

Tax Cuts and Jobs Act - Cost Recovery Provisions, Expensing, and Like-kind Exchanges – last updated 12.27.2017

The Tax Cuts and Jobs Act was signed into law by the President on Friday, December 22, 2017. There are still a number of questions regarding how these new provisions will be interpreted, but the details of the new law are stated here based on early analysis. Consider the following information subject to change based on additional details being released and further analysis.

Additional First Year Depreciation (bonus):

Current law: Currently, you can claim 50% additional first year depreciation on NEW property placed in service in 2017. A phase down of bonus depreciation was scheduled to begin after 12/31/2017.

New law: For NEW or USED property placed in service after 09/27/2017 and in the first year after 09/27/2017, the taxpayer can elect to take 50% or 100% additional first year depreciation.

Including USED property is a departure from prior law, which specifically excluded used property. The only requirement for USED property is that the taxpayer didn't use the property previously.

Although you can elect 50% or 100% for property acquired after 09/27/2017 including the first year after 09/27/2017. In subsequent years ending before January 1, 2023, you can elect only 100% additional first year depreciation.

The phase down for additional first year depreciation that was scheduled to begin in 2018 is repealed, and the phase down for additional first year depreciation is now scheduled to begin after 12/31/2022. For 2023 the additional first year rate is 80%, 60% for 2024, 40% for 2025, and 20% for 2026.

Observation: Bonus depreciation is elected on a class-by-class basis. No guidance has been provided indicating whether you have to elect 50% for all assets in a class or if you can elect 50% for some and 100% for others acquired after September 27, 2017. It would seem obvious that the intention is to allow you to elect 50% for those acquired before September 28, 2017 since you don't have a choice, and elect 50% or 100% for those acquired after September 27, 2017.

Luxury Auto Depreciation Caps:

Current law: Currently, for autos placed in service in 2017, if bonus depreciation is not claimed, the maximum allowable deduction is \$ 3,160 for the first year, \$ 5,000, \$ 2,950, and \$ 1,775, for the 2nd, 3rd, and subsequent years.

If bonus depreciation is claimed, the allowable deduction is increased by \$ 8,000 (\$ 11,160 in 2017, but down to \$ 9,560 in 2018 due to the phase out that was scheduled to begin in 2018.

New law: For autos placed in service after 12/31/2017, and additional first year depreciation is NOT claimed, the maximum allowable deduction is increased to \$ 10,000 for the year the auto is placed in service. For the 2nd, 3rd, and later years, the caps are increased to \$ 16,000, \$ 9,600, and \$ 5,760, respectively.

If bonus depreciation is claimed, the depreciation cap in the first is increased by \$ 8,000, as it was in previous years.

Warning - 100% additional first year depreciation on luxury autos.

In each year that a passenger auto is depreciated, the cost recovery deduction is limited to the lesser of:

- Section 280F limitation or
- The depreciation that would have been computed under Section 168 (normal depreciation)

Therefore, if you elect 100% bonus on a new vehicle, you would get up to \$ 18,000 (the Section 280F limitation) or the full cost of the vehicle (under Section 168 it is 100% of the qualifying cost).

However, in years two through six, the depreciation is again limited to the lesser of:

- Section 280F limitation or
- The depreciation allowed under Section 168 (normal depreciation)

The amount allowed under Section 168 is 0.00 in years 2 through 6 because you were allowed 100% in year 1. The lesser of the 2nd year limitation of \$ 16,000 and 0.00 is 0.00, therefore, no further deduction would be allowed in year 2 and this would be the case until the recovery period expires at which time you would get \$ 5,760 per year until the entire cost is recovered.

If you look back to 2011 when 100% bonus depreciation was permitted, the IRS issued a safe harbor calculation for luxury autos that provided for cost recovery in years 2 through 6 even though 100% bonus was taken in year 1. While the IRS has not yet issued a procedure specifying a safe harbor calculation for luxury autos when you claim 100% bonus, we have included this calculation for assets acquired after 2017 in Asset Keeper Pro in anticipation that this will be done. Therefore, you will see a depreciation calculation for subsequent years even though you took 100% bonus depreciation.

Should the IRS not provide for a safe harbor calculation sometime before 2019, we will modify the 2nd and subsequent year's cost recovery for luxury autos that will result in no deduction till the life expires.

For acquisitions in 2017, there is no logical reason to claim 100% bonus depreciation on luxury autos since you will not get a larger cost recovery amount in 2017. You should therefore elect 50% bonus percentage for luxury autos, trucks, and vans acquired in 2017. You may have to use the Override button on the Add / Edit screen to change the bonus percentage from 100% to 50%.

For acquisitions in 2018 and later, you will need to decide whether you believe the IRS will permit safe harbor calculations for luxury autos where 100% bonus was claimed. If you do, then taking 100% bonus on luxury autos provides an \$ 8,000 larger cost recovery limitation, and potentially larger deduction, in year 1. If you do not want to take the risk, then do not claim 100% bonus on any luxury autos and settle for a smaller deduction in year 1, but continued cost recovery amounts in subsequent amounts even if the IRS does not permit the safe harbor calculations.

Observation: One other complicating factor is to remember that electing bonus depreciation is based on a class-by-class election. That is, if you elect bonus depreciation for one qualifying 5-year asset, then you have to elect it for all qualifying 5-year assets. Conversely, if you do not elect bonus depreciation for ALL assets in a class, then you can not elect it for any qualifying assets in that class.

For an example of how the safe harbor calculations are made, see the example at the end of this document.

Section 179 Expensing:

Current law: Currently, you can claim \$ 500,000 of Section 179 expensing for qualified tangible personal property with a dollar-for-dollar reduction for acquisitions in excess of \$ 2,000,000.

