How Tax Reform Affects Bonus Depreciation & Cost Recovery

Agenda

- Lower tax rate considerations
- Changes to 15-year qualified property
- Changes to qualified improvement property
- Changes to bonus depreciation rules
- Bonus depreciation interaction with section 163(j) rules
- Increased Section 179 limits and minor tweaks
- Luxury automobiles and personal use property
- Farm property

Tax Rates

- C-Corp rate reduced from 35% to 21%
  - + Blended rate for fiscal year taxpayers
- Top individual tax rate drops from 39.6% to 37%
  - + Top rate could drop as low as 29.6% with full 20% QBI deduction
- Consider Form 3115's for 2017 tax year
  - + Reg. Sec. 301-9100-2(b) relief allows for Form 3115 to be filed with amended return within six months of the original due date for the year of change (even if an extension wasn't filed)
  - + In conjunction with a cost segregation study

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Polling Question #1

True or False – A Form 3115 can be filed for 2017 with an amended return even if though you timely filed the original return.

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15-Year Qualified Property (QLHI, QRP, & QRIP)

- TCJA eliminated all three types of 15-year qualified property after 12.31.17
  - + Qualified leasehold improvement property (QLHI)
  - + Qualified restaurant property (QRP)
  - + Qualified retail improvement property (QRIP)
- So what are we left with?

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Qualified Improvement Property (QIP)

- Qualified improvement property first created by the PATH Act and originally effective beginning 1.1.16
  - + New interior improvements to nonresidential real property placed in service anytime after the original placed in service date;
  - + Not an elevator or escalator; and
  - + Not the interior structural framework of the building
- Due to congressional oversight, 15-year recovery period not assigned when moved within the code
- Improvements that formerly qualified as 15-year property are now generally 39-year property (40 years for ADS)
- Bonus depreciation currently no longer available for 39-year property, formerly QIP

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Cost Recovery Life Comparison

2017 Tax Law

Life	Classification
40 Years	Residential (ADS)
15 years	Qualified Leasehold Improvement (MACRS)
15 Years	Qualified Restaurant Property (MACRS)
15 Years	Qualified Retail Improvement (MACRS)
20 Years	Qualified Leasehold Improvement (ADS)
20 Years	Qualified Restaurant Property (ADS)
20 Years	Qualified Leasehold Improvement (ADS)

2018 Tax Law

Life	Classification
30 Years	Residential (ADS)
39 Years	Qualified Improvement Property (MACRS)
40 years	Qualified Improvement Property (ADS)
Sec. 179	Roof, HVAC, Fire Protection, Security and Alarm Systems – Not original UOP

Bonus Depreciation

- Qualifying property acquired **and** placed in service after 09.27.17 and before 12.31.22 qualifies for 100% bonus
  - + Phased down 20% a year over the 5 years (2023 – 2027)
  - + Don't overlook binding contract and work of a significant nature rules
- Property acquired before 9.28.17, placed in service after 9.27.17 follow old law (i.e. 50% for 2017, 40% for 2018, and 30% for 2019)
- Original use requirement is removed after 09.27.17
  - + Bonus depreciation now applies to purchases of new and used property
  - + Acquisition from a related party doesn't count
- Does not include property used in a trade or business with floor plan financing indebtedness
- Does not include property used in a real property trade or business or farm that makes the irrevocable election out of the interest expense limitation rules under 163(j)
  - + More than likely will require a method to change to adopt ADS retroactively
  - + No concrete IRS guidance to date

Polling Question #2

- True or False - Used property is not eligible for bonus depreciation.

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Bonus Depreciation – Effective Dates and Allowances

Date	Applicable Percentage
Acquired before Sept. 27, 2017	50%
Acquired and placed in service after Sept. 27, 2017, and before January 1, 2023	100%
Acquired and placed in service in the taxpayer's first tax year ending after Sept. 27, 2017 with an election made to use 50% rather than 100%	50%
Acquired after December 31, 2022, and PIS in before January 1, 2024	80%
Acquired after December 31, 2023, and PIS in before January 1, 2025	60%
Acquired after December 31, 2024, and PIS before January 1, 2026	40%
Acquired after December 31, 2025, and PIS before January 1, 2027	20%
PIS on or after January 1, 2027	0%

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Bonus Depreciation – Placed in Service Rules Refresher

- Two part test, must pass both
- (1) When is an asset considered placed in service?
  - + Generally when the asset is first placed in a condition or state of readiness and available for a specifically assigned function; and
  - + The trade or business must have started
  - + Recent taxpayer friendly case (Stine, LLC v. United States):
    - The taxpayer was allowed to claim depreciation on a building even though the location had not yet opened for business
    - Building only ready to accept furniture and equipment
    - IRS has since non-acquiesced
- But why did we talk about placed in service first?

