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¶410 Additional Depreciation Allowance (Bonus Depreciation)

NEW LAW EXPLAINED

Bonus depreciation extended and increased to 100 percent; additional modifications made.—For qualified property acquired after September 27, 2017, the 50 percent bonus depreciation rate is increased to 100 percent and phased-out as follows:

1) 100 percent for property placed in service after September 27, 2017 and before January 1, 2023
2) 80 percent for property placed in service after December 31, 2022 and before January 1, 2024
3) 60 percent for property placed in service after December 31, 2023 and before January 1, 2025
4) 40 percent for property placed in service after December 31, 2024 and before January 1, 2026
5) 20 percent for property placed in service after December 31, 2025 and before January 1, 2027
6) 0 percent (bonus expires) for property placed in service after December 31, 2026 (Code Sec. 168(k)(6)(A), as amended by Tax Cuts and Jobs Act).

Property acquired before September 28, 2017. Property acquired before September 28, 2017 is subject to the 50 percent rate if placed in service in 2017, a 40 percent rate if placed in service in 2018, and a 30 percent rate if placed in service in 2019. Property acquired before September 28, 2017 and placed in service after 2019 is not eligible for bonus depreciation. In the case of longer production property (LPP) and non-commercial aircraft (NCA) these placed-in-service dates are extended one year (Code Sec. 168(k)(8), as added by the 2017 Tax Cuts Act). These are the rules that applied before enactment of the 2017 Tax Cuts Act. They continue to apply to property acquired before the September 28, 2017 cut-off date set by Congress.

If a written binding contract for the acquisition of property is in effect prior to September 28, 2017, the property is not considered acquired after the date the contract is entered into (Act Sec. 13201(h)(1) of the 2017 Tax Cuts Act). Consequently, property subject to a binding written contract entered into before September 28, 2017 is not eligible for the 100 percent rate and is subject to a 40 percent rate if placed in service in 2018 and a 30 percent rate if placed in service in 2019. The 50 percent rate applies if such property is placed in service in 2017.

COMMENT

Prior to the enactment of the Protecting Americans from Tax Hikes Act of 2015 (PATH Act) on December 18, 2015, property acquired before January 1, 2008 (or pursuant to a written binding contract entered into before January 1, 2008) was not eligible for bonus depreciation and property acquired before September 8, 2010 (or pursuant to a written binding contract entered into before September 8, 2010) was not eligible for the 100 percent bonus depreciation rate that applied to property placed in service after September 7, 2010 and before January 1, 2012 (before January 1, 2013 for LLP and NCA). With the passage of time, the acquisition date and binding contract requirements became irrelevant and were stricken by the PATH Act, effective for property placed in service after December 31, 2015. Now that an acquisition date requirement is reinstated for purposes of determining whether a 50 percent or 100 percent rate will apply, various issues revolving around the definition of an “acquisition” are back in play. The acquisition date requirements in the context of the 100 percent bonus depreciation rate for property acquired after September 7, 2010 were specifically addressed in Rev. Proc. 2011-26. The IRS will presumably issue similar guidance in the future for purposes of determining whether property is considered acquired after September 27, 2017 and eligible for the 100 percent rate. See also Reg. §1.168(k)-1(b)(4) for rules regarding the determination of acquisition dates.

Specified plants. The applicable rates above also apply to specified plants acquired after September 27, 2017, except that the date the specified plant was planted or grafted replaces the placed in service date (Code Sec. 168(k)(6)(C), as amended by the 2017 Tax Cuts Act). In general, a specified plant is any tree or vine which bears fruits or nuts, and any other plant which will have more than one yield of fruits or nuts and which generally has a pre-productive period of more than 2 years from the time of planting or grafting to the time at which such plant begins bearing fruits or nuts (Code Sec. 168(k)(5)).

Property with longer production period and non-commercial aircraft. In the case of property with a longer production period (LPP) and non-commercial aircraft (NCA), the placed-in-service deadlines for property acquired after September 27, 2017 are extended for one year as follows:

1) 100 percent for property placed in service after September 27, 2017 and before January 1, 2024
2) 80 percent for property placed in service after December 31, 2023 and before January 1, 2025
3) 60 percent for property placed in service after December 31, 2024 and before January 1, 2026
4) 40 percent for property placed in service after December 31, 2025 and before January 1, 2027
5) 20 percent for property placed in service after December 31, 2026 and before January 1, 2028
6) 0 percent (bonus expires) for property placed in service after December 31, 2027 (Code Sec. 168(k)(6)(B), as amended by the 2017 Tax Cuts Act).

