

## Tax Notes

# Guidance Released on Bonus Depreciation

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Are you looking for valuable tax write-offs? Well, for 2018, you may be in luck. There are some significant benefits that kick in as a result of the tax reform legislation signed into law last December. The Tax Cuts and Jobs Act (TCJA) provides for two important incentives for business owners, both of which require tax planning and deep understanding as to how the law is being interpreted.

Recently, the IRS released important guidance in these two areas:

- Additional first year depreciation (bonus depreciation) equal to 100% of the cost of property acquired and placed in service after September 27, 2017.
- The Qualified Business Income (QBI) deduction which allows individuals and some estates and trusts a deduction of up to 20% of income from a domestic business operated as a pass-through entity such as an LLC, partnership, S Corporation or sole proprietorship.

These are in addition to another valuable incentive — Qualified Opportunity Funds (QOFs) — that we covered in [an earlier newsletter](#).

In this article, we will discuss the additional first year “bonus” depreciation rules. In future e-newsletters, we will cover the Qualified Business Income deduction and other issues relative to the implementation of the tax incentives contained in the TCJA.

## Background

After a long wait and much tax practitioner speculation and comments, the IRS and Treasury have released proposed regulations on additional first-year depreciation as part of the TCJA for qualified property acquired and placed in service after September 27, 2017. The proposed regulations cover a number of issues including the types of property that qualify, the application of the placed-in-service requirements, the time and manner for making certain elections, and the application to certain partnership-related transactions.

## Amendments to First-Year Depreciation Allowance

The TCJA made several amendments to the allowance for first-year depreciation. The significant items include:

- Extended bonus depreciation availability through 2026.
- Increased bonus depreciation percentage from 50% to 100% with respect to qualified property acquired and placed in service after September 27, 2017 and before January 1, 2023.

- Bonus depreciation phases down to 80% for qualified property placed in service before January 1, 2024; 60% before January 1, 2025; 40% before January 1, 2026; and 20% before January 1, 2027.
- Removed **qualified leasehold improvement property** from the definition of qualified property (albeit unintentionally), but added qualified film or television production and qualified live theatrical production.
- Expanded the definition of qualified property to include both new and used property.
- Added a new election which allows taxpayers to elect to claim 50% bonus depreciation in lieu of 100% bonus depreciation for property acquired after September 27, 2017 and placed in service in the first tax year ending after September 27, 2017 and before January 1, 2023.

## Four Requirements

Generally, the proposed regulations provide guidance on the four requirements to claim bonus depreciation:

1. the depreciable property must be of a **specified type**;
2. the original use of the depreciable property must commence with the taxpayer **or used depreciable property must meet certain acquisition requirements**;
3. the depreciable property must be **placed in service** by the taxpayer within a specified time period; and
4. the depreciable property must be **acquired** by the taxpayer after September 27, 2017.

The proposed regulations provide welcome clarification of certain areas. We will cover two such items in this e-newsletter with more clarification to follow in later issues.

## Qualified Improvement Property (QIP)

The proposed regulations do not correct the TCJA drafting error that made certain property meeting the QIP definition ineligible for bonus depreciation. Thus, unfortunately, certain improvements to commercial real property acquired and placed in service after December 31, 2017 must be depreciated over a 39-year period rather than be eligible for bonus depreciation. However, the proposed regulations do confirm that QIP acquired after September 27, 2017, and placed in service before January 1, 2018, is eligible for 100% bonus depreciation. This is welcome relief for individuals who have not filed their 2017 returns and were on extension waiting for this guidance.

### PKFOD Observation:

This is one of the most important clarifications since the real estate industry faced significant uncertainty. We are now clear on the treatment of acquisitions from September 27, 2017 to December 31, 2017 (eligible for 100% bonus) and those acquisitions after December 31, 2017 (ineligible). Unless a technical corrections bill is passed, QIP that is placed in service on or after January 1, 2018 will be subject to a 39-year recovery period and will not be eligible for bonus depreciation under Section 168(k), regardless of when it was acquired.

### Congressional Action to Correct:

Members of the Senate Finance Committee have stated that they intend to introduce technical corrections legislation to “fix” this problem. They noted that congressional intent provided rules related to the depreciation of real property, and they want the law to reflect such intent. In their words:

“Specifically, in eliminating the separate definitions of qualified leasehold improvement, qualified restaurant, and qualified retail improvement property and providing a new single definition of qualified improvement property, the language in the signed law failed to designate qualified improvement property as 15-year property under the modified accelerated cost recovery system ...”

“In addition, there is a typographical error in a cross-reference identifying qualified improvement property as property which is recovered over 20 years under the alternative depreciation system. Congressional intent was to provide a 15-year MACRS recovery period and a 20-year ADS recovery period for qualified improvement property.”

Taxpayers would certainly benefit if technical corrections legislation was passed especially if it becomes effective retroactive to January 1, 2018.

### Used Property Now Eligible

TCJA expanded the prior law definition of qualified property to include both original used property and certain used property. The proposed regulations clarify that used property will qualify for bonus depreciation to the extent the acquisition of the used property satisfies the following requirements:

- Such property was not used by the taxpayer or a predecessor at any time prior to such acquisition.
- The property must not be acquired from a related party, another component member of a controlled group, or in a non-taxable transaction in which the basis of the property in the hands of the acquirer is determined in whole or in part by reference to the basis in the hands of the person from whom acquired.

#### *Illustration*

Taxpayer A, a lessee of real property, during its lease term with taxpayer B (lessor) places improvements in service. On August 1, 2018, A and B enter into an agreement whereas A will purchase from B the leased property. The proposed regulations provide that the additional depreciable interest (acquired property) is not treated as being previously used by A. The improvements, however, would be considered previously used by A and, therefore, not included in the depreciable basis of the acquired property.

### Stay Tuned

Our next e-newsletter will deal with the new 20% pass-through entity deduction.

### Contact Us

If you have any questions about bonus depreciation or any other tax matter, please contact your PKF O'Connor Davies tax advisor or, if you are not currently a client, contact Leo Parmegiani, CPA, Partner at [lparmegiani@pkfod.com](mailto:lparmegiani@pkfod.com).

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