GMS Surgent
CERTIFIED PUBLIC ACCOUNTANTS AND ADVISORS

A Practical Approach: Tax Depreciation Opportunities under the Tax Cuts and Jobs Act

The new tax law has created new opportunities to accelerate tax write-offs. Below is a summary of some of the changes made to tax depreciation under the new tax law.

Bonus Depreciation

The most significant depreciation-related change in the new tax law is the enhancement of "bonus depreciation" by allowing 100% expensing of certain assets both acquired and placed into service after September 27, 2017 through December 31, 2022. There is no dollar limit to the amount of bonus depreciation a business can take. This means that a business can create a tax loss via bonus depreciation. For assets acquired between January 1, 2017 and September 27, 2017, 50% bonus depreciation is allowed. After 2022, bonus depreciation decreases by 20% each year, until January 1, 2027, when the provision for bonus depreciation expires. Most types of personal property qualify for bonus depreciation, including computer software, computer hardware, machinery and equipment, furniture and fixtures, and qualified improvement property (mentioned below). The definition has also been expanded to include used property, but it needs to be new in the hands of the taxpayer purchasing the property. Another important aspect of the enhancement of bonus depreciation is that the accelerated depreciation deductions may make the economics of certain potential acquisitions more appealing for buyers, as the buyer may be able to immediately write-off a significant portion of the purchase price.

Section 179 Expensing

Section 179 allows a taxpayer to immediately deduct (i.e. not capitalize and depreciate) the cost of certain property, including computer software, computer hardware, machinery and equipment, furniture and fixtures, and qualified improvement property (mentioned below), provided there is net income from a trade or business. The new tax law increases the maximum Section 179 deduction to $1,000,000 from $510,000, starting in 2018. The Section 179 deduction begins to phase out if a significant amount of purchasing occurs in a particular year. At annual purchases of $2,500,000 ($2,030,000 for 2017), the Section 179 deduction will be reduced, dollar for dollar, for additional purchases above this amount, until it is completely phased out. The new tax law also makes Section 179 available for the following types of nonresidential building improvements: roofs, HVAC equipment, fire protection and alarm systems, and security systems. In addition, Section 179 is now available for tangible personal property used to furnish lodging (i.e. a residential rental property or a hotel). Given the requirement that there be net income from a trade or business in order to claim a Section 179 deduction, careful consideration must be given regarding electing bonus depreciation, which does not require net income, in lieu of a Section 179 deduction. Taxpayers have the option of using bonus depreciation on certain assets and a Section 179 deduction on others.

Qualified Improvement Property (QIP)

Over the years, there have been different categories of improvements for nonresidential real property with different lives and different rules. The new tax law attempts to simplify this by leaving only one category remaining: qualified improvement property. QIP is defined very broadly, and refers to most types of nonstructural improvements to the interior portion of a nonresidential building if the improvement is placed in service any time after the date the building was first placed in service. There are some technical corrections that we are hoping will occur so that QIP will be considered 15-year property (and, therefore, subject to bonus depreciation and Section 179), as originally intended by Congress under the Tax Cuts and Jobs Act. Assuming these corrections occur, landlords, lessees, and even related-party or owner-occupied building owners will be able to immediately write-off significant improvement costs. As always, a cost segregation study may also provide significant tax benefits by carving certain improvement costs into faster depreciation lives, with a current year catch-up for missed prior depreciation deductions.

Interest Expense Limitation and Real Property Depreciation Alternatives

Under the new law, the maximum allowable deduction of interest expense for certain businesses cannot exceed 30% of the business' adjusted taxable income. Many businesses with average annual gross receipts of less than $25 million are not subject to this limitation. However, a business that is defined as a "tax shelter" (i.e. more than 35% of losses are allocated to limited partners) is subject to the limitation even if gross receipts are lower. This 30% limitation can be avoided by an election available to "real property trades or businesses" that by definition are engaged in leasing, construction, development, acquisition, operation, management, or brokerage of real property. If the real property trade or business elects out of being subject to the 30% limitation, it must use a new alternative depreciation system (ADS) method. The ADS life for residential property is 30 years (vs. 27.5 years), and the ADS life for nonresidential property is 40 years (vs. 39 years), with no bonus depreciation allowed for either under ADS.

Listed Property

Certain property is readily usable for personal use as well as business use, such as passenger vehicles, including any 4-wheeled vehicles. This type of property is called listed property and has historically been subject to reduced annual depreciation limits. The new tax law enhances the annual depreciation deductions available to these types of assets. The maximum first-year depreciation available for a passenger automobile has been increased from $10,650 to $18,000. For vans, SUV's, and trucks weighing more than 6,000 pounds, the entire cost of the vehicle may be written off.

Repair Regulations Still in Play

The repair regulations that were effective for most taxpayers beginning January 1, 2014 are still in effect. These regulations describe three types of expenditures that generally require capitalization: (1) betterment (fixes a material defect, is a material addition, or is expected to increase productivity, efficiency, strength, quality, or output); (2) restoration (restores to ordinarily operating condition, rebuilds to a like-new condition, or is for the replacement of a major component); or (3) adaptation (adapts to a new or different use). The new bonus depreciation and Section 179 rules may provide enhanced depreciation deductions for these costs that are required to be capitalized. Nonmaterial enhancements can be deducted immediately; for example, costs paid to replace 2 out of 10 HVAC units are not considered material additions to or material increases in the capacity of the HVAC system.

The repair regulations also allow an immediate deduction for certain "refresh" costs. Refresh-type costs are commonly incurred in between tenants, and include costs such as relocating lighting, repainting interior walls, replacing damaged ceiling tiles, and power-washing exterior walls.

In addition, the repair regulations allow for a de minimis safe harbor election to expense tangible personal property costing less than $2,500 per item ($5,000 with audited financial statements), if the taxpayer's accounting policy is to expense those dollar amounts, and the items are also expensed on the taxpayer's books and records.

What should you do?

In the last alert in our "A Practical Approach" series, we described the new 20% pass-through deduction. That deduction must be considered together with the new depreciation rules mentioned above. Taking advantage of these new rules requires careful analysis and planning. Careful tax planning does not always mean taking all possible deductions immediately; in other words, sometimes spreading out deductions across tax years maximizes the overall tax savings by applying those deductions against higher tax brackets. Please contact us so that we may assist you in calculating the best possible tax savings.

About Us

GMS Surgent is a mid-sized, full service, certified public accounting and advisory firm serving business and individual clients located primarily (but not limited to) the Greater Philadelphia area. We warmly invite you to click around our website to learn a little more about our firm, our clients and the ways in which our services could benefit you.

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