2027 production expenditures for LPP do not qualify for bonus depreciation (Code Sec. 168(k)(2)(B)(ii), as amended by the 2017 Tax Cuts Act). This rule does not apply to non-commercial aircraft (NCA).

Election to apply 50 percent rate. A taxpayer may elect to apply the 50 percent rate instead of the 100 percent rate for property placed in service during the taxpayer's first tax year ending after September 27, 2017. The time and manner of making the election will be provided by the IRS (Code Sec. 168(k)(8), as added by the 2017 Tax Cuts Act). For example, a calendar year taxpayer making this election can apply the 50 percent rate to all qualified property placed in service in 2017 and ignore the 100 percent rate that would otherwise apply to qualified property acquired and placed in service after September 27, 2017 and before January 1, 2018.

COMMENT

When Congress last increased the bonus rate from 50 percent to 100 percent, the IRS provided a similar election to use the 50 percent rate on a property class basis (Rev. Proc. 2011-26). For example, the election could be made to apply to all 5-year property only. Presumably, the IRS will again provide a similar rule

CAUTION

The explanation below for qualified improvement property assumes that qualified improvement property placed in service after December 31, 2017 will have a 15-year recovery period as intended by Congress.

The original Senate bill would have provided a 10-year recovery period for qualified improvement property. The House bill contained no provision. The final bill, according to the Conference Report on H.R. 1, Tax Cuts and Jobs Act (H. Rept. 115-466) sets a 15-year recovery period for qualified improvement property. However, the text of the final bill omits the provision which would have given a 15-year recovery period for qualified improvement property. A technical correction will be needed to create a 15-year recovery period for qualified improvement property and all such property in the absence of such a correction will be treated as 39-year nonresidential real property, effective for property placed in service after December 31, 2017 (no acquisition date requirement applies). See ¶425 for a detailed discussion of qualified improvement property.

An unintended consequence of failing to provide a 15-year recovery period for qualified improvement property placed in service after December 31, 2017, is that such property will not qualify for bonus depreciation if placed in service after that date. As explained below, qualified improvement property was removed as a specific category of bonus depreciation property, effective for property placed in service after December 31, 2017 (Code Sec. 168(k)(3), as stricken by the 2017 Tax Cuts Act) on the assumption that all qualified improvement property would have a 15-year recovery period and, therefore, qualify for bonus depreciation under the general rule that allows MACRS property with a recovery period of 20 years or less qualify for bonus depreciation.

Qualified improvement property. Qualified improvement property is removed as a specifically named category of property eligible for bonus depreciation, effective for property placed in service after December 31, 2017 (this provision applies without regard to the acquisition date) (Code Sec. 168(k)(2)(A)(IV) and Code Sec. 168(k)(3), stricken by the 2017 Tax Cuts and Jobs Act). However, all qualified improvement property remains eligible for bonus depreciation (assuming the correction described in the "Caution" note above is made)..

It was previously necessary to list qualified improvement property as a separate category of property eligible for bonus depreciation because some types of improvements which met the definition of qualified improvement property had a recovery period of 39 years. Therefore, this 39-year qualified improvement property would not have been eligible for bonus depreciation without the separate category for qualified improvement property because bonus depreciation generally otherwise only applies to property with an MACRS recovery period of 20 years or less (Code Sec. 168(k)(2)(A)(i))). The 2017 Tax Cuts and Jobs Act, however, provides a standard 15-year recovery period for all qualified improvement property (assuming the correction discussed above is made) placed in service December 31, 2017. This means qualified improvement will qualify for bonus depreciation because it has a recovery period of 20 years or less.

