

Highlights from Final and Proposed Regulations for Bonus Depreciation

By: Anna Twardy

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History of Bonus Depreciation

- Bonus depreciation was created by the Job Creation and Worker Assistance Act of 2002 by the addition of Section 168(k).¹
- The original bonus depreciation amount was 30% of the initial basis of qualified property taken in the year in which it was placed in service.
- “Qualified property” included personal property that had a class life of 20 years or less, and the original use of such property had to commence with the taxpayer (i.e., “new” property).



¹ Unless otherwise provided, all “Section” references are to the Internal Revenue Code of 1986, as amended.

History of Bonus Depreciation

- The bonus depreciation percentages have changed several times throughout the years:

| Beginning Date | End Date | Bonus Percentage |
|----------------|------------|------------------|
| 9/11/2001 | 5/4/2003 | 30% |
| 5/5/2003 | 12/31/2004 | 50% |
| 1/1/2005 | 12/31/2007 | 0% |
| 1/1/2008 | 9/8/2010 | 50% |
| 9/9/2010 | 12/31/2011 | 100% |
| 1/1/2012 | 12/31/2017 | 50% |

Bonus Depreciation Under the TCJA

- The Tax Cuts and Jobs Act (the “**TCJA**”) amended Section 168(k) as follows:
 - Added “used” property so that taxpayers can claim bonus depreciation on both “original use” and “used” property
 - Added qualified film, television, and live theatrical productions to qualify for bonus depreciation
 - Revised the bonus depreciation percentages as follows:

| Beginning Date | End Date | Bonus Percentage |
|----------------|------------|------------------|
| 9/28/2017 | 12/31/2022 | 100% |
| 1/1/2023 | 12/31/2023 | 80% |
| 1/1/2024 | 12/31/2024 | 60% |
| 1/1/2025 | 12/31/2025 | 40% |
| 1/1/2026 | 12/31/2026 | 20% |
| 1/1/2027 | Thereafter | 0% |

Final Regulations

- T.D. 9874 is effective on September 24, 2019
- Affect taxpayers who depreciate qualified property acquired and placed in service after September 27, 2017
- Depreciable property must meet four requirements to be qualified property eligible for bonus depreciation:
 - 1) The depreciable property must be of a specified type;
 - 2) The original use of the depreciable property must commence with the taxpayer or used depreciable property must meet the acquisition requirements of Section 168(k)(2)(E)(ii);
 - 3) The depreciable property must be placed in service by the taxpayer within a specified time period or must be planted or grafted by the taxpayer before a specified date (i.e., refer to dates in previous table to determine the applicable bonus depreciation percentage); and
 - 4) The depreciable property must be acquired by the taxpayer after September 27, 2017.

Property of a Specified Type – In General

- Qualified property must be one of the following:
 - 1) MACRS property that has a recovery period of 20 years or less
 - 2) Computer software
 - 3) Water utility property
 - 4) Qualified film or television production
 - 5) Qualified live theatrical production
 - 6) Specified plant (i.e., any tree or vine that bears fruits or nuts)
- For qualified film, television, and live theatrical productions, direct production costs and acquisition costs are eligible for bonus depreciation in the hands of the owner, so long as the production was acquired before the initial date of release (or initial live staged performance).
- A live theatrical performance is considered placed in service when it begins commercial exhibition (i.e., performance in front of paying audiences and not exhibitions to attract further funding or to determine if the production should proceed).

Property of a Specified Type – Retail Glitch

- Qualified property used to include qualified leasehold improvements, qualified restaurant property, and qualified retail improvement property, which all related to making improvements to nonresidential property.
 - Improvements to nonresidential property are usually required to be depreciated over 39 years, but these three categories were given a 15-year life so that they became eligible for bonus depreciation.
 - These categories were difficult for landlords to utilize because of lease requirements, related party prohibitions, and square footage rules. A building also had to be at least three years old before any qualifying improvements could be made.
- In 2015, Congress added a fourth class called qualified improvement property (“**QIP**”). QIP did not have the same definitional issues as the previous three classes since it covered any improvement made to the interior of a nonresidential building any time after the building was placed in service.
 - QIP still had a 39-year life, but Section 168(k) was amended to allow bonus depreciation for property meeting the definition of QIP.
 - Therefore, qualified property separately included assets with a life of 20 years or less and QIP.
- What Was Supposed to Happen: The goal of the TCJA was to simplify these nonresidential property improvement classes by eliminating qualified leasehold, restaurant, and retail property and consolidating everything into QIP. QIP, in turn, would be given a 15-year life.
 - What They Got Wrong: When the TCJA was drafted, Section 168(e) was never amended to give QIP a 15-year life.
 - What They Got Right: Since QIP was supposed to have a 15-year life, QIP was removed as a separate item from the list of bonus-eligible assets because it was supposed to fall under the “20 years or less” catch-all.
 - The Consequence: Based on the way that Section 168(k) is written right now, QIP is not eligible for bonus depreciation and must be depreciated over 39 years.
- The Final Regulations state that a legislative change is required in order to correct this mistake. A technical corrections bill has not been passed yet.