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Bonus Depreciation – Acquisition Rules

- (2) Acquisition rules depend on whether the asset is acquired or self-constructed
  - + (a) With acquired property, eligible property is considered acquired after 9.27.17 if there was not a written binding contract prior to the acquisition date
  - + What is a binding contract?
    - Legally enforceable against the taxpayer under state law
    - Does not limit damages to a specified amount (unless the damages are limited to at least 5% of the contract price)
    - Any conditions are not within control of either party
    - Any changes to conditions are insubstantial
    - Supply agreements must include the amount and design specifications of the purchase to be binding
    - Purchasing a component or components of a larger asset is not considered a binding agreement to purchase the larger asset
  - + Note: An option to buy property is not considered a binding contract

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Bonus Depreciation – Acquisition Rules (continued)

+ (b) With self-constructed property, eligible property is considered acquired after 9.27.17 if manufacturing, construction, or production began after that date.
  - Manufacturing, construction, or production is considered to have begun when physical work of a significant nature begins
    - Physical work does not include preliminary activities such as planning or designing, securing financing, exploring, or researching
  - Typically based on facts and circumstances
  - Taxpayer can choose to utilize the 10%-of cost safe harbor (does not include land or preliminary activities)

Section 163(j) & Floor Plan Financing Interest

- If a business has floor plan financing interest that is taken into account under Section 163(j)(1)(C), its property used in that trade or business is ineligible for bonus depreciation under Section 168(k)(9)(B)
- What about a real estate company leasing property to a business with floor plan financing interest?

Section 163(j) & Floor Plan Financing Interest (continued)

- "Floor plan financing interest" means interest paid or accrued on floor plan financing indebtedness
- "Floor plan financing indebtedness" means debt –
  + Used to finance the acquisition of motor vehicles held for sale or lease, AND
  + Secured by the acquired inventory
- "Motor vehicle" is any of the following:
  + Any self-propelled vehicle designed for transporting persons or property on a public street, highway or road
  + A boat
  + Farm machinery or equipment
  + "Motor vehicles" does not seem to include at least some construction equipment, jet skis, and trailers

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Section 163(j) & Electing Real Property Trades or Businesses

- If a qualifying taxpayer makes the irrevocable election out of the Section 163(j) interest expense limitation rules, its nonresidential real property, residential rental property, and qualified improvement property become mandatory ADS property under MACRS
  + More than likely will require a method to change to adopt ADS retroactively
  + No concrete IRS guidance to date
- Under the ADS, these 3 groups receive 40-year, 30-year and 40-year recovery periods and are ineligible for bonus depreciation
- If Congress makes technical corrections, QIP should receive a 20-year ADS recovery period.

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Section 179 Rules

- Maximum amount that may be deducted $1,000,000
- Phase-out begins at $2,500,000 of current year section 179 property acquired
  - Both will be indexed for inflation
- Limited to taxable income
- Section 179 can be carried over
- Sport Utility Vehicles now will be indexed for inflation ($25,000 for 2018)
- Expands expensing election to:
  + Furnishing lodging property – hospitality and apartment buildings
  + Roofs, HVAC property, fire protection, alarm and security systems (only applies to nonresidential real property under expansion or improvement, placed into service after the building was placed into service)

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Polling Question #3

Under Section 179 expenses, the maximum yearly deduction increased to what amount?

a. $500k
b. $750k
c. $1 million
d. $1.5 million

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Depreciation Limitations: Luxury Automobiles and Personal Use Property

- Computers are no longer subject to listed property rules
- Increases to annual depreciation limitations placed on passenger automobiles
- New limitations will be indexed for inflation

2017 Tax Law

Year	Limitation
1	$3,160
2	$5,100
3	$3,050
4+	$1,875

2018 Tax Law

Year	Limitation
1	$10,000
2	$16,000
3	$9,600
4+	$5,760

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Farm Property

2017 Tax Law

- Farming property with a recovery period of 10 years or less is depreciated using the 150% declining balance method

2018 Tax Law

- Farming property with a recovery period of 10 years or less is no longer required to be depreciated using the 150% declining balance method. Rather, it may be depreciated using the 200% declining balance method
- The recovery period for certain machinery and equipment used in a farming business is shortened from 7 years to 5 years
- Farming businesses electing out of the interest expense limitation are required to use ADS to depreciate certain property

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Polling Question #4

True or False – Starting in 2018, 7 year farm property can now be depreciated using the 200% double declining method?

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Why and where can we do a Cost Segregation?

- Property allocations typically average between 10% and 20% for 5-year or 7-year personal property and 10% and 20% for 15-year land improvements
- Optimize the bonus depreciation rules
- Permanent tax savings for 2017
- Conduit to capitalize many invoices at project completion
- Real property detail for future repairs and disposals
  + Partial disposals recently added to IRS LB&I initiative
- Domestic properties including renovations, expansions, new buildings, purchases and repairs
- Single projects that exceed $1 million basis

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Who benefits from Cost Segregation?

- Taxpayers with near-term expiring NOLs
- C-corps, S-Corps, and Partnerships (big interest in permanent timing differences for extended 2017 tax returns)
- Renovations that include Qualified Improvement Property (39-year), not yet eligible for bonus depreciation in 2018
- There is no more Qualified Leasehold Improvements, Qualified Restaurant, or Qualified Retail Property (15-year) starting in 2018

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Examples of Cost Segregation Benefits

Description	Basis	NPV	Permanent Savings
2017 Purchase (39.6%)	$10M	$410K	$6K
2018 Purchase (37.0%)	$10M	$600K	$0
2017 New with 50% Bonus (39.6%)	$10M	$530K	$35K
2018 New with 0% Bonus w floor financing (37.0%)	$10M	$390K	$0
2017 C-Corp (35%)	$10M	$470K	$190K
2018 C-Corp (21%)	$10M	$340k	$0

- *All scenarios include a 7% discount rate, 10% 15-year land improvements, and 15% 5-year personal property.*

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