COMMENT

The new law does not change the definition of qualified improvement property. It simply assigns a 15-year recovery period and straight-line method to such property (assuming the correction discussion above is made). Qualified improvement property is defined as an improvement to the interior of nonresidential real property but does not include improvements for expenditures attributable to the enlargement of a building, elevator or escalator, or the internal structural framework of a building (Code Sec. 168(e)(6), as added by the 2017 Tax Cuts and Jobs Act). The new law eliminates the categories of 15-year qualified leasehold improvement property, 15-year qualified retail improvement property, and 15-year restaurant property, effective for property placed in service after December 31, 2017. A 15-year recovery period (and bonus depreciation) will apply to this type of property when placed in service after December 31, 2017 only if the definitional requirements of 15-year qualified improvement property are satisfied. See ¶425 for a detailed discussion.

EXAMPLE

A calendar-year taxpayer makes an improvement to the interior of an office building in June 2016. Assume the improvement is depreciable over 39 years as non-residential real property because it does not satisfy the definition of 15-year qualified leasehold improvement, 15-year retail improvement, or 15-year restaurant property. Even though the improvement has a 39-year recovery period is may qualify for bonus depreciation because for property placed in service in 2017 qualified improvement property is listed as a separate category of property eligible for bonus depreciation. If the same improvement is made in 2018, the recovery period of the improvement is 15 years and the improvement may qualify as bonus depreciation under the bonus depreciation category for MACRS property with a recovery period of 20 years or less.

Exclusion for property of rate-regulated utility. Under a new provision, rate-regulated utilities are preventing from claiming bonus depreciation, effective for property acquired and placed in service after September 27, 2017 (Code Secs. 168(k)(d)(9) and 163(j)(7)(A)(iv), as added by the 2017 Tax Cuts Act). Specifically, property does not qualify for bonus depreciation if it is primarily used in a trade or business of furnishing or selling for regulated rates:

- electrical energy or water,
- sewage disposal services,
- gas or steam through a local distribution system, or
- transportation of gas or steam by pipeline.

Rates are regulated if established or approved by a State or political subdivision thereof, by any agency or instrumentality of the United States, by a public service or public utility commission or other similar body of any State or political subdivision thereof, or by the governing or ratemaking body of an electric cooperative.

Exclusion for property used by certain motor vehicle, boat, farm machinery businesses that used floor financing indebtedness. Property used in a trade or business that has had floor plan financing indebtedness does not qualify for bonus depreciation if the floor plan financing interest on the indebtedness was taken into account under the new rules that limit the business interest deduction to 30 percent of adjusted taxable income plus floor plan financing interest and interest income (Code Sec. 168(k)(9)(B) and Code Sec. 163(j), as added by the 2017 Tax Cuts Act). Floor plan financing indebtedness means indebtedness:

- used to finance the acquisition of motor vehicles held for sale or lease; and
- secured by the inventory acquired (Code Sec. 168(j)(3)(9), as added by the 2017 Tax Cuts Act).

A motor vehicle means:

- Any self-propelled vehicle designed for transporting persons or property on a public street, highway, or road;
- A boat; or
- Farm machinery or equipment.

COMMENT

The interest deduction limitation does not apply in any tax year that a taxpayer meets the gross receipts test of Code Sec. 448(c) by having average annual gross receipts for the three-taxable year period ending with the prior tax year that do not exceed $25 million (Code Sec. 163(j)(3), as added by the 2017 Tax Cuts Act). However, if a taxpayer has floor financing interest in any tax year that it is not exempt from the 30 percent deduction limitation by reason of the gross receipts test or otherwise, the exclusion from bonus depreciation continues to apply in tax years that it is exempt.

The 30 percent of taxable business limitation on deductible interest is discussed at ¶510.

Used property qualifies for bonus depreciation. Effective for property acquired and placed in service after September 27, 2017, property previously used by an unrelated taxpayer may qualify for bonus depreciation if it meets “acquisition requirements” (Code Sec. 168(k)(2)(A)(ii)). The acquisition requirements are met if (Code Sec. 168(k)(2)(E)(ii), as amended by the 2017 Tax Cuts Act):

- the taxpayer did not use the property at any time before acquiring it; and
- the taxpayer acquired the property by “purchase” within the meaning of Code Sec. 179(d)(2) (Code Sec. 168(k)(2)(E)(ii), as amended by the 2017 Tax Cuts Act).