SUVs have a \$ 25,000 Section 179 limitation imposed on them.

New law: For qualifying property placed in service in year beginning after 12/31/2017, Section 179 expensing is increased to \$ 1,000,000 with an acquisition phase out limit of \$ 2,500,000.

The Section 179 limitation and acquisition limit will be indexed for inflation for tax years beginning after 2018.

The \$ 25,000 limitation that applies to SUVs continues and will be indexed for inflation beginning after 2018.

The definition of Section 179 property was modified to include certain depreciable tangible personal property used predominantly to furnish lodging or in connection with providing lodging. It further expanded the definition of qualified real property eligible for Section 179 expensing to include any of the following improvements to nonresidential real property. Roofs, heating, ventilation, air-conditioning property, fire protection and alarm systems, and security systems are now eligible for Section 179 expensing.

Real Property:

Current law: Qualified improvement, qualified leasehold improvement property, qualified restaurant, and qualified retail property all had separate definitions to determine if they qualified for a shorter recovery period and different depreciation convention. Generally, non-residential property has a 39-year recovery period and residential property has a 27.5-year recovery period and both use a mid-month convention. If property met the qualifications for improvement, leasehold improvement, restaurant, or retail, then you could use a 15-year recovery period with a half-year convention.

New law: For property placed in service after 12/31/2017, the separate definitions of qualified leasehold, restaurant, and retail property are eliminated. A general 15-year recovery period and straight-line depreciation are provided for qualified improvement property with a 20-year ADS recovery period.

Restaurant property placed in service after 12/31/2017 that does not meet the definition of qualified improvement property is depreciated as non-residential real property with a 27.5-year life and mid-month convention.

Farming Equipment and Machinery:

Current law: Depreciable assets used in agriculture activities are assigned a recovery period of 7-years and included: machinery and equipment, grain bins, and fences that are used in the production of crops or plants, vines, and trees, livestock, the operation of farm dairies, nurseries, greenhouses, sod farms, mushroom cellars, cranberry bogs, apiaries, and fur farms, and the performance of agriculture, animal husbandry, and horticultural services.

Farming property, other than nonresidential real property, residential rental property, and trees, and vines bearing fruits or nuts, was subject to the 150% declining balance method. If the election to deduct pre-period expenditures was made all farming assets are depreciated using the alternative depreciation system (straight-line with longer recovery periods).

New law: For property placed in service after 12/31/2017, in tax years ending after that date, the cost recovery period is shortened from 7-years to 5-years for any machinery or equipment (other than grain bin, cotton ginning asset, fence, or land improvement) used in a farming business, the original use begins with the taxpayer.

Additionally, the required use of the 150% declining balance method for property used in a farming business is repealed.

Thus, farming property can generally be depreciated using the 200% declining balance method except for the following:

- Buildings and trees or vines bearing fruits or nuts (straight-line method)
- Property for which the taxpayer elects either the straight-line or 150% declining balance method
- 15 or 20-year MACRS property that has to be depreciated using 150% declining balance method
- Property subject to the ADS

Like-kind Exchanges:

Current law: Real and personal property used in a business can be exchanged under Section 1031 and the gain on the exchanged property is deferred until the newly acquired property is disposed.

New law: Like-kind exchanges under Section 1031 will be limited to exchanges of REAL property that is not primarily held for resale.

This provision applies to exchanges after 12/31/2017 unless the newly acquired property was received before 12/31/2017.

Example of Luxury Auto Safe Harbor Calculation:

Assumptions - Cost of vehicle is \$ 60,000 and vehicle was purchased after 12/31/2017.

Year 1 – deduction is limited to lesser of cost \$ 60,000 or Section 280F limitation \$ 18,000 (first year limit \$ 10,000 + \$ 8,000 increase in limitation when 100% bonus is claimed).

Subsequent years – First, you must determine if there is unrecovered basis by doing the following: Recalculate year 1 depreciation as if 50% bonus was claimed without regard to limitations. This results in a first year deduction of \$ 36,000, or, 50% of the cost ($\$ 60,000 \times 50\% = \$ 30,000$) plus 20% (1st year applicable percentage) of the remaining basis ($(\$ 60,000 - \$ 30,000) \times 20\% = \$ 6,000$).

Next, subtract from the recalculated year 1 depreciation of \$ 36,000 the amount calculated for year 1 which was \$ 18,000. This results in \$ 18,000 of unrecovered basis. If there is no unrecovered basis, then no deduction is allowed until the recovery period expires.

If there is an unrecovered basis, then subsequent years calculations are calculated as follows:

Formula: (Cost – 50% bonus amount) X applicable rate from 5-year table or SL

Year 2 – \$ 9,600 - Lesser of: ($\$ 60,000 - \$ 30,000$) X 32% or \$ 16,000

Year 3 – \$ 5,760 - Lesser of: $(\$ 60,000 - \$ 30,000) \times 19.2\%$ or \$ 9,600
Year 4 – \$ 3,456 - Lesser of: $(\$ 60,000 - \$ 30,000) \times 11.52\%$ or \$ 5,760 or SL
Year 5 – \$ 3,456 - Lesser of: $(\$ 60,000 - \$ 30,000) \times 11.52\%$ or \$ 5,760 or SL
Year 6 – \$ 1,728 - Lesser of: $(\$ 60,000 - \$ 30,000) \times 5.76\%$ or \$ 5,760 or SL
Year 7 – \$ 5,760 - Lesser of: \$ 5,760 or SL
Year 8 – \$ 5,760 - Lesser of: \$ 5,760 or SL
Year 8 – \$ 5,760 - Lesser of: \$ 5,760 or SL
Year 10 – \$ 720 - Lesser of: \$ 5,760 or SL

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