



# Tax Reform Update: Proposed Regulations on Bonus Depreciation

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**Thursday, September 27, 2018**  
**2:00-3:00 pm ET**

We will be starting soon



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# Speakers



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# Learning objectives

1

Describe key provisions in the proposed bonus depreciation regulations

2

Identify what property is eligible for 100 percent bonus depreciation

3

Identify the implications of the proposed regulations

# Agenda

1

Tax reform changes to bonus depreciation

2

Highlights of the proposed regulations

3

Implementation and planning

# Tax reform changes to bonus depreciation

## Highlights

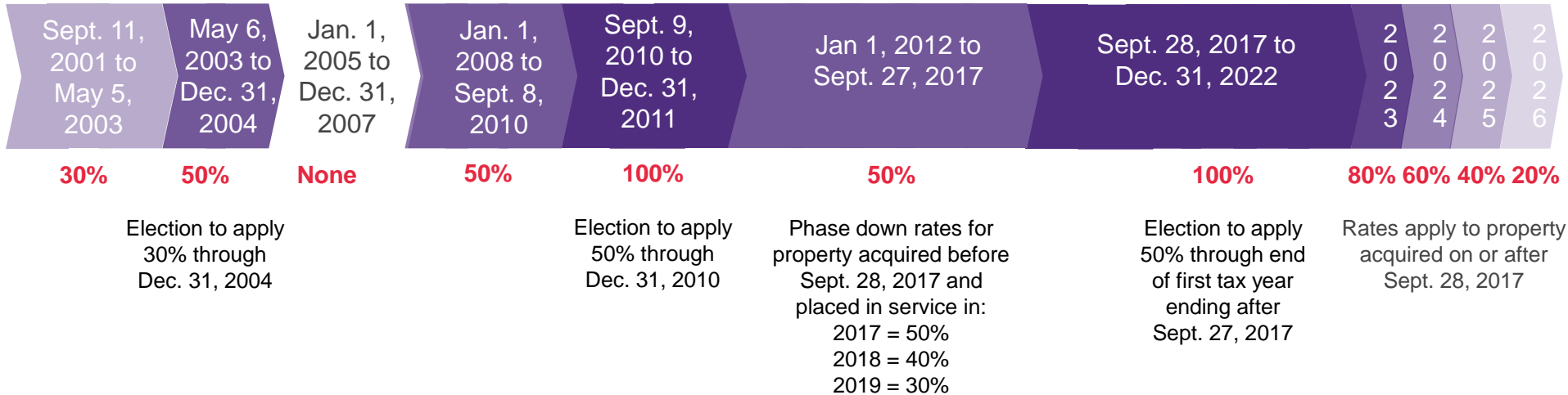
The Tax Jobs and Cuts Act ("TJCA") made significant changes to bonus depreciation:

- 100% bonus depreciation for property acquired and placed in service after Sept. 27, 2017 through the end of 2022
  - Additional five-year extension beyond 2022 at reduced rates
  - One year longer for long production period property (LPPP)
- Special phase down rules apply for property acquired prior to and placed in service after Sept. 27, 2017
- Expanded bonus depreciation to include:
  - Purchases of used property
  - Certain qualified films and theatrical productions
- Restricted bonus depreciation to exclude certain property used in businesses not subject to the interest limitation in Section 163(j)

# Tax reform changes to bonus depreciation

## Bonus depreciation since inception

Bonus depreciation rates for qualified property acquired and placed in service between



Long production period property generally has an additional year to be placed in service.

# Tax reform changes to bonus depreciation

## Highlights

Watch for different effective dates

### Includes

- Purchases of used property, but not from related parties
- Certain qualified films, tv and theatrical productions

Property acquired and placed in service after Sept. 27, 2017

### Excludes

- Property used in regulated utilities
- Trades or businesses that have floor plan financing
- Property used in "electing real property trade or business"\*

Property acquired and placed in service after Sept. 27, 2017

### Repeals

- AMT credits in lieu of bonus depreciation

For taxable years beginning after Dec. 31, 2017

\*Also excludes certain property used in "electing farming business"

# Other tax reform changes to depreciation

## Highlights

### ADS for real property



Electing real property trades or businesses must use ADS to depreciate the real property assets (no bonus depreciation)



