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IRS Floats Rules On Enhanced Depreciation Tax Deduction

By **Amy Lee Rosen**

Law360 (August 3, 2018, 4:42 PM EDT) -- The Internal Revenue Service on Friday released proposed regulations clarifying the requirements that must be met for property to qualify for an enhanced depreciation deduction provided in the federal tax overhaul.

The Tax Cuts and Jobs Act expanded bonus depreciation under Internal Revenue Code Section 168(k) to allow for a 100 percent first-year deduction for the cost of qualified property. Among other things, the proposed rules described and clarified the statutory requirements that must be met for depreciable property to qualify for the tax break. The regulations also set out rules that apply to consolidated groups and partnerships in relation to the deduction.

The IRS' new regulations require depreciable property to be of a specified type. (AP)

“The proposed regulations follow Section 168(k)(2), as amended by the act, and Section 13201(h) of the act to provide that depreciable property must meet four requirements to be qualified property,” the IRS and U.S. Department of Treasury said.

The new regulations require depreciable property under Section 168(k) to be of a specified type, that the original use must start with the taxpayer or that used property must meet the seven acquisition requirements, the property has to be placed in service in a certain time frame and it must have been acquired by the taxpayer after Sept. 27, 2017, the government said.

David K. Burton, a partner at Mayer Brown LLP, told Law360 on Friday he was pleased with the effective date provision.

“The effective date provision enables taxpayers to rely on the proposed regulations prior to the promulgation of final regulations,” Burton said. “This is a sensible approach given the many questions the amendments made to Section 168(k) in the Tax Cuts and Jobs Act created for taxpayers.”

The regulations explained a “specified type” of property must be one of six types, which range from Modified Accelerated Cost Recovery System, or MACRS, property with a recovery period of 20 years or

less, to certain types of computer software, water utility property, certain qualified film or television production, qualifying live theatrical productions or a specified plant, the government said.

When determining whether it is a new property, the government said it generally retains the original rules from Section 1.168(k)-1(b)(3) and said the regulations will not provide a date by which the original use of the property must start with the taxpayer.

Meanwhile, used property can only receive the depreciation deduction if it was not used by the taxpayer or a predecessor at any time before the acquisition, the acquisition of the property meets certain party and carryover basis requirements under IRC Section 179(d)(2) and the acquisition of the property meets certain cost requirements under IRC Section 179(d)(3) and regulation 1.179-4(d), the IRS said.

Treasury said the regulations will treat property that is used only if the taxpayer had a depreciable interest in it at any time before the acquisition, regardless of if the taxpayer or predecessor claimed depreciation deductions.

If a taxpayer has a depreciable interest and acquires an extra depreciable interest, the regulations will also allow that the additional interest to not be treated as previously used by the taxpayer. But if a taxpayer holds the depreciable interest, sells that portion and acquires an interest in another portion of the same property, that will be considered as having a depreciable interest, the IRS said.

“The Treasury Department and the IRS request comments on whether a safe harbor should be provided on how many taxable years a taxpayer or a predecessor should look back to determine if the taxpayer or the predecessor previously had a depreciable interest in the property,” the government said. “Such comments should provide the number of taxable years recommended for the look-back period and the reasoning for such number.”

After the proposed regulations are published in the Federal Register there will be a 60-day comment period open to the public to weigh in on the regulation.

The government also examined how the rules applied to members of a consolidated group, who are generally treated as separate taxpayers, the regulations said.

“The Treasury Department and the IRS believe that the additional first-year depreciation deduction should not be permitted to members of a consolidated group when property is disposed of by one member of a consolidated group outside the group and subsequently acquired by another member of the same group because permitting such a deduction would not clearly reflect the group’s income tax liability,” the government said.

As such, a consolidated group will be treated as if it has a depreciable interest in a property if any past or present member of that group had a depreciable interest in that property while a member of the consolidated group, Treasury said. The government noted that the additional first-year depreciation will not be allowed when one or more members of the consolidated group acquire both the stock of a corporation that used to have a depreciable interest in the property and the property itself.

In the area of partnerships, the guidance said under the remedial allocation method, the amount in the partnership’s book basis in the contributed property that is greater than the adjusted tax basis is recovered using any type of recovery period and depreciation.

However the remedial allocations that occur under IRC Section 704(c) will not qualify for the additional first-year depreciation deduction, and this also applied in the case of revaluations of partnership property, the government said.

Burton explained that the regulations curtail some of the possible opportunities in partnership planning that tax practitioners had been debating.

“For instance, used property contributed to a partnership is not eligible for bonus depreciation; further, adjustments under Section 704(c) to reflect differences between the basis of contributed used property and the fair market value of such property are not eligible for bonus depreciation,” he said. “Finally, used property distributed to partners is not eligible for bonus depreciation.”

The regulations explained that the syndication transaction rule allows for either new or used property to be deductible if a lessor has a depreciable in the property and did the lessor or predecessor had no previous interest in the property, the property is sold by the lessor within three months after the property was originally placed in service, and the property lessee after the sale remains the same as when the property was put in service by the lessor, but the taxpayer is the person who acquired the property and originally placed it in service, the IRS said.

“If a transaction is within the rules described above, the purchaser of the property in the last sale during the three-month period is eligible to claim the additional first-year depreciation for the property — assuming all requirements are met — and the earlier purchasers of the property are not,” the government said.

To calculate the additional first-year deduction, that is simply equal to the applicable percentage defined in IRC Section 168(k)(6) of the unadjusted depreciable basis of the property, the regulations said.

This deduction is allowed for both alternative minimum tax and regular tax purposes, the government said.

Bonus depreciation had been on the government’s updated priority watch list since February, and in May an official said to expect guidance over the summer.

“The Tax Cuts and Jobs Act is making it easier for businesses of all sizes to grow and create jobs for hardworking Americans,” Treasury Secretary Steven T. Mnuchin said in a news release Friday. “This expensing provision will be a key driver in creating greater business investment and growth.”

--Editing by Robert Rudinger and Neil Cohen.

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