

Depreciation and Deductions for Fixed Assets

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Notice

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The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

Agenda

Overview of Select Deductions for Business Fixed Assets

— What is new in the Tax Cuts and Jobs act (TCJA)

- Section 179 Deductions
- Bonus Depreciation (100% expensing)
- Automobile Depreciation
- Change in use rules when for real property trades or businesses electing out of the Section 163(j) interest expense limitations
- QIP changes and the repeal of Qualified Leasehold, Qualified Retail, and Qualified Restaurant Property

— What has not changed but still relevant

- De minimis expensing
- Materials and supplies
- Deductible repairs

— Considerations in practice

- Example of deductions
- Elections/accounting method changes

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What's New

Section 179

Dollar Limitation:

- Increased from \$510,000 (2017) to \$1 million

Asset Limitation:

- Increases the phase-out threshold to \$2,500,000 (from \$2,030,000 for 2017)

Both limitations are inflation-adjusted beginning in 2019

Eligibility is expanded to include: **New**

- Qualified improvement property (QIP), discussed later
- Certain nonresidential real property improvements – specifically, roofs; heating, ventilation, and air-conditioning (HVAC) property; fire protection and alarm systems; and security systems
- Personal property used predominantly in lodging

Provision is elective and can be taken on new or used property

Depreciable basis reduced by amount of 179 deduction

Deductions do not create or can be applied to NOLs

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Bonus Depreciation

The Act provides 100% bonus depreciation for qualified property acquired and placed in service after September 27, 2017, and before January 1, 2023.

Qualified Property is

- **Property of a specified type:**
 - Tangible property with a MACRS recovery period of 20 years or less
 - Computer software
 - Water utility property
 - Qualified film, television, and live production property  **New**
- **Property that is either:**
 - Original-use property to the taxpayer, OR
 - Used property acquired by purchase from an unrelated party (so long as taxpayer has not previously used the property)  **New**
- **Property that is not required to use the ADS method of depreciation, including:**
 - Foreign-use property
 - Property leased to a tax exempt entity
 - Certain building property owned by an “electing real property trade or business” or “electing farming business” as defined in section 163(j)  **New**

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Bonus Depreciation

- **Property is acquired no later than the date a written binding contract for the acquisition is entered into**
- **Reduced percentages apply for property placed in service after 2022 as follows:**
 - 80% in 2023,
 - 60% in 2024,
 - 40% in 2025, and
 - 20% in 2026.
- **Property used in a business excluded from section 163(j) interest limitation is not bonus eligible**
 - Regulated utility property
 - Floor plan financing property
- **Election out of bonus depreciation**
 - Made by recovery class and by entity
- **Election to use 50% in lieu of 100%**
 - Available only for first tax year ending after 9/27/2017
 - Applies to all qualified property for which taxpayer has not made a valid election out

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Bonus depreciation percentages

Placed in Service Year ⁵⁰⁰	Bonus Depreciation Percentage	
	Qualified Property in General/Specified Plants	Longer Production Period Property and Certain Aircraft
Portion of Basis of Qualified Property Acquired before Sept. 28, 2017		
Sept. 28, 2017 – Dec. 31, 2017	50 percent	50 percent
2018	40 percent	50 percent
2019	30 percent	40 percent
2020	None	30 percent ⁵⁰¹
2021 and thereafter	None	None
Portion of Basis of Qualified Property Acquired after Sept. 27, 2017		
Sept. 28, 2017 – Dec. 31, 2022	100 percent	100 percent
2023	80 percent	100 percent
2024	60 percent	80 percent
2025	40 percent	60 percent
2026	20 percent	40 percent
2027	None	20 percent ⁵⁰²
2028 and thereafter	None	None

Source: Conference Report to Accompany H.R. 1, Pub. L. 115-97, 115th Cong. 1st Sess., p. 192. (2017).

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Automobiles

Annual depreciation limitations for listed property (Section 280F), generally referred to as the passenger cars or light duty trucks, are increased as follows:

- \$10,000 for the year in which the vehicle is placed in service,
- \$16,000 for the second year,
- \$9,600 for the third year, and \$5,760 for the fourth and later years in the recovery period

The limitation are indexed for inflation for automobiles placed in service after 2018.

The TCJA retains the **\$8,000** limit for additional first year (100% bonus) depreciation for passenger automobiles and light trucks now applies to used as well and new qualified property. The additional first year limit plus the \$10,000 first limitation provides **\$18,000** as the maximum deductible amount for 2018.

