Implementing the Bonus Depreciation Regulations

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Section 168(k) Background

• Section 168(k) amended by the TCJA to increase bonus depreciation to 100% for qualified property acquired and placed in service after September 27, 2017 and before January 1, 2023
  • Phases down by 20% beginning in 2023 (extra year for longer production period property (LPPP) and certain aircraft)
  • Qualified property acquired pre-September 28, 2017, and placed in service in 2018 and 2019, 40% and 30% bonus eligible (extra year for LPPP and certain aircraft)

• Property eligible for 100% bonus depreciation must be
  • Qualified property
  • Original use or certain used property
  • Acquired after September 27, 2017 (including acquisition pursuant to a written binding contract in effect on such date)
  • Placed in service before January 1, 2023 (subsequent years’ percentage is phased down)
Section 168(k) Regulatory Guidance

• On August 3, 2018, Proposed Regulations ("2018 Proposed Regulations") issued as reliance guidance for property placed in service acquired and placed in service after September 27, 2017

• On September 24, 2019, Final Regulations and 2019 Proposed Regulations issued under section 168(k)
  • The Final Regulations apply to property placed in service during or after the tax year that includes September 24, 2019, but taxpayers may rely on the Federal Regulations, if applied in their entirety, for property acquired and placed in service after September 27, 2017
  • The 2019 Proposed Regulations are reliance guidance, if applied in their entirety, for property acquired and placed in service after September 27, 2017
Qualified Property

• Under the Final and 2019 Proposed Regulations, Qualified Property includes—

• Property leased to a trade or business described in section 168(k)(9) (trade or business with floorplan financing indebtedness or certain regulated public utilities) by lessors not in such trades or businesses

• Property described in section 168(k)(9)(B), if floorplan financing interest is not taken into account by a trade or business that has had floorplan financing indebtedness because there is no section 163(j) limitation taking into account only business interest income and 30 percent of adjusted taxable income
  • Determination of whether a trade or business has had floorplan financing indebtedness made annually

• Certain regulated utility property acquired on or before September 27, 2017
Qualified Property (Cont.)

• 2019 Proposed Regulations adopted the first JCT example regarding the ability to claim bonus depreciation but not the second –
  • Taxpayers may claim bonus depreciation if their total interest expense (including floor plan financing) is less than the sum of their interest income and 30% of their ATI
  • Taxpayers whose interest expense exceeds this threshold cannot elect to forego deducting their floor plan interest expense in favor of claiming bonus depreciation

• What is the rationale for adopting the first example but not the second?
  • Any consideration in changing the position on the second example?

• Proposed Section 163(j) Regulations provide that depreciation, amortization and depletion included in COGS is not be added back in computing ATI

• Any consideration in changing this position in the Final Section 163(j) Regulations?
Used Property – “Depreciable Interest”

• Taxpayer and predecessor not considered to have used property at any time prior to acquisition so long as taxpayer and predecessor(s) maintained no depreciable interest in the property for the five calendar years immediately proceeding year the property was placed in service
• Partner is considered to have depreciable interest in property in proportion to its ownership in the partnership, and five-year lookback rule applies
• In determining whether a taxpayer has a prior depreciable interest, where property is acquired in a series of related party transactions, any party in a series that is neither the original transferor nor the ultimate transferee is disregarded in applying the relatedness test
• Certain section 168(i)(7) transfers are disregarded in applying the relatedness test in a multi-step transfer.
 Used Property – “Depreciable Interest”

• 2019 Proposed Regulations provide an exception for assets held for less than 90 days
  • A taxpayer is not considered to have a prior depreciable interest in property if the taxpayer disposes of the property to an unrelated party within 90 calendar days after the property was originally placed-in-service by the taxpayer and the taxpayer later re-acquires and places the property in service
  • This rule does not apply if the property is re-acquired and placed in service in the same calendar year as the prior disposition
  • The “same calendar year” limitation is to “prevent the churning of assets” per the Preamble
  
• Should property reacquired in the same tax year be eligible for bonus depreciation?
Acquisition Date

• Qualified property is property that is acquired after September 27, 2017 (including acquisition pursuant to a written binding contract in effect on such date)

• The 2019 Proposed Regulations provide that the acquisition date for property (that is not self-constructed property) the acquisition date is the date on which the taxpayer paid or incurred more than 10 percent of the total cost of the property

• The 2019 Proposed Regulations provide that contracts for the purchase of substantially all of the assets of a trade or business are treated as binding if the contract is enforceable under state law

• The presence of a condition outside of the taxpayer’s control (e.g., regulatory approval) does not prevent the contract from being binding

• Continued negotiation regarding insubstantial contract terms does not prevent contract from being binding
The Final Regulations provide that the acquisition date of property acquired pursuant to a written binding contract is the later of:

- Date contract is entered into,
- Date contract is enforceable under state law,
- Date all cancellation periods end, or
- Date all contingency clauses are satisfied

A cancellation period is the number of days under the contract terms for any party to cancel the contract without penalty.

