

¶415 Depreciation Caps on Luxury Cars

NEW LAW EXPLAINED

Depreciation caps for passenger automobiles increased.—The annual depreciation caps are increased, effective for vehicles placed in service after December 31, 2017. The increased caps that apply to vehicles placed in service in 2018 are (Code Sec. 280AF(a)(1), as amended by the Tax Cuts and Jobs Act):

- Tax Year 1.....\$10,000 (\$18,000 if bonus depreciation claimed)
- Tax Year 2.....\$16,000
- Tax Year 3.....\$9,600
- Tax Years 4 -6.....\$5,760

Any unrecovered basis remaining at the end of the regular recovery period of a vehicle is recovered at the rate of \$5,760 per tax year.

COMMENT

The recovery period of a vehicle is 5 years. However, the 5-year recovery period covers 6 tax years because under the MACRS half-year or mid-quarter convention a full year's depreciation is not allowed in the tax year that the vehicle is placed in service.

These caps are adjusted annually for inflation effective for vehicles placed in service after 2018 (Code Sec. 280F(d), as amended by the 2017 Tax Cuts Act). The \$8,000 bump-up to the first-year cap if bonus depreciation is claimed is not adjusted for inflation.

COMMENT

For vehicles placed in service in 2018, the preceding caps will apply to all types of vehicles. However, the IRS figures inflation adjustments differently for (1) trucks (including SUVs treated as trucks) and vans and (2) regular passenger cars. Thus, beginning in 2019 when these figures are first adjusted for inflation, separate inflation adjusted caps will be provided for (1) trucks (including SUVs) and vans and for (2) regular passenger cars.

\$8,000 increase in first-year cap if bonus depreciation claimed. The first-year depreciation cap on a passenger vehicle that is subject to the annual depreciation limitations of Code Sec. 280F is increased by \$8,000 if 100 percent bonus depreciation is claimed. This is the same increase that applies when bonus depreciation is claimed at a 50 percent rate. However, the scheduled decrease in the \$8,000 bump-up to \$6,400 in 2018 and \$4,800 in 2019 is eliminated (Code Sec. 168(k)(2)(F)(iii), stricken by the 2017 Tax Cuts Act). Thus, the \$8,000 increase will continue to apply.

No depreciation deductions after first recovery year if 100 percent bonus claimed unless IRS provides safe harbor. When Congress last enacted a 100 percent bonus rate for property acquired after September 8, 2010 and placed in service before January 1, 2012 in the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010), an unforeseen consequence was that taxpayers claiming the 100 percent bonus deduction on a vehicle were limited to a deduction equal to the first-year cap amount and could not claim any further depreciation deductions until after the end of the vehicle's regular recovery period. This is because (1) the basis of qualified property is reduced by the full amount of depreciation, including the bonus and section 179 allowance, without regard to the caps and (2) depreciation deductions that are disallowed by the depreciation caps (including bonus depreciation) are effectively deferred until after the end of the vehicle's recovery period (Code Sec. 280F(a)(1)(B)).

The IRS, however, provided a safe harbor method that allowed a taxpayer to compute depreciation as if a 50 percent bonus rate applied so that depreciation deductions could be claimed during the entire recovery period of the vehicle (Rev. Proc. 2011-21, 2011-12 I.R.B. 560).

COMMENT

According to the General Explanation of Tax Legislation Enacted in the 111th Congress (JCS-2-11) (the "Blue Book" explanation) Congress intended that a 50 percent bonus depreciation rate apply to vehicles placed in service after September 8, 2010 that were eligible for the 100 percent rate and subject to the Code Sec. 280F depreciation limitations. The report further states that a technical correction might be necessary to accomplish this result (Footnote 1597 of JCS-2-11). The IRS safe harbor in effect accomplished this result and no technical correction was enacted.

The following example illustrates why the safe harbor will once again be needed.

EXAMPLE

A car (5-year MACRS property) costing \$35,000 that is subject to the luxury car limitations is placed in service in November 2017 by a calendar-year taxpayer and the taxpayer claims 100 percent bonus depreciation on its 5-year property, including the vehicle. However, because the first-year depreciation cap for the vehicle is \$11,160, the bonus deduction that may be deducted is limited to \$11,160. If the IRS does not reinstate the safe harbor method of accounting, the \$23,840 excess (\$35,000 - \$11,160) may only be recovered at the rate of \$1,875 per year beginning in 2023, which is the first year after the end of the vehicle's recovery period. No regular depreciation deductions are allowed after the first year of the vehicle's regular recovery period because the vehicle's basis for computing depreciation deductions is reduced to \$0 by the entire amount of the bonus depreciation allowable without regard to the first-year depreciation cap. The table percentages when applied to a depreciable basis of \$0 are equal to \$0 in each year of the vehicle's regular 5-year recovery period. The same problem applies to vehicles placed in service in 2018 and later years in which 100 percent bonus depreciation applies.

<i>Year</i>	<i>Regular Deduction</i>	<i>Luxury Car Cap</i>	<i>Allowable Depreciation</i>	
2017	\$35,000		\$11,160	\$11,160
2018	\$0		\$5,100	\$0
2019	\$0		\$3,050	\$0
2020	\$0		\$1,875	\$0
2021	\$0		\$1,875	\$0
2022	\$0		\$1,875	\$0
			TOTAL	\$11,160

COMMENT

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 (Code Sec. 168(k)(8), as added by the 2017 Tax Cuts Act). See ¶410. Thus, for the 2017 tax year only, the taxpayer in the preceding example could avoid the adverse result by electing the 50 percent rate. The election, however, would apply to all 5-year property placed in service during the 2017 tax year and not just vehicles with a 5-year recovery period.

\$25,000 limit on certain vehicles adjusted for inflation. The \$25,000 maximum Code Sec. 179 deduction that may be claimed on specified vehicles that are exempt from the luxury car caps will be adjusted for inflation in tax years beginning after 2018 (Code Sec. 179(b)(6), as amended by the 2017 Tax Cuts Act).

COMMENT

The \$25,000 limit applies to a sport utility vehicle, truck with an interior cargo bed length less than six feet, and a van that seats fewer than 10 persons behind the driver's seat if the vehicle is exempt from the annual depreciation caps because it has a gross vehicle weight rating in excess of 6,000 pounds, or if it is otherwise exempt (Code Sec. 179(b)(5)).

The amount of the inflation adjustment is based on the cost-of-living adjustment determined under Code Sec. 1(f)(3) for the calendar year in which the tax year begins, by substituting calendar year 2017 for calendar year 1992. When adjusting the dollar limitation or the investment limitation for inflation, the resulting amount must be rounded to the nearest multiple of \$100.

Effective date. The amendments apply to property placed in service after December 31, 2017 (Act Sec. 13202(c) of the Tax Cuts and Jobs Act).