Computers and peripheral equipment placed in service after 2017 is not longer consider “listed property”, and thus not required to be depreciated using the straight-line method if the business use falls below 50%.

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Relationships of 100 % Bonus and IRC § 280F

Passenger automobiles are subject to the IRC § 280F limitations and taking bonus depreciation could impact future depreciation deductions.

Under prior 100% bonus law guidance, Rev Proc. 2011-26 stated that If the unadjusted depreciable basis of a passenger automobile exceeded the first-year limitation amount, the excess amount was not deductible until the first taxable year succeeding the end of the recovery period.

Example:

If a taxpayer buys a used \$28,000 car in 2018 (used 100% for business), he or she can immediately depreciate \$18,000, however the remaining \$10,000 would not be depreciable until year 2024.

Rev. Proc. 2011-26 provided a safe harbor for this in 2011 but at this time it is unknown how the IRS will address the issue.

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SUVs and Larger Vehicles

Gross vehicle weight rating above 6,000 lbs..

- are not subject to depreciation limits , however
- are limited to a \$25,000 Section 179 deduction limit

No depreciation or Section 179 limits apply to SUVs with a GVW more than 14,000 lbs..

Trucks and vans with a GVW rating above 6,000 lbs., but not more than 14,000 lbs.. generally have the same limits, however, are not subject to the Section 179 \$25,000 limit if special capacity and configurations exceptions apply.

Although SUVs and larger vehicles purchased after September 27, 2017, remain subject to the \$25,000 Section 179 limit, they are eligible for 100% bonus depreciation if they are above 6,000 lbs.. This is true for both new and used vehicles.

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Examples

Example 1

Taxpayer 1 acquired and placed into service a \$45,000 8,000 lbs. SUV (new or used) in January 2018 that is used 100% for business.

Taxpayer 1 is able to depreciate the entire amount in 2017 using 100 percent bonus depreciation.

If electing out of bonus then the taxpayer can take \$25,000 maximum Section 179 deduction and regular MACRS depreciation on the remaining \$20,000 over 5 years.

Example 2

Taxpayer 2 acquired and placed into service (new or used) light-duty pickup truck for \$16,000 in March 2018.

Purchase is eligible for bonus depreciation, and taxpayer 2 is able to deduct her entire purchase since the 2018 Section 280F first-year limitation is \$18,000, more than the purchase amount purchase.

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ADS Depreciation on Building Property

Effective as of 2018 ADS depreciation on building property is mandatory for real property trades or business electing out of the 163(j) interest limitation.

- Building property includes: non-residential real (39-year), residential rental (27.5 year) and QIP (15 or 39 year, includes assets that were QLHI, QRP or QRIP).
- ADS applies to all building property currently and previously placed into service at the time of election. And building property service in years following the election.

Change in use regulations 1.168(i)-4 apply while making ADS depreciation adjustments for building property assets previously placed into service.

- Remaining basis of the assets to be depreciated over the remaining ADS life. (example on next page)
- Filing a Form 3115 is not required.

Bonus depreciation (100% expensing) is still available for all MACRS property with a life of 20 years.

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Qualified Improvement Property (QIP)

Effective for assets placed in service AFTER 2017, the Act removed:

- 15-year recovery classifications for Qualified Leasehold Improvement Property (QLHI); Qualified Restaurant Property (QRP) and Qualified Retail Improvement Property (QRIP)
- Qualified Improvement Property (QIP) from the list of property that is qualified for bonus depreciation

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Qualified improvement property (QIP)

The Act intended:

- To create a new 15-year recovery classification for QIP
- Would have included all assets that would have been QLHI or QRIP and certain assets that would have QRP or non-residential real property
- As 15-year property, QIP would have been bonus eligible as MACRS property with a recovery period of less than 20 years

Due to a drafting error, the intended QIP classification was not included in the Act. Consequently, QIP placed in service after 2017 is 39 year property, and, if acquired after 9/27/17 is not bonus eligible. A technical correction is required to fix this issue.

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What's not
changed but
still relevant

The Tangible Property Regulations (TPR)

The Final Regulations apply to costs incurred throughout the entire life cycle of the taxpayer's tangible property, from the time the taxpayer first begins considering whether (and which) property to acquire, through maintaining and improving the property during its operational life, and finally to the treatment of the property's remaining basis when the taxpayer disposes of the property.

