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PARTNERS BEYOND BOUNDARIES

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US FEDERAL TAX ALERT

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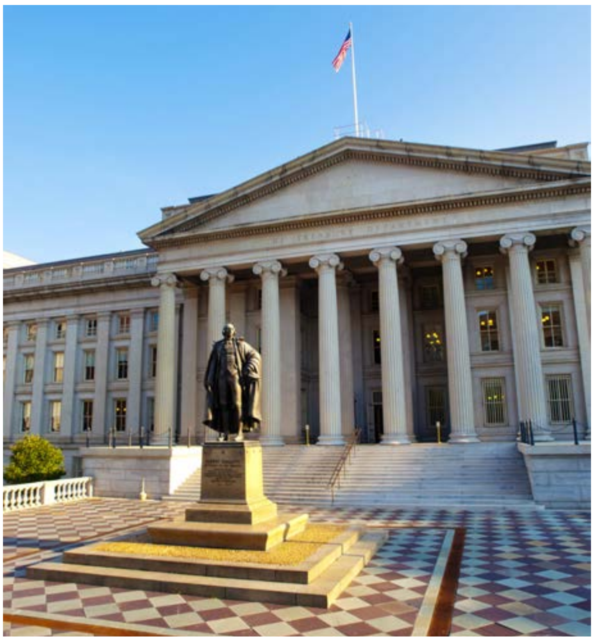
Proposed Regulations released by the IRS provide additional guidance on bonus depreciation under IRC section 168(k).

On August 8, 2018, the IRS issued proposed regulations addressing changes made by the Tax Cuts and Jobs Act (TCJA) to bonus depreciation (the additional first-year depreciation deduction under IRC section 168(k)). Proposed regulations affect taxpayers who claim depreciation with respect to qualified property acquired and placed in service after September 27, 2017.



The TCJA made favourable changes to the depreciation rules under IRC section 168(k). Prior to the enactment of TCJA, the IRC section 168(k) provided an immediate write-off of 50 percent of the cost of certain qualifying property for the tax year in which the property was placed in service by the taxpayer. This is, provided the property was not previously being used by any person in a trade or business. The TCJA amended IRC section 168(k) to increase the amount of the immediate deduction to 100 percent of qualified property's cost, acquired after September 27, 2017, and for the first time, allows taxpayers to claim bonus depreciation on "used" property.

A summary of the guidance and the proposed regulations is presented below.

The proposed regulations (IRC section 1.168(k)-2) describe and clarify the statutory requirements that must be met for depreciable property to qualify for the additional first year depreciation deduction provided by IRC section 168(k).

ELIGIBLE PROPERTY:

The proposed regulations provide that depreciable property must meet following requirements to be treated as qualified property for bonus depreciation purposes:

- The depreciable property must be of a specified type (i.e. a MACRS property having a recovery period of 20 years or less.)
- The original use of the depreciable property must commence with the taxpayer or used depreciable property must meet the acquisition requirements
- The depreciable property must be acquired and placed in service by the taxpayer after September 27, 2017

QUALIFIED IMPROVEMENT PROPERTY:

The TCJA introduced new category "Qualified Improvement Property (QIP)" to replace the prior categories of qualified restaurant property, retail property, and leasehold improvement property. The replaced qualified categories did originally qualify for bonus depreciation. However, due to what is considered as a drafting error, the TCJA removed QIP from the list of qualified property for bonus depreciation purposes.

The TCJA amended IRC section 168(e) to eliminate the 15-year MACRS property classification for qualified improvement property and accordingly the QIP is assigned a 39-year recovery period and is not eligible for bonus depreciation. Because of the effective date of the amendment, 100% bonus depreciation can still be claimed on the QIP acquired by the taxpayer after September 27, 2017 until December 31, 2017. However, no bonus depreciation can be claimed on the QIP acquired by the taxpayer after December 31, 2017.

BONUS DEPRECIATION ON USED PROPERTY:

Previously, the taxpayer was eligible to claim bonus depreciation only on the property which was not previously being used by any person in a trade or business. However, the proposed regulations provide that the acquisition of used property is also eligible for the additional first year depreciation deduction. This is, if the property was not previously used by the taxpayer or a predecessor and such property was not acquired from a related party.

Accordingly, the qualified used property acquired by the taxpayer in an asset acquisition or in an acquisition, for which an IRC section 338(h)(10) election (deemed asset acquisition) has been made, shall also be eligible for 100% bonus depreciation. This increases the incentive for buyers to structure taxable acquisitions as actual or deemed asset purchase, rather than stock acquisitions by enabling the purchasing entity in an asset acquisition to immediately deduct a significant component of the purchase price and potentially generate an immediate tax benefit.

DATE OF ACQUISITION – WRITTEN BINDING CONTRACT:

The proposed regulations provide that the 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.

SELF-CONSTRUCTED PROPERTY

- In case of property that is constructed by the taxpayer, the property is treated as acquired when the taxpayer begins manufacturing, constructing, or producing the property. Regs 1.168(k)-1(b)(4)(iii) provides a safe harbor that permits a taxpayer to determine the acquisition date as the date on which more than 10% of the total cost of the property has been incurred.

Where property is manufactured, constructed, or produced for the taxpayer by a third party, under a written binding contract that is entered prior to the manufacture, construction, or production of the property, is treated as acquired pursuant to a written binding contract. In such case, a taxpayer that entered into a written binding contract with a third-party contractor prior to September 28, 2017, to construct property on its behalf will not be eligible to claim 100% bonus depreciation on such property, even if construction begins after September 27, 2017.

IMPACT ON PARTNERSHIPS:

The proposed regulations provide the following clarification regarding the application of the bonus depreciation provisions to partnerships:

- Section 734(b) or section 732 basis adjustments (on distribution of property to a partner by a partnership) are not eligible for bonus depreciation because they do not meet the original use or used property requirements, as the partnership will have used the property prior to making the distribution giving rise to the adjustment.

  Bonus depreciation will not be allowable for remedial allocations in case of property contributed by partners to the partnership where fair market value of the contributed property exceeds the tax basis in the hands of partners.

- Bonus depreciation shall also not be allowed on property contributed to the partnership with a zero adjusted tax basis, because with the additional first year depreciation deduction, the partners may have the potential to shift built-in gain among partners.

- Section 743(b)(1) provides that, in the case of a transfer of a partnership interest, either by sale or exchange or as a result of the death of a partner, a partnership that has a section 754 election in effect will increase the adjusted basis of partnership property by the excess of the transferee's basis in the transferred partnership interest over the transferee's share of the adjusted basis of partnership's property. This increase is an adjustment to the basis of partnership property with respect to the transferee partner only and, therefore, is a partner-specific basis adjustment to partnership property. Prior to the TCJA, a section 743(b) adjustment would always fail the original use requirement as the property would have been previously used by the partnership and its partners prior to the transfer that gave rise to a section 743(b) adjustment. After the act, while a section 743(b) basis adjustment still fails the original use clause, a transaction giving rise to a section 743(b) basis adjustment may satisfy the used property clause if the transaction is between unrelated parties.

AMENDMENT TO IRC SECTION 179:

A taxpayer may elect to expense the cost of any IRC section 179 property and deduct it in the year the property is placed in service. The TCJA modified the IRC section 179 expensing election to increase the maximum amount that may be deducted to $1 million (up from $500,000). The deduction to be claimed under IRC section 179 is reduced dollar-for-dollar to the extent the total cost of assets (eligible for IRC section 179 property) placed in service during the tax year exceeds $2.5 million (up from $2 million) (the phase-out amount). The changes are effective for property placed in service in tax years beginning after 2017.

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