Personal property not changed (bonus depreciation still allowable)



ADS recovery period for residential rental property shortened to 30 years

For tax years beginning after Dec. 31, 2017

### Qualified improvement property



Eliminates qualified leasehold improvement property (QLIP), qualified retail improvement property (QRIP), and (QRP) qualified restaurant improvement property



Legislative history states qualified improvement property recovery period reduced from 39 years to 15 years



However, this does not appear in the statutory text

For property placed in service after Dec. 31, 2017



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# Bonus depreciation proposed regulations

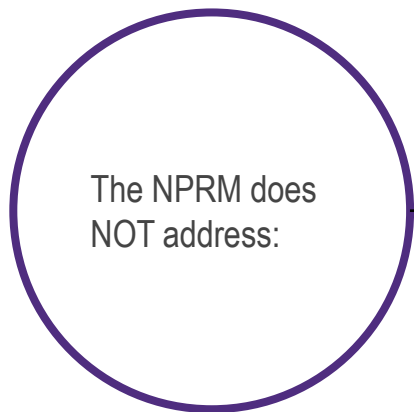
## Highlights

The NPRM proposes rules for the TCJA amendments to Section 168(k)

- Taxpayers may choose whether to rely on the proposed regulations until they are finalized, but uncertainties remain
- Current Treas. Reg. §1.168(k)-1 and series of revenue procedures generally continue to apply to property acquired prior to Sept. 28, 2017
- Major changes from current guidance:
  - Bonus percentage
  - Qualified property
  - Acquisition date and written binding contracts
    - Application to self-constructed assets
  - Original use - Used property and related party transactions
  - Elections

# Bonus depreciation proposed regulations

## Highlights



The treatment of electing real property trade or business

The treatment of electing farm trade or business

Election to accelerate AMT credits in lieu of bonus depreciation (e.g. for Sept. 28 to Dec. 31, 2017, for a calendar year taxpayer)

# Bonus depreciation proposed regulations

Qualified Property Requirements	Prior rules	Proposed regulations
Qualifying property	<ul style="list-style-type: none"> <li>• Recovery period of 20 years or less</li> <li>• Computer software</li> <li>• Water utility property</li> <li>• QIP, QLIP, QRIP, and QRP that is QIP</li> </ul>	<ul style="list-style-type: none"> <li>• Recovery period of 20 years or less</li> <li>• Computer software</li> <li>• Water utility property</li> <li>• Qualified films, live theatrical, and television productions</li> <li>• Certain grafted plants</li> <li>• QIP, QLIP, QRIP, and QRP that is QIP placed in service <u>before</u> 1/1/2018</li> </ul>
Original use	<ul style="list-style-type: none"> <li>• New property</li> <li>• No used property</li> </ul>	<ul style="list-style-type: none"> <li>• New property</li> <li>• Certain used property not acquired from a related party</li> </ul>
Acquisition date & written binding contract	Before 9/28/2017	After 9/27/2017
Placed in service date	<ul style="list-style-type: none"> <li>• 50% bonus before 1/1/2018 (LPPP 1/1/2019)</li> <li>• 40% bonus before 1/1/2029 (LPPP 1/1/2020)</li> <li>• 30% bonus before 1/1/2020 (LPPP 1/1/2021)</li> </ul>	<ul style="list-style-type: none"> <li>• 100% bonus: before 1/1/2023 (LPPP 1/1/2024)</li> <li>• 80% bonus: before 1/1/2024 (LPPP 1/1/2025)</li> <li>• 60% bonus: before 1/1/2025 (LPPP 1/1/2026)</li> <li>• 40% bonus: before 1/1/2026 (LPPP 1/1/2027)</li> <li>• 20% bonus: before 1/1/2027 (LPPP 1/1/2028)</li> </ul>

# Bonus depreciation proposed regulations

## Qualified property

Watch for different effective dates

Acquired before  
9/28/2017 and  
placed in service  
before 1/1/2018

- QIP, QLIP, QRIP, & QRP that is QIP: eligible for 50% bonus
- QIP: 39 year recovery
- QLIP, QRIP, QRP: 15 year recovery

