

# Bonus Depreciation for 2017 and Beyond

## Tax Advisory Group

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The “Protecting Americans from Tax Hikes Act of 2015” (i.e., the 2015 PATH Act) extended and expanded an important tax provision for business: bonus depreciation.

“Qualified improvement property” defines what type of real property is eligible for bonus depreciation. It is not an asset class on its own.

Businesses are allowed to deduct the cost of capital expenditures over time according to depreciation schedules. In previous legislation, Congress allowed businesses to more rapidly deduct capital expenditures of most new tangible personal property, and certain other new property, by permitting an additional first-year write-off of the cost. For qualified property placed in service before Jan. 1, 2015, the additional first-year depreciation was 50 percent of the cost. The new law extended additional first-year depreciation for investments placed in service during 2015 through 2019 (with an additional year for the longer production period property and aircraft). The bonus depreciation percentage is 50 percent for the remainder of 2017 and phases down to 40 percent in 2018, and 30 percent in 2019. However, for the long production period property and aircraft, the 40 percent and 30 percent rates apply instead in 2019 and 2020 respectively.

Generally, to qualify for bonus, the property must be (1) tangible depreciable property with a recovery period of 20 years or less; (2) water utility property; (3) computer software; or (4) qualified improvement property. Also, the original use of the property must commence with the taxpayer; used property does not qualify.

### QUALIFIED IMPROVEMENT PROPERTY

“Qualified improvement property,” or “QIP,” replaces the old category of “qualified leasehold improvement property.” “Qualified improvement property” defines what type of real property is eligible for bonus depreciation. It is not an asset class on its own. The new category is broader than the old category and includes 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. The new category does not include any improvement for which the expenditure is attributable to the enlargement of the building, any elevator or escalator, or the internal structural framework of the building.

The above change treats building improvements as qualified property without regard to whether the improvements are property subject to a lease, and removes the requirement that the improvement be placed in service more than three years after the date the building was first placed in service. These were requirements for 2015 and prior to meeting the definition of qualified leasehold improvements. This concept is still in existence to determine the use of a 15-year life and straight-line depreciation, but is no longer applicable to the concept of bonus depreciation.

Improvements to rentals, condominiums, nursing homes, apartments buildings, etc., which use a 27.5-year life cannot use the QIP designation.

Under these new more relaxed rules, if improvements are made to a 39-year property after the building is placed in service and otherwise qualify as QIP, the 39-year property can be eligible for 50 percent bonus depreciation in 2017, 40 percent in 2018, or 30 percent in 2019.

This could present a planning opportunity for taxpayers putting new real estate in service in the current year. After the initial building is in service, additional renovations or improvements done in subsequent years could qualify for bonus depreciation. The initial construction does not qualify for bonus, as it would be getting the building ready for initial service to the taxpayer.

It is also important to note that this must be nonresidential property to be QIP. Improvements to rentals, condominiums, nursing homes, apartments buildings, etc., which use a 27.5-year life cannot use the QIP designation.

### **ELECTION-OUT OF BONUS DEPRECIATION FOR QUALIFIED PROPERTY IS NARROWED TO NO LONGER INCLUDE AN ELECTION OUT OF AMT RELIEF.**

Under the bonus rules, if property qualifies for the use of bonus depreciation, it is also exempt from the alternative minimum tax (AMT) depreciation adjustment, which is the adjustment that requires that certain property depreciated on the 200 percent declining balance method for regular income tax purposes must be depreciated on the 150 percent declining balance method for AMT purposes.

Bonus depreciation is mandatory unless an express election out of the method is filed with the tax returns. Prior to 2016, opting out also included opting out of the AMT relief, which created an unfavorable AMT adjustment.

For 2016 and forward, an election out of bonus is NOT an election out of AMT relief and the 200DB method will still be allowed for both regular and AMT depreciation even if bonus depreciation is opted out.

Keep in mind that there are currently many changes to the tax law that are being proposed by President Donald Trump and the GOP. Under new legislation we may be dealing with new capitalization, depreciation and AMT rules for 2017 and beyond.



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