De Minimis Costs

Materials and Supplies

Repair and Maintenance Expenditures

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De Minimis Costs

Taxpayers with audited financial statements can expense up to \$5,000 under a de minimis safe harbor. To qualify the company must have a written policy as of the beginning of the year that provides for expensing either items costing less than a specified dollar amount (must be \$5,000 or less) or that have a useful life of not more than 12 months.

Taxpayers without audit financial statements can deduct items up to \$2,500 or that have a useful life of not more than 12 months.

KEY TAKEAWAY: The De Minimis Safe Harbor is applied on a "per item" basis.

— Example: \$6,000 invoice for the purchase of three \$2,000 motors.

The de minimis safe harbor must be elected annually by including a statement in the taxpayer's timely filed original federal income tax return for the year elected.

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Materials and Supplies Overview

Materials and supplies as tangible property used or consumed in the taxpayer's operations that does not qualify as inventory and that:

Is a component acquired to maintain, repair, or improve a Unit of Property ("UOP") owned, leased, or serviced by the taxpayer and that is not acquired as part of any single unit of tangible property;

- Consists of fuel, lubricants, water, and similar items, reasonably expected to be consumed in 12 months or less, beginning when used in the taxpayer's operations;
- Is a UOP that has an economic useful life of 12 months or less, beginning when the property is used or consumed in the taxpayer's operations;
- Is a UOP that has an acquisition or production cost of \$200 or less; OR
- Is identified in published guidance in the Federal Register or in the Internal Revenue Bulletin as materials and supplies for which treatment is permitted under this section.

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Types of Materials and Supplies

Incidental Materials and Supplies

- Incidental material and supplies include items that are carried on hand and for which no record of consumption is kept or of which physical inventories are not taken.
- Amounts paid to acquire or produce incidental materials and supplies are deductible in the taxable year in which they are paid/acquired.

Non-incidental Materials and Supplies

- Non-incidental supplies include items for which a record of consumption is kept or a physical inventory is taken.
- Amounts paid to acquire or produce incidental materials and supplies are deductible in the taxable year in which they are used or consumed in the taxpayer's operations.

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Small Taxpayer Safe Harbor for Improvement Expensing

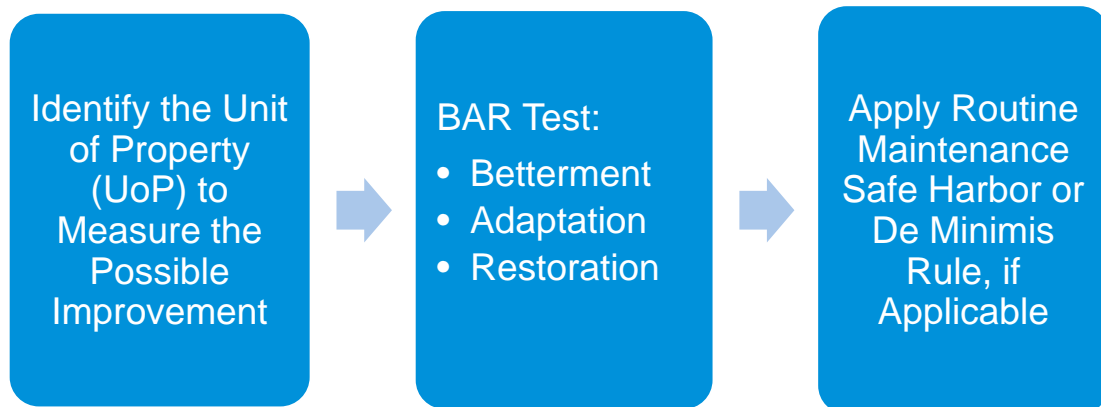
You are not required to capitalize as an improvement, and therefore may be permitted to deduct, the costs of work performed on owned or leased buildings, e.g., repairs, maintenance, improvements or similar costs, that fall into the safe harbor election for small taxpayers. The requirements of the safe harbor election for small taxpayers are:

- Average annual gross receipts of \$10 million or less; and
- Owns or leases building property with an unadjusted basis of less than \$1 million or less; and
- The total amount paid during the taxable year for repairs, maintenance, improvements, or similar activities performed on such building property doesn't exceed the lesser of-
 - Two percent of the unadjusted basis of the eligible building property; or
 - \$10,000 (for questions about how to calculate the unadjusted basis, refer to "Figuring the Unadjusted Basis of Your Property" in [Publication 946](#))

You make the election to use the safe harbor for each taxable year in which qualifying amounts are incurred.

