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TO: Association Executives

FROM: Mark S. Morgan, PMAA Regulatory Counsel

RE: New Business Depreciation and Expensing Provisions

DATE: November 19, 2018

REGULATORY COMPLIANCE BULLETIN

November 19, 2018

NEW FEDERAL RULES FOR BUSINESS DEPRECIATION AND EXPENSING

NEW FEDERAL RULES AND LIMITATIONS FOR DEPRECIATION AND EXPENSING:

The Internal Revenue Service (IRS) is reminding small business taxpayers that changes to the federal tax code means they can immediately expense more of the cost of certain business property. Many are now able to write off most depreciable assets in the year they are placed into service. The Tax Cuts and Jobs Act (TCJA), passed in December 2017, made tax law changes that will affect virtually every business and individual in 2018 and beyond. Among those for business owners are tax rate changes for pass-through entities, changes to the cash accounting method for some, limits on certain deductions and more.

I. Businesses can Immediately Expense More

A taxpayer may elect to expense the cost of any section 179 property and deduct it in the year the property is placed in service. The new law increased the maximum deduction from $500,000 to $1 million. It also increased the phase-out threshold from $2 million to $2.5 million. For taxable years beginning after 2018, these amounts of $1 million and $2.5 million will be adjusted for inflation.

The TCJA also expands the definition of section 179 property to allow the taxpayer to elect to include the following improvements made to nonresidential real property after the date when the property was first placed in service:

- Qualified improvement property, which means any improvement to a building's interior. However, improvements do not qualify if they are attributable to:
    - the enlargement of the building,
    - any elevator or escalator or
    - the internal structural framework of the building.
- Roofs, HVAC, fire protection systems, alarm systems and security systems.

These changes apply to property placed in service in taxable years beginning after Dec. 31, 2017.

II. Temporary 100 Percent Expensing for Certain Business Assets (First-Year Bonus Depreciation)

The TCJA increases the bonus depreciation percentage from 50 percent to 100 percent for qualified property acquired and placed in service after Sept. 27, 2017, and before Jan. 1, 2023. The bonus depreciation percentage for qualified property that a taxpayer acquired before Sept. 28, 2017, and placed in service before Jan. 1, 2018, remains at 50 percent. Special rules apply for longer production period property and certain aircraft.

The definition of property eligible for 100 percent bonus depreciation was expanded to include used qualified property acquired and placed in service after Sept. 27, 2017, if all the following factors apply:

- The taxpayer or its predecessor didn't use the property at any time before acquiring it.
- The taxpayer didn't acquire the property from a related party.
- The taxpayer didn't acquire the property from a component member of a controlled group of corporations.
- The taxpayer's basis of the used property is not figured in whole or in part by reference to the adjusted basis of the property in the hands of the seller or transferor.
- The taxpayer's basis of the used property is not figured under the provision for deciding basis of property acquired from a decedent.
- Also, the cost of the used property eligible for bonus depreciation doesn't include the basis of property determined by reference to the basis of other property held at any time by the taxpayer (for example, in a like-kind exchange or involuntary conversion).

This exclusion applies if the rates for the furnishing or sale have to be approved by a federal, state or local government agency, a public service or public utility commission, or an electric cooperative.

The new law also adds an exclusion for any property used in a trade or business that has had floor-plan financing indebtedness if the floor-plan financing interest was taken into account under section 163(j)(1)(C). Floor-plan financing indebtedness is secured by motor vehicle inventory that in a business that sells or leases motor vehicles to retail customers.

The new law eliminated qualified improvement property acquired and placed in service after December 31, 2017 as a specific category of qualified property.

III. Changes to Depreciation Limitations on Luxury Automobiles and Personal Use Property

The TCJA changed depreciation limits for passenger vehicles placed in service after Dec. 31, 2017. If the taxpayer doesn't claim bonus depreciation, the greatest allowable depreciation deduction is:

- $10,000 for the first year,
- $16,000 for the second year,
- $9,600 for the third year, and
- $5,760 for each later taxable year in the recovery period.

If a taxpayer claims 100 percent bonus depreciation, the greatest allowable depreciation deduction is:

- $18,000 for the first year,

- $16,000 for the second year,
- $9,600 for the third year, and
- $5,760 for each later taxable year in the recovery period.

The TCJA also removes computer or peripheral equipment from the definition of listed property. This change applies to property placed in service after Dec. 31, 2017.

IV. Applicable Recovery Period for Real Property

The TCJA law keeps the general recovery periods of 39 years for nonresidential real property and 27.5 years for residential rental property. But now, the alternative depreciation system recovery period for residential rental property changed from 40 years to 30 years. Qualified leasehold improvement property, qualified restaurant property and qualified retail improvement property are no longer separately defined and no longer have a 15-year recovery period under the new law.

These changes affect property placed in service after Dec. 31, 2017.

Under the new law, a real property trade or business electing out of the interest deduction limit must use the alternative depreciation system to depreciate any of its nonresidential real property, residential rental property, and qualified improvement property. This change applies to taxable years beginning after Dec. 31, 2017.

V. Additional Information

- Publication 535, Business Expenses
- Publication 946, How to Depreciate Property
- Additional First Year Depreciation Deduction (Bonus) FAQs

Tax Cuts and Jobs Act: A Comparison for Businesses