National Association of Tax Professionals

Pros and Cons of Full Expensing (Section 179) Under the Tax Cuts and Jobs Act of 2017

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Code §179 Property Defined

- Generally defined as new or used depreciable tangible §1245 property that is purchased for use in the active conduct of a trade or business. (Code §179(d)(1))

Enter the Tax Cuts and Jobs Act of 2017

- Code §179 deduction limitations increased, qualified real property expensing expanded, lodging facility property made eligible, $25,000 limit on SUV's inflation adjusted.

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Code §179

- Generally, the cost of a depreciable item is the limitation on the §179 deduction.
- There are maximums however:
  - In 2017 deduction limit = $ 510,000
  - In 2017 investment limit = $2,030,000

Other Limits?

- Taxable Income of the ‘Entity’
- Too much eligible property placed into service?
- Can Code §179 create a loss?

Tax Cuts and Jobs Act of 2017

- The Code §179 dollar limitation is increased to $1 million and the investment is increased to $2.5 million for tax years after 2017.

- The definition of qualified real property eligible for expensing is redefined to include improvements to the interior of any nonresidential real property.

Qualified Improvement Property

- Previously, qualified real property eligible for expensing consisted of qualified leasehold improvement property, qualified retail improvement property, and qualified restaurant improvements and buildings eligible for a MACRS 15 year recovery period.

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Qualified Improvement Property

- An improvement to an interior portion of a nonresidential real property that is placed into service after the date the building was first placed into service.
- This Includes:
    - Roofs
    - Heating
    - Ventilation
    - A/C Property
    - Fire protection and Alarm Systems
    - Security Systems

Code §179 and Like Kind Exchanges

- For tax years after 2017, like kind exchanges are limited to real estate only.
- So the question becomes what happens when we exchange one business asset for another after 2017?

Answer:
Claim the proceeds allowed on the old as income and start over with depreciation on the full cost of the new asset.

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Code §179 and Like Kind Exchanges

- Example:
  - Truck purchased in 2016
  - Cost $35,000
  - §179 expensing calculated and allowed
  - Basis now = $0

- In 2018 truck is traded in for a new truck which costs $60,000.
  - $20,000 allowed for the old truck
  - $40,000 difference

Code §179 and Like Kind Exchanges

- Gain on trade: $20,000
- Previous §179: -($35,000) Basis = $0
- Tax treatment: $20,000 ordinary income as Code §1245 recapture.
  - Tax on a previous tax break—
  - No capital gain treatment

Code §179 and Like Kind Exchanges

- What about the new truck?
  - Start depreciation at $60,000 if eligible, can elect Code §179 on full $60,000 or bonus or regular depreciation whichever suits the client situation best.

Final Thought on the Older Truck

- What if we sold it outright for $40,000?
- What's the tax consequence?
  - Basis = $0 ($35,000 original cost, fully expensed)
  - Gain = $40,000
  - Taxed as: $35,000 Code §1245 recapture at ordinary income tax rates.
    - $5,000 Code §1231 gain subject to capital gains rates.
  - The $35,000 is taxed at higher rates because it is the tax on a previous tax break. The other $5,000 has never been taxed.

Code §179 Recapture

- When does that happen and how does it happen?
  - If during the normal depreciable life of a qualified Code §179 asset the business use drops to less than 50% then the difference between depreciation allowed or allowable and the amount of Code §179 claimed is added back to income from whence the deduction came.

Code §179 Recapture

5-year asset purchased in 2017	$10,000
Code §170 claimed	$10,000
Adjusted basis	$0
Normal depreciation would have been	$3,600
RECAPTURE AMOUNT	**$6,400**

In June 2018, asset given to kids. Business use drops below 50%.

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Code §179 Recapture

- Reported on Form 4797 Part IV.
- Difference between §179 claimed and regular depreciation is reported where original §179 deduction was claimed.
  - Likely Schedule C or F
  - Has potential S/E tax impact
- Income recapture amount restores that amount of basis to the asset.
- Restored basis is depreciable.

Mr. “I’m Not Doing That Business Any Longer”

- Client started a business in 2017 will full intent that this was going to be the million dollar idea.
- Client wrote off (Code §179) all of the equipment, a truck, etc., against other income on the tax return.
- Comes to see you this year. You ask about the million dollar idea and he tells you, “Yeah, I’m not doing that anymore.”

Enter the Qualified Business Income Deduction (QBI)

- 20% deduction from taxable income (overly simplified explanation) available to partners and shareholders, self employed taxpayers and some beneficiaries of trusts and estates.
- Not available for C corporations---this is a personal deduction from taxable income.
- Code §179 reduces taxable income and therefore amount eligible for the QBI.

Making the Decision

- To maximize Code §179 in a vacuum without consideration for other impacts on the taxpayer such as a reduction in QBI be a mistake?
- We decide to write off 100% of an asset under Code §179 yet is the real income tax result 80% of that amount (or less) because of the QBI—but when the asset is sold 100% of the proceeds are taxable?

Unreimbursed Employee Expenses and Code §179 in the aftermath of the Tax Cuts and Jobs Act

- For tax years after 2017, unreimbursed employee business expenses are no longer allowed.
- Many employees have business related assets that are being depreciated over time.

Unreimbursed Employee Expenses and Code §179 in the aftermath of the Tax Cuts and Jobs Act World

- What do we do for those employees with assets being depreciated?
  - Rev Proc 2008-54 allows Code §179 to be elected in or elected out for open years.
  - Consider going back to 2015-2016-2017 returns and electing Code §179 for assets placed into service during those years and Code §179 was not elected originally.
  - For other assets could de minimis safe harbors now in effect be utilized?

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