Acquired and  
placed in service  
after 9/27/2017 and  
before 1/1/2018

- QIP, QLIP, QRIP, & QRP that is QIP: eligible for 100% bonus
- QIP: 39 year recovery
- QLIP, QRIP, QRP: 15 year recovery

Placed in  
service after  
1/1/2018

- QIP: not eligible for bonus\*
- QIP: 39 year recovery\*
- QLIP, QRIP, QRP are repealed

\*Unless a technical correction is passed to change recovery to 15 years

# Bonus depreciation proposed regulations

## Qualified property

### Property not eligible for bonus

- Property required to use ADS
  - This includes real property for an electing real property trade or business
  - This includes property with a recovery period of 10 years or more held by an electing farming business
- Certain regulated utility property
  - Applies to property that is acquired after Sept. 27, 2017 and placed in service in a tax year that begins after Dec. 31, 2017
- Property used in a trade or business that has had floor plan financing indebtedness
- Property for which the taxpayer does not use MACRS (other than software)

# Bonus depreciation proposed regulations

## Acquisition date

To be eligible for 100% bonus, the property must be acquired after Sept. 27, 2017

- For property under a written binding contract, the acquisition date is the date on which the contract was entered into
  - Must be enforceable under State law and does not limit the damages
  - An option is not binding
  - A letter of intent is not binding
  - Supply agreements – amount and design specs must be specified
  - Components – contract to acquire a component does not taint the entire asset, only the component
    - But see 10% rule

# Bonus depreciation proposed regulations

## Acquisition date

Property other than LPPP that is produced for the taxpayer pursuant to a written binding contract entered into prior to production is NOT self-constructed property

- This is different than the rules in Treas. Reg. §1.168(k)-1
- Thus, if taxpayer entered into a written binding contract prior to Sept. 28, 2017 to have property produced for the business, the property will not be eligible for 100% bonus depreciation

LPPP produced for the taxpayer pursuant to a written binding contract entered into prior to production is self-constructed property



# Bonus depreciation proposed regulations

## Self constructed property

Self-constructed property can be complex

- Rules related to acquisition of components are generally consistent with the existing regulations NOT with the generous rule provided in Rev. Proc. 2011-26
- Any components acquired prior to Sept. 28, 2017 must be carved out of the basis for 100% bonus
- Application of 10% safe harbor

Beware: Different rules for long production period property

- Application of 10% safe harbor to property produced under written binding contract

# Bonus depreciation proposed regulations

## Original use/Used Property

### Used Property

- May be eligible for bonus depreciation if not used by taxpayer or predecessor at any time prior to acquisition
- "Use" defined as having a depreciable interest
- Includes property acquired in Section 338 and Section 336(e) election transactions
- Must meet related party and carryover basis requirements
  - Section 179(d)(2)(A), (B), and (C) apply, not Section 197 anti-churning rules
  - Special rules for transactions in consolidated groups
  - Special rules for a series of related transactions
  - These rules potentially will require burdensome tracking!

# Bonus depreciation proposed regulations

## Original Use/Used Property

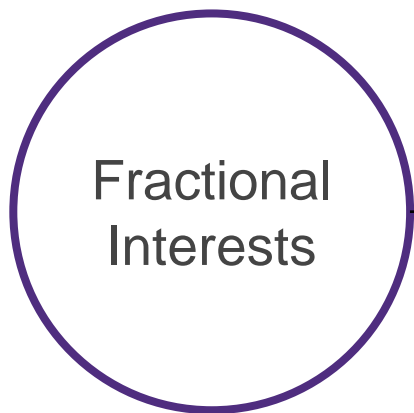


A lessee who leases an asset and acquires the asset at the end of the lease term will not be treated as having used the asset prior to its acquisition

If a lessee acquires the property it is leasing pursuant to a true tax lease, the additional basis acquired (over the lessee's own improvements to the property) may be eligible for bonus depreciation

