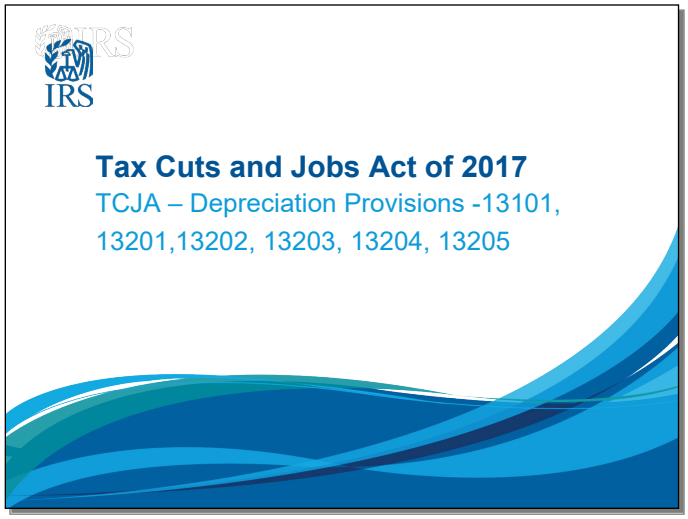
Tax Cuts and Jobs Act (TCJA)

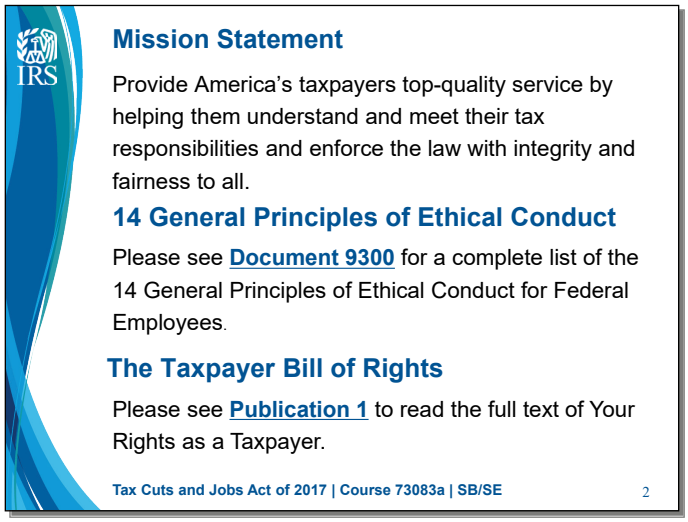
Depreciation Provisions

Provisions 13101, 13201, 13202, 13203, 13204, 13205

Slide 1 – Tax Cuts and Jobs Act of 2017



Slide 2 – Mission Statement, 14 General Principles of Ethical Conduct, The Taxpayer Bill of Rights



Slide 3 – Course Navigation

Course Navigation

1. Section 13101 – Section 179 Deduction
2. Section 13201 – Additional First Year Depreciation Deduction – Bonus Depreciation
3. Section 13202 – Depreciation Luxury Auto Limitations
4. Section 13203 – Modifications of Treatment of Certain Farm Property
5. Section 13204 – Applicable Recovery Period for Real Property
6. Section 13205 – Use of Alternative Depreciation System for Electing Farming Businesses

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 3

Slide 4 – Course Objectives

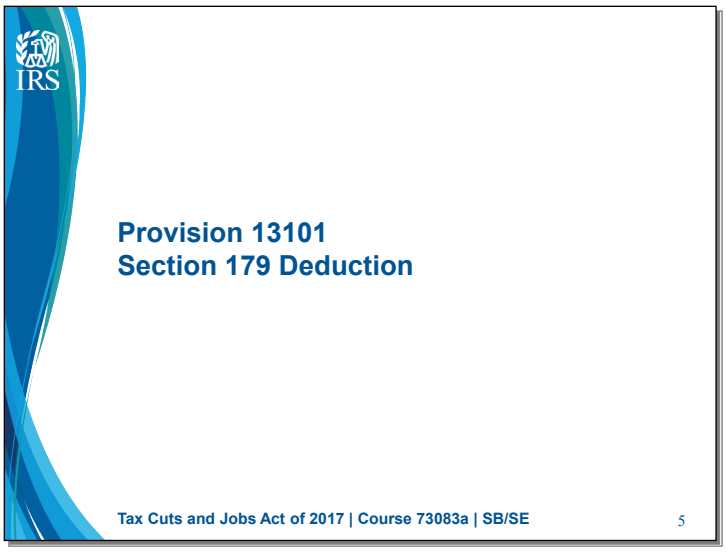
Course Objectives

By the end of this course, you will be able to:

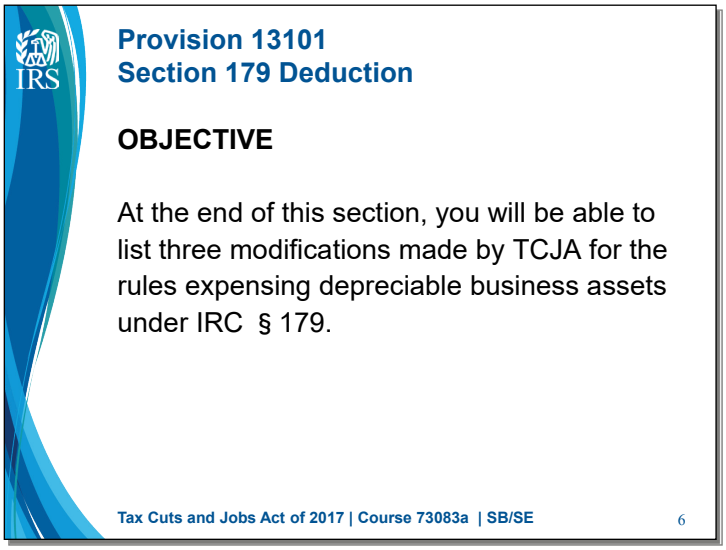
- Identify key elements of the following provisions:
  - Section 13101 – Section 179 Deduction
  - Section 13201 – Additional First Year Depreciation Deduction – Bonus Depreciation
  - Section 13202 – Depreciation Luxury Auto Limitations
  - Section 13203 – Modifications of Treatment of Certain Farm Property
  - Section 13204 – Applicable Recovery Period for Real Property
  - Section 13205 – Use of Alternative Depreciation System for Electing Farming Businesses
- Communicate critical information to taxpayers related to the listed provisions

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 4

Slide 5 – Provision 13101, Section 179 Deduction



Slide 6 – Objective



Slide 7 – References

Provision 13101
Section 179 Deduction

References

- IRC § § 179(b) and 179(d)
- Publication 946 – How to Depreciate Property
- Form 4562 Instructions
- RGS Depreciation Worksheet (currently being revised)

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 7

Slide 8 – Introduction

Provision 13101
Section 179 Deduction

Introduction

Modifications of rules for expensing depreciable business asset or Section 179 Deduction.

General Rule – allows taxpayers other than trusts, estates, and certain noncorporate lessors to elect, rather than capitalize, the cost of section 179 property purchased and placed in service during the tax year.

- Taxpayers must elect to use section 179
- Limited to amount of taxable income from any of the taxpayer's active trades or businesses
- Does not apply to investment property or property held for the production of income.

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 8

Slide 9 –Prior Law

Provision 13101 Section 179 Deduction

Prior Law

Section 179 dollar limitations vary from year to year. For tax years beginning in 2013 – 2017, limits are:

- Dollar Limit - $500,000
- Reduction Limitation - $2,000,000
- Sport Utility Vehicle Limit - $25,000

