non-residential property (39 years) or residential rental property (27.5 years)
 - QIP is currently 39-year property pending expected technical correction
 - 15-year qualified restaurant property no longer exists
- ▶ Section 1031 Like-Kind Exchanges for Real Property Only

Tax Reform 2017

▶ Historic Rehabilitation Tax Credit

- 20% credit for certified historic structures remains
- 20% credit is spread rateably over 5 years beginning with year placed in service
- 10% credit for pre-1936 structures is eliminated
- Transition rules provide ability to claim 10% and 20% credit under previous guidelines for certain projects

▶ Green Energy Tax Incentives

- The Sec. 48 business energy investment tax credit for many technologies (e.g., geothermal heat pump, combined heat and power, etc.) extended through 2021 subject to phase-out



New Vehicle Safe Harbor Depreciation

REV. PROC. 2019-13

- ▶ Rev. Proc. 2019-13 provided a safe-harbor method to determine depreciation deductions for passenger automobiles that qualify for the 100% additional first-year depreciation deduction
- ▶ The safe harbor does not apply when the taxpayer elects Sec. 179 treatment.
- ▶ Tax reform increased the first-year limitation amount by \$8,000 to \$18,000. If the depreciable basis of a passenger automobile for which the 100% additional first-year depreciation deduction is allowed exceeds the first-year limitation in Rev. Proc. 2018-25, the excess amount is deductible in the first tax year after the end of the recovery period
- ▶ The safe harbor allows depreciation deductions for the excess amount during the recovery period subject to the depreciation limitations that apply to passenger automobiles.



New Vehicle Safe Harbor Depreciation

REV. PROC. 2019-13

To implement the safe-harbor method, the taxpayer must use the depreciation table in Appendix A of IRS Publication 946, *How to Depreciate Property*.

The safe-harbor method does not apply to:

- ▶ A passenger automobile placed in service after 2022
- ▶ One for which the taxpayer elected out of the 100% bonus depreciation
- ▶ One for which the taxpayer elected under Sec. 179 to expense all or part of the automobile's cost

To adopt the safe-harbor method in the revenue procedure, taxpayers apply it to their depreciation deduction for a passenger automobile on their return for the first tax year following the placed-in-service year.