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Deductible Repairs and Maintenance Expenditures



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Betterment Examples

Not a Betterment	Betterment
Building refreshes (e.g. repainting, patching holes in walls, repairing damaged ceiling tiles)	Building remodels (e.g. installation of more efficient lighting, replacement of existing plumbing fixtures with fixtures that conserve water and energy)
Replacement of HVAC parts resulting in 10% increased efficiency	Addition of insulation to building to reduce energy and power costs by 50%
Replacement of elevator part resulting in 5% increased capacity	Addition of a new elevator
Movement of wall to accommodate better use of space	Expansion of pediatrics unit (doubled in size)
Relocation and reinstallation of equipment with no change in condition	Relocation and reinstallation of equipment with increased productivity

Restoration Examples

Not a Restoration	Restoration
Replacement of 3 of 10 roof-mounted HVAC units	Replacement of 5 of 10 roof-mounted HVAC units
Replacement of single sprinkler	Replacement of sprinkler system
Replacement of 30% of wiring throughout building	Replacement of all wiring throughout building
Replacement of toilets and sinks on 1 of 3 floors	Replacement of toilets and sinks on 2 of 3 floors
Replacement of 100 of 300 windows where 300 windows represent 25% of surface area of building	Replacement of 200 of 300 windows where 300 windows represent 25% of surface area of building
Replacement of floors which represent 10% of square footage of building	Replacement of floors which represent 40% of square footage of building

Routine Maintenance Safe Harbor

You are not required to capitalize as an improvement, and therefore may deduct, amounts that meet all of the following criteria:

- Amounts paid for recurring activities that you expect to perform;
- As a result of your use of the property in your trade or business;
- To keep the property in its ordinarily efficient operating condition; and
- You reasonably expect, at the time the property is placed in service, to perform the activities:

For building structures and building systems, more than once during the 10-year period beginning when placed in service, or For property other than buildings, more than once during the class life of the unit of property.

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Considerations
in practice

Office Remodel Example A:

Facts & Circumstances:

- \$2,700,000 office remodel: all interior except for roof and HVAC RTUs
- \$300,000 additional office furniture
- Sec. 179 limit reduced to \$500,000 since Sec. 179 property investment is more than \$2,500,000
- Construction started after 9/27/17 and completed before 12/31/18

Best Way to Treat \$3,000,000?

- Use Sec. 179 first
- Use a cost segregation study to find eligible Sec. 179 property, personal property, and QIP

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Office Remodel Example A:

	Sec 179	5 & 7 Year Personal Property w/ 100% Bonus	39 Year QIP
	\$150,000 of roof work	\$300,000 office furniture	\$1,600,000 of interior real property improvements
	\$250,000 of HVAC RTU	\$270,000 of office casework, removable finishes	
	\$100,000 Fire Sprinkler	\$330,000 of business related electrical and plumbing	
Totals	\$500,000	\$900,000	\$1,600,000
	16.67%	30%	53.33%

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Office Remodel Example B:

Facts & Circumstances:

- \$9,000,000 office remodel: all interior except for roof and HVAC RTUs
- \$1,000,000 additional office furniture
- Sec. 179 limit reduced to \$0 since Sec. 179 property investment is more than \$3,500,000
- Construction started after 9/27/17 and completed before 12/31/18

Best Way to Treat \$10,000,000?

- Use a cost segregation study to find eligible personal property and QIP

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Office Remodel Example B:

	5 & 7 year Personal Property w/ 100% Bonus	39 Year QIP	39 Year Real Property
	\$1,000,000 office furniture	\$5,700,000 of interior real property improvements	\$500,000 of roof work
	\$900,000 of office casework, removable finishes		\$800,000 of HVAC RTU
	\$1,100,000 of business related electrical and plumbing		
Totals	\$3,000,000	\$5,700,000	\$1,300,000
	30%	57%	13%

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Income Tax Filing Guideline

Item	Election made with affirmative statement	Election made by reporting on the return	Method change with 481(a) adjustment	Method change with limited 481(a)
Book de minimis policy safe harbor	✓			
Book capitalization policy conformity	✓			
Current period partial building disposition		✓		
Repairs versus improvements (if not on method currently)			✓	
Materials and supplies				✓
Section 179 expensing		✓		
Small Taxpayer Safe Harbor Election to Expense and not apply improvement rules	✓			
Election out of bonus	✓			
Election out of QIP	✓			