Under Code Sec. 179(d)(2), any acquisition is considered a purchase unless the property:

- is acquired from a person whose relationship to the taxpayer would bar recognition of a loss in any transaction between them under Code Sec. 267 (with the taxpayer's family limited to spouse, ancestors and lineal descendants) or Code Sec. 707(b);
- is acquired by one member of a controlled group of corporations from another member (substituting 50 percent for the 80 percent that would otherwise apply with respect to stock ownership requirements);
- has a basis in the hands of the acquiring taxpayer determined in whole or in part by reference to the adjusted basis of the person from who the property was acquired (e.g., a gift or section 1022 basis property); or
- has a basis determined under Code Sec. 1014(a) relating to inherited or bequeathed property (Reg. §1.179-4(c)).

Used property received in carryover basis transactions. The acquisition is also subject to the requirements of Code Sec. 179(d)(3) (Code Sec. 168(k)(2)(E)(ii)(II), as added by the 2017 Tax Cuts Act). Code Sec. 179(d)(3) (see also Reg. §1.179-4(d)), provides that the cost of property eligible for section 179 expensing does not include basis of property that is determined by reference to the basis of other property held at any time by the person acquiring the property (e.g., the carryover basis in a like-kind exchange does not qualify for expensing but any additional cash paid does) (Conference Report on H.R. 1, Tax Cuts and Jobs Act (H. Rept. 115-466).

COMMENT

According to the Conference Report on H.R. 1, Tax Cuts and Jobs Act (H. Rept. 115-466), the reference to Code Sec. 179(d)(3) means that in the case of trade-ins, like-kind exchanges, or involuntary conversions, bonus depreciation only applies to any money paid in addition to the trade-in property or in excess of the adjusted basis of the replaced property. This limitation should only apply when the replacement property is used property. Bonus depreciation regulations currently in effect provide that bonus depreciation may be claimed on the carryover and excess basis of property acquired in a like-kind exchange if the property received in the exchange meets all other qualification requirements, including the original use requirement (Reg. §1.168(k)-1(f)(5)).

Rule for sale-leasebacks eliminated. Since the original use requirement is now supplemented with the rule above allowing used property to qualify for bonus depreciation, a special rule for sale-leasebacks in Code Sec. 168(k)(2)(E)(ii), prior to amendment by the 2017 Tax Cuts Act, is stricken.

COMMENT

The eliminated rule provides an exception to the requirement that original use must begin with the taxpayer in a sale-leaseback. The rule applies to new property that was originally placed in service after December 31, 2007 by a person who sells it to the taxpayer and then leases it from the taxpayer within three months after the date that the property was originally placed in service. In this situation, the property is treated as originally placed in service by the taxpayer-lessor and the taxpayer-lessor's placed-in-service date is deemed to occur no earlier than the date that the property is used by the lessee under the leaseback.

Bonus allowed for film and television productions and live theatrical productions. Bonus depreciation is allowed for a qualified film, television show, or theatrical production placed in service after September 27, 2017 if it would have qualified for the Code Sec. 181 expense election without regard to the $15 million expensing limit or the December 31, 2016 expiration date (Code Sec. 168(k)(2)(A)(i), as amended by the 2017 Tax Cuts Act). A qualified film or television production is placed in service at the time of its initial release or broadcast. A qualified live theatrical production is placed in service at the time of its initial live-staged performance (Code Sec. 168(k)(2)(H), as added by the 2017 Tax Cuts Act).

COMMENT

Property acquired before September 28, 2017 does not qualify for bonus depreciation at the 100 percent rate (Act Sec. 13201(h)(1) of the 2017 Tax Cuts Act). If a film, television show, or theatrical production is deemed acquired before that date, bonus depreciation may not be claimed since it would not be qualified property. A 50 percent rate, however, would apply to other types of qualified property acquired before September 28, 2017. The IRS may need to provide guidance on how the acquisition requirement applies to films, television shows, and theatrical productions. One possibility is that the acquisition date for this purpose may be deemed to occur, at least in the case of a film or television show, when the production "commences," as defined below. Another possibility is to adapt the generally applicable rule for tangible property produced by or for a taxpayer that treats acquisition as occurring when physical work of a significant nature begins (Reg. §1.168(k)-1(b)(4)(iii)(B)).