New and Used Property

- New Property
 - “Original use” of the property begins with the taxpayer
 - Defined to mean the first use to which the property is put, whether or not that use corresponds to the use of the property by the taxpayer
- Used Property
 - Must meet three acquisition requirements:
 - 1) The property was not used by the taxpayer or a predecessor at any time prior to the acquisition;
 - 2) The acquisition of the property meets the related party and carryover basis requirements of Section 179(d)(2)(A), (B), and (C) and Treas. Reg. Section 1.179-4(c)(1)(ii), (iii), and (iv), or Treas. Reg. Section 1.179-4(c)(2); and
 - 3) The acquisition of the property meets the cost requirements of Section 179(d)(3) and Treas. Reg. Section 1.179-4(d).

Used Property – Predecessor

- The term “predecessor” is defined as:
 - 1) A transferor of an asset to a transferee in a transaction to which Section 381(a) applies;
 - 2) A transferor of an asset to a transferee in a transaction in which the transferee’s basis in the asset is determined, in whole or in part, by reference to the basis of the asset in the hands of the transferor;
 - 3) A partnership that is considered as continuing under Section 708(b)(2);
 - 4) The decedent in the case of an asset acquired by an estate; or
 - 5) A transferor of an asset to a trust.

Used Property – Depreciable Interest

- Property is treated as being used by the taxpayer or a predecessor at any time prior to acquisition by the taxpayer or predecessor if such taxpayer or predecessor had a depreciable interest in the property at any time prior to such acquisition, whether or not such taxpayer or predecessor claimed depreciation deductions for the property.
 - “Depreciable interest” has the same meaning as in Section 167(a) (property must be used in the taxpayer’s trade or business or held by the taxpayer for the production of income) (e.g., a lessee that purchases property upon the expiration of a lease can claim bonus depreciation on such property because it did not hold a depreciable interest).
 - Only the five calendar years immediately prior to the taxpayer’s current placed-in-service year of the property are taken into account.
 - If a taxpayer acquires or places in service substantially renovated property (i.e., the cost of used parts is not more than 20% of the total cost of the substantially renovated property) and the taxpayer or predecessor previously had a depreciable interest in the property before it was substantially renovated, that taxpayer’s or predecessor’s depreciable interest is not taken into account for determining whether the substantially renovated property was used by the taxpayer or predecessor at any time before its acquisition by the taxpayer.

Used Property – 338 and 336(e) Elections

- Property deemed to have been acquired by a new target corporation as a result of either a Section 338 or 336(e) election made with respect to a qualified stock disposition not described, in whole or in part, in Section 355(d)(2) or (e)(2) is considered acquired by purchase.
- Dispositions described in Section 355(d)(2) or (e)(2) are not included because, under the sale-to-self model, old target will be treated as acquiring the assets in which it previously had a depreciable interest.

Used Property - Application to Partnerships

- Section 704(c) allocations and 734(b) adjustments do not qualify for bonus depreciation.
- In determining whether a Section 743(b) basis adjustment meets the used property acquisition requirements, each partner is treated as having owned and used the partner's proportionate share of partnership property.
- Property held by a partnership in which at least one partner is a tax-exempt entity is "tax-exempt use property" that must be depreciated using the alternative depreciation system ("**ADS**"), which renders such property ineligible for bonus depreciation.
 - However, only the tax-exempt entity's proportional share of such property is ineligible for bonus depreciation.

Date of Acquisition

- Property must be acquired by the taxpayer after September 27, 2017 or acquired by the taxpayer pursuant to a written binding contract entered into by the taxpayer after September 27, 2017.
- Property that is manufactured, constructed, or produced for the taxpayer by another person under a written binding contract that is entered into prior to the manufacture, construction, or production of the property for use by the taxpayer in its trade or business or for its production of income is self-constructed property.
 - The acquisition rules are treated as met if the taxpayer begins manufacturing, constructing, or producing such property after September 27, 2017.
 - If a component of a larger self-constructed property that is acquired under a binding written contract entered into before September 28, 2017 is more than 10% of the total cost of the property (excluding land and preliminary activities), the manufacture, construction, or production of the larger self-constructed property begins on the date on which the taxpayer paid or incurred the cost of such component.
- The acquisition date of property that the taxpayer acquired pursuant to a written binding contract is the later of:
 - 1) The date on which the contract was entered into;
 - 2) The date on which the contract is enforceable under state law;
 - 3) If the contract has one or more cancellation periods, the date on which all cancellation periods end; or
 - 4) If the contract has one or more contingency clauses, the date on which all conditions subject to such clauses are satisfied.

