



January 31, 2018

Tax Reform Alert: Depreciation

The Tax Cuts and Jobs Act made significant changes to individual and corporate taxation by generally lowering tax rates and widening tax brackets. In addition, certain deductions were curtailed. There are several provisions that changed regarding depreciation, some of which impact 2017 tax returns.

Bonus Depreciation

Businesses can take 100% bonus depreciation (immediate write-off) on qualified property acquired and placed in service after September 27, 2017. Previously, such property was eligible for 50% bonus depreciation. 100% bonus depreciation remains in effect through 2022. After that the percentage is scaled down to 80% - 2023, 60% - 2024, 40% - 2025, and 20% - 2026. Qualified property for bonus depreciation now includes used assets and generally applies to property with a depreciable life of 20 years or less. This is a significant change as previously only new assets qualified.

Section 179

The maximum deduction under the Section 179 provisions is \$1,000,000 starting in 2018. This is an increase from \$510,000 in 2017. The starting point for the phaseout threshold (maximum property that can be placed in service) was increased from \$2,070,000 to \$2,500,000.

As important, the property eligible for Section 179 has expanded in two regards. First, tangible property (furniture, appliances, etc.) used to furnish hotels and apartment buildings are now eligible. Second, improvements to nonresidential real property such as roofs, heating, ventilation, air conditioning, fire alarm, and security systems are also eligible (must be placed in service after the date the building was placed in service).

Qualified Improvement Property (QIP)

In 2018, the Act also eliminates the separate definitions of qualified leasehold improvement, qualified restaurant and qualified retail improvement property, and instead provides one general 15-year recovery period for Qualified Improvement Property (QIP).

QIP is any improvement to an interior portion of a building that is nonresidential real property if the improvement is placed in service after the date the building was first placed in service (excluding enlargements to a building, elevators/escalators, and internal structural framework). The improvements do not need to be made pursuant to a lease and there are no related party exclusions (owner occupied property is eligible). Note: QIP is eligible Section 179 property.

Illinois Impact

Illinois allows 100% bonus depreciation as a deduction absent a statute change. However, 80% bonus depreciation and lower percentages would not be allowed under Illinois rules.

Illinois matches the Federal Section 179 amount, so absent future changes, any Section 179 amounts would also be allowed in Illinois.

Luxury Auto Limits

The Act increases the depreciation limits for luxury autos (passenger vehicles under 6,000 pounds) to \$10,000 for the first year, \$16,000 for the second year, \$9,600 for the third year, and \$5,760 for the fourth and later years.

Sidebar: Like Kind Exchanges for Personal Property

While the Act kept like kind exchange for real estate (Section 1031 exchanges), it eliminated the ability to defer the gain on an exchange of personal property (equipment and vehicles). This will mean that the trade in allowance will be considered cash sale proceeds and gain will be recognized for the amount that this exceeds basis.

Because of recognizing the gain, the entire cost of the equipment being acquired will be eligible for depreciation. Therefore, given the new depreciation provisions, many times the overall transaction can still result in a wash for tax purposes. Gain on sale of item traded off can be completely offset by first year depreciation on acquired item.

This issue is also something to watch for those S corporations who are still within the 5-year built in gains recognition period (corporation who elected S status on January 1, 2014, or later). For those S corporations, trading equipment will trigger the federal built-in gain tax, where previously the built-in gain tax could be deferred.

Summary

Overall, there are several favorable tax changes regarding depreciation. For many taxpayers, capital purchases or improvements will be able to be expensed in the year of purchase by using either bonus depreciation or Section 179 expense. Please contact our office for more information.