COMMENT

The Code Sec. 181 deduction expired effective for productions commencing after December 31, 2016 (Code Sec. 181(g)) and was not extended by the new law. In the case of a film or television show a production commences on the date of first principal photography. A theatrical production commences on the date of the first public performance before a paying audience. If a section 181 election is made production costs are expensed in the tax year paid or incurred. If the production does not commence until after the December 31, 2016 expiration date, costs expensed under section 181 are subject to recapture. Under the bonus depreciation rule, production costs will now be expensed in the tax year the production is placed in service and without regard to the $15 million limit.

COMMENT

A taxpayer generally makes an election under Code Sec. 181 on the income tax return for the tax year in which production costs are first paid or incurred (Reg. §1.181-2(b)) and not at the later time when the production is placed in service, as defined above for bonus depreciation purposes. A taxpayer that made a Code Sec. 181 election at the time a production commenced is prohibited from claiming bonus depreciation on the same production if it is placed in service after September 27, 2017 unless the IRS grants permission to revoke the section 181 election (Code Sec. 181(b) and (c)). Automatic consent, however, will be granted without filing a letter ruling request if the taxpayer recaptures previously claimed deductions under section 181 (Reg. §181-2(d)(2)).

Coordination with passenger automobile depreciation caps. The first-year depreciation cap on a passenger vehicle that is subject to the annual depreciation limitations of Code Sec. 280F because its gross vehicle rate rating does not exceed 6,000 pounds is increased by $8,000 if 100 bonus depreciation is claimed. This is the same increase that applies when bonus depreciation is claimed at a 50 percent rate. The scheduled decrease in the $8,000 bump-up to $6,400 in 2018 and $4,800 in 2019 to reflect the formerly scheduled decreases in the bonus rate from 50 percent to 40 percent in 2018 and to 30 percent in 2019 will only apply to vehicles acquired before September 28, 2017 and placed in service after September 27, 2017 (Code Sec. 168(k)(2)(F)(iii), stricken by the 2017 Tax Cuts Act).

COMMENT

The annual depreciation caps are substantially increased by the new law (Code Sec. 280F(a), as amended by the 2017 Tax Cuts Act). In addition, for taxpayers that claims 100 percent bonus on a vehicle subject to the caps, the IRS will likely need to issue a safe harbor similar to one that was previously issued when a 100 percent bonus rate applied, that will allow such taxpayers to claim depreciation deductions after the first-year a vehicle is placed in service. See ¶415.

Long-term accounting method relief. In determining the percentage of completion under Code Sec. 460(b)(1)(A) for purposes of the long-term contract method of accounting, the cost of property with a MACRS recovery period of 7 years or less that qualifies for bonus depreciation is taken into account as a cost allocated to the contract as if the bonus depreciation had not been enacted. The provision applies only to property placed in service (1) after December 31, 2009 and before January 1, 2011 (before January 1, 2012 in the case of property with a longer production period) and (2) after December 31, 2012, and before January 1, 2027 (before January 1, 2028, in the case of long production property) (Code Sec. 460(c)(6)(B), as amended by the 2017 Tax Cuts Act).

COMMENT

With the exception of transportation property, property with a longer production period must have a recovery period of 10 years or greater. Thus, longer production property that is not transportation property does not qualify for the special treatment provided by this provision. Transportation property is tangible personal property used in the trade or business of transporting persons or property, such as an airliner, and is not subject to the rule that requires a MACRS depreciation period of 10 years or greater in order to constitute long-production property (Code Sec. 168(k)(2)(B)(iii)).

Corporate election to claim unused AMT credits in lieu of bonus depreciation. The annual election provided to corporations to claim unused alternative minimum tax (AMT) credits in place of bonus depreciation on property placed in service during the tax year of the election is stricken effective for tax years beginning after December 31, 2017 (Code Sec. 168(k)(4), stricken by the 2017 Tax Cuts Act).

COMMENT

The corporate AMT is repealed, effective for tax years beginning after December 31, 2017. See ¶310.

Effective date. The amendments made by this section generally apply to property which is acquired after September 27, 2017, and is placed in service after September 27, 2017 (Act Sec. 13201(h)(1) of the Tax Cuts and Jobs Act). For this purpose, if a written binding contract for the acquisition of property is in effect prior to September 28, 2017, the property is not considered acquired after the date the contract is entered into. The amendments related to specified plants apply to specified plants planted or grated after September 27, 2017 (Act. Sec. 13201(h)(2) of the 2017 Tax Cuts Act).