# Bonus depreciation proposed regulations

## Original Use/Used Property

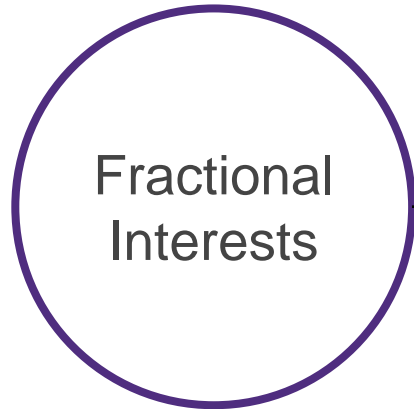


Taxpayer initially acquires a depreciable interest in a portion of an asset and subsequently acquires an additional depreciable interest in the same property

The proposed regulations provide that the additional depreciable interest is not treated as being previously used by the taxpayer

# Bonus depreciation proposed regulations

## Original Use/Used Property



Taxpayer holds a depreciable interest in a portion of an asset, sells that portion or a part of that portion, and subsequently acquires a depreciable interest in another portion of the same property

The proposed regulations provide that the taxpayer will be treated as previously having a depreciable interest in the property up to the amount of the portion for which the taxpayer held a depreciable interest in the property before the sale

# Bonus depreciation proposed regulations

## Special rules

### Special rules

- Transfers of property under Section 168(i)(7)
- Transfers between members of consolidated group
  - If a member of a consolidated group acquires depreciable property and the consolidated group previously had a depreciable interest in such property, the acquiring member will be treated as having a depreciable interest in the property prior to the acquisition
- Series of related transactions
  - Taxpayers need to analyze transactions to determine whether the depreciable property being acquired was, at some point, held by a related party
- Partnership transactions

# Bonus depreciation proposed regulations

## Special rules

Transaction	Prior rules	Proposed regulations
<b>Section 754 basis adjustments</b>	<ul style="list-style-type: none"> <li>Ineligible for bonus depreciation</li> </ul>	<ul style="list-style-type: none"> <li>Section 743(b) adjustments generally eligible for bonus depreciation (except for transactions between related parties)</li> <li>Section 734(b) adjustments are ineligible</li> </ul>
<b>Section 704(c) basis adjustments</b>	<ul style="list-style-type: none"> <li>Ineligible for bonus depreciation</li> </ul>	<ul style="list-style-type: none"> <li>Ineligible for bonus depreciation</li> </ul>
<b>Section 168(i)(7) transfers</b>	<ul style="list-style-type: none"> <li>Bonus depreciation allocated between transferor and transferee by months</li> </ul>	<ul style="list-style-type: none"> <li>Bonus depreciation allocated between transferor and transferee by months, except in certain contributions of property to a partnership</li> <li>Section 732 increase in basis ineligible for bonus depreciation</li> </ul>
<b>Technical terminations</b>	<ul style="list-style-type: none"> <li>Bonus depreciation allocated to newly formed partnership</li> </ul>	<ul style="list-style-type: none"> <li>Bonus depreciation allocated to newly formed partnership</li> </ul>

# Bonus depreciation proposed regulations

## Elections

*Election out of bonus:* generally, the election not to deduct additional first year depreciation is made by property class

- There is ambiguity in making the election out for certain classes (e.g. QLIP, QIP, etc.)
- The election out of bonus must be made separately for Section 743(b) adjustments
- Attach a statement to timely filed return

*Election to deduct 50% instead of 100%:* for assets PIS after 9/27/17 in the taxable year including 9/28/17 the election is made for **all** qualified property (not made by property class)

- Attach a statement to timely filed return

There does not appear to be a prohibition against making both elections

- E.g. taxpayer may make election to apply 50% to all qualified property, and then make an election out of bonus for a class of property



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# Implementation and planning

- Maximize the time value of money with the rate cut
- Use documentation procedures to minimize exposure to risk
  - E.g. Documentation of analysis of acquisition date including written binding contract date
  - E.g. Acquisitions of used property and related party rules – how will you track property for future dispositions and acquisitions?
  - E.g. Treatment of QIP – how will you implement if Congress passes a Technical Correction?

# Implementation and planning

1

Depreciation automatic method change

- Cost segregation
- Can be filed even in final year of the taxpayer

2

Repairs automatic method change

- If did not file the repairs change in past 5 years

3

Section 174 Prototypes automatic method change

- Develop custom machinery or equipment
- Alternative is to argue Rev. Rul. 58-74

4

No method change required

- Elections
- Partial dispositions
- Retirements

# Questions?

# Speakers



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