A contingency clause is a condition or action within the control of the party or predecessor.
Self-constructed property is—
- Property manufactured, constructed, or produced by taxpayer for its own use, or
- Property manufactured, constructed, or produced by a third-party for taxpayer’s use under a written binding contract entered into prior to the manufacture, construction, or production of such property

The Final Regulations provide that the acquisition date of self-constructed property (whether or not pursuant to a written binding contract) is the date—
- Physical work of a significant nature begins, or
- Under the safe harbor, when the taxpayer has paid or incurred 10% of the total cost of the self-constructed property (excluding land and preliminary activities)
Acquisition Date – Component Election

- The 2019 Proposed Regulations permit taxpayers to elect to treat one or more components of a larger self-constructed property that are acquired or self-constructed after September 27, 2017, as eligible for 100% bonus depreciation
  - Larger unit of property must be eligible for bonus depreciation under pre-TCJA law and taxpayer must have begun construction of such larger unit of property before September 28, 2017
  - Applies to components acquired pursuant to a written binding contract entered into after September 27, 2017
  - Applies to self-constructed components if construction of the component begins after September 27, 2017
  - Installation costs (including labor) to install a component of a larger self-constructed property are eligible for bonus depreciation only if the components being installed meet the component election eligibility requirements
• Does not apply to larger acquired or self constructed property that is—
  • Placed in service before September 28, 2017,
  • Placed in service after 12/31/19 (or 12/31/20 for certain longer production period (“LPP”) or transportation property),
  • Not original use property under pre-TCJA section 168(k),
  • Described in section 168(k)(9),
  • Described in section 168(g)(1)(F) (electing farming business) or section 168(g)(8) (electing real property trade or business),
  • Qualified Improvement Property, or
  • Any property included in any class of property that taxpayer made an election not to claim bonus depreciation
Component Election (cont.)

• Bonus depreciation for the component is determined by multiplying the basis in the component by the bonus depreciation percentage for the placed-in-service taxable year of the larger self-constructed property

• Election made by attaching statement to the timely-filed return (including extensions) for the placed in service year
  • Include affirmative statement and whether the election is for one or more component(s)
  • Election is made separately by each person that owns qualified property (e.g., each member of a consolidated group)
Component Election (cont.)

• Under the 2019 Proposed Regulations, in order to be eligible to make a component election with respect to a larger property, the larger property must be eligible for bonus depreciation
  • Example: Taxpayer begins construction on a building and more than 10% of the total project costs were incurred prior to September 27, 2017. The property is completed and placed-in-service in 2018 and taxpayer performs a cost segregation study on the building.
  • Are the components of the building acquired after September 27, 2017 that are classified as tangible personal property eligible for a component election or because the building is not “qualified property” under Section 168(k), are none of the related personal property assets are eligible for the component election?

• What is the rationale for the requirement that the larger property must be eligible for bonus depreciation?
  • Any consideration of removing this requirement and expanding the election to cover components of larger assets that are not bonus eligible?

• Why is the building considered the larger property in this scenario?
  • Does the contract language matter? Does the use of general v. sub-contractors matter?
Component Election (cont.)

- Component election currently only applies to self-constructed assets
  - Any consideration of expanding the election to apply to acquired assets?
- Procedures for making component elections for prior years
  - Considering a process other than 9100 relief to make these late elections?
Procedural Issues

• How will anticipated procedural guidance allow taxpayers to apply the Final Regulations and 2019 Proposed Regulations?
  • Change from 2018 Proposed Regulations to Final Regulations
  • Change from current method to 2019 Proposed Regulations
  • Similar guidance to Rev. Proc. 2019-33 that provided a “do-over” for 2017 elections?
  • Considering retroactive method changes to account for tax rate change between 2017 and 2018?

• Sample fact patterns:
  • Taxpayers with third-party constructed property that relied on the written binding contract rules in 2018 Proposed Regulations
    • Permissible-to-permissible method? Section 481(a) adjustment?
  • Taxpayers with floor plan financing that did not apply Bluebook example adopted in 2019 Proposed Regulations rule and did (or did not) elect out of bonus—how will the guidance address the interplay with Section 163(j)?
  • Taxpayers with floor plan financing that followed the second example in the Bluebook and claimed bonus depreciation in lieu of floor plan interest —how will the guidance address the interplay with Section 163(j)?
QUESTIONS?