Re: 2017 Tax Cuts Act: Depreciation and Sec. 179 Expensing

Dear Client:

The Tax Cuts and Jobs Act modifies provisions related to depreciation and expensing of fixed assets. These changes extend and modify the additional first-year depreciation deduction through 2026 (through 2027 for longer production period property and certain aircraft), increase the Code Sec. 179 dollar and investment limitations, expand the definition of Code Sec. 179 property, and modify the MACRS recovery period for farm property.

Bonus Depreciation

The first-year depreciation allowance is increased to 100 percent for property placed in service after September 27, 2017, and before January 1, 2023 (January 1, 2024, for longer production period property and certain aircraft), as well as for specified plants planted or grafted after September 27, 2017, and before January 1, 2023. The 100-percent allowance is phased down by 20 percent per calendar year for property placed in service, and specified plants planted or grafted, in taxable years beginning after 2022 (after 2023 for longer production period property and certain aircraft).

Transition rules. The phase-down of bonus depreciation remains unchanged for property acquired before September 28, 2017, and placed in service after September 27, 2017. Also, for a taxpayer's first tax year ending after September 27, 2017, the taxpayer may elect to apply a 50-percent allowance instead of the 100-percent allowance.

The Tax Cuts and Jobs Act removes the requirement that the original use of qualified property commence with the taxpayer. Therefore, the additional first-year depreciation deduction is allowed for new and used property.

Listed Property

The Tax Cuts and Jobs Act increases the depreciation limitations under section 280F that apply to listed property. For passenger automobiles placed in service after December 31, 2017, and for which the additional first-year depreciation deduction is not claimed, the maximum amount of allowable depreciation is $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 limitations are indexed for inflation for passenger automobiles placed in service after 2018.

In addition, the Tax Cuts and Jobs Act removes computer or peripheral equipment from the definition of listed property. Such property is therefore not subject to the substantiation requirements that apply to other listed property.

Farm Property

The Tax Cuts and Jobs Act shortens the recovery period from seven to five years for any new machinery or equipment (other than any grain bin, cotton ginning asset, fence or other land improvement) used in a farming business placed in service after December 31, 2017.

The requirement to use the 150-percent declining balance method for property in a farming business (i.e., for 3-, 5-, 7-, and 10-year property) is repealed for property placed in service after December 31, 2017. However, the 150-percent declining balance method continues to apply to any 15-year or 20-year property used in the farming business to which the straight line method does not apply, or to property for which the taxpayer elects to use the 150-percent declining balance method.

Real Property

The separate definitions of qualified leasehold improvement, qualified restaurant and qualified retail improvement property are eliminated. Qualified improvement property is treated as a new class of MACRS property with a recovery period of 15 years, effective for property placed in service after December 31, 2017. The definition of qualified improvement property for purposes of the new 15-year recovery period is the same as the definition applied for bonus depreciation purposes. Specifically, qualified improvement property is defined as any improvement to an interior portion of a building which is nonresidential real property if the improvement is placed in service after the date the building was first placed in service by any taxpayer.

The Tax Cuts and Jobs Act also requires a real property trade or business electing out of the limitation on the deduction for interest to use ADS to depreciate any of its nonresidential real property, residential rental property and qualified improvement property.

Code Sec. 179 Expensing

The Tax Cuts and Jobs Act increases the maximum amount a taxpayer may expense under Code Sec. 179 to $1 million, and the phase-out threshold amount to $2.5 million for tax years after 2017. These amounts are indexed for inflation for tax years beginning after 2018.

For tax years beginning after 2017, the definition of qualified real property under Code Sec. 179 is expanded to include

- certain depreciable tangible personal property used predominantly to furnish lodging or in connection with furnishing lodging; and
- any of the following improvements to nonresidential real property placed in service after the date such property was first placed in service: roofs; heating, ventilation, and air-conditioning property; fire protection and alarm systems; and security systems.

The incentives for investing in business property are significant and must be coordinated. For example, Code Sec. 179 expensing is claimed prior to the additional depreciation allowance. In general, taxpayers should expense under Code Sec. 179, assets with the longest recovery (depreciation) period in order to accelerate the recovery of their costs. Planning for your capital and equipment acquisitions and retirements is essential.

If you have any questions about how these developments apply to you, or about any other aspect of this legislation, please contact our office at your convenience.

Sincerely,

DeMarco Walter & Co