Use of ADS

- In general, property that is required to be depreciated under ADS is not eligible for bonus depreciation.
- However, using ADS to determine asset basis for purposes of determining the foreign derived intangible income (“**FDII**”) deduction (Section 250) or measuring global intangible low-taxed income (“**GILTI**”) (Section 951A) does not make that property ineligible for bonus depreciation.

Proposed Regulations

- REG-106808-19 will be effective on the date adopted as final regulations in the Federal Register.
- Affect taxpayers who depreciate qualified property acquired and placed in service after September 27, 2017
- Public hearing is scheduled for November 13, 2019 (topics must be received by October 23, 2019)
- The Proposed Regulations cover the following:
 - Rules relevant to the definition of qualified property
 - Rules for consolidated groups
 - Rules regarding components acquired or self-constructed after September 27, 2017, for larger self-constructed property for which the manufacture, construction, or production began before September 28, 2017
 - Rules regarding the application of the mid-quarter convention

Qualified Property

- Sale-leaseback exception: (1) If a taxpayer acquires and places in service property, (2) the taxpayer or a predecessor did not previously have a depreciable interest in the property, (3) the taxpayer disposes of the property to an unrelated party within 90 calendar days after the date the property was originally placed in service by the taxpayer, and (4) the taxpayer reacquires and again places in service the property, the taxpayer's depreciable interest in the property during that 90-day period is not taken into account for determining whether the property was used by the taxpayer or a predecessor at any time prior to its reacquisition by the taxpayer.
 - To prevent churning assets, this proposed rule does not apply if the taxpayer reacquires and again places in service the property during the same taxable year the taxpayer disposed of the property.
- Related transactions rule: In the case of a series of related transactions, the relationship between the parties is tested immediately after each step in the series, and between the original transferor and the ultimate transferee immediately after the last transaction in the series.
 - A party in the series that is neither the original transferor nor the ultimate transferee is disregarded in applying the relatedness test if the party placed in service and disposed of the property in the party's same taxable year or did not place the property in service.

Consolidated Groups

- A member of a consolidated group that acquires depreciable property is treated as having a prior depreciable interest in such property if the consolidated group had a depreciable interest at any time prior to the member's acquisition of the property.
- A member of a consolidated group is treated as having a depreciable interest in the property prior to the time of its acquisition if, as part of a series of related transactions, the property is acquired by a member of a consolidated group and a corporation that had a depreciable interest in the property becomes a member of that consolidated group.
 - A departing member does not continue to have a depreciable interest in the property unless it actually owned such property.
- If a member of a consolidated group acquires depreciable property from another member of the same consolidated group (the "**Selling Group**") in a taxable transaction, and if the transferee member ceases to be a member of the Selling Group in a series of related transactions that includes the property acquisition within 90 calendar days of the date of the property acquisition, then
 - 1) The disposition and acquisition of the property are treated as occurring one day after the date on which the transferee member ceases to be a member of the Selling Group (the "**Deconsolidation Date**") for all federal income tax purposes, and
 - 2) The transferee member is treated as placing the depreciable property in service not earlier than one day after the Deconsolidation Date for purposes of claiming the depreciation or the investment credit.
- Deemed acquisitions of property are treated the same as actual acquisitions of property. This rule applies if (1) the transferee member acquires the stock of another member of the same group that holds depreciable property ("**Target**") in a qualified stock purchase or a qualified stock disposition for which a Section 338 or 336(e) election is made, and (2) the transferee member and Target cease to be members of the consolidated group within 90 calendar days of the acquisition date or disposition date as part of the same series of related transactions that includes the acquisition.

Acquisition of Property and Components

- A contract to acquire all or substantially all of the assets of a trade or business or to acquire an entity is binding if it is enforceable under state law against the parties to the contract.
 - The presence of a condition outside the control of the parties will not prevent the contract from being binding (e.g., regulatory approval).
 - The fact that insubstantial terms remain to be negotiated by the parties to the contract or that customary conditions remain to be satisfied does not prevent the contract from being binding.
- The acquisition date of property that is acquired other than pursuant to a binding written contract is the date on which the taxpayer paid or incurred more than 10% of the total cost of the property, excluding the cost of any land and preliminary activities.
- For components of larger self-constructed property for which the manufacture, construction, or production of the larger self-constructed property began before September 28, 2017, a taxpayer can elect to treat one or more components acquired or self-constructed after September 27, 2017 as being eligible for bonus depreciation.

Mid-Quarter Convention

- In determining whether the mid-quarter convention applies for a taxable year under Section 168(d)(3) and Treas. Reg. Section 1.168(d)-1, the depreciable basis for the taxable year the qualified property is placed in service by the taxpayer is not reduced by the allowed or allowable bonus depreciation for that taxable year.

Contact Information

For more information about this presentation, please contact:

Morris, Manning & Martin, LLP
1600 Atlanta Financial Center
3343 Peachtree Road, NE
Atlanta, Georgia 30326

Anna Twardy

atwardy@mmmlaw.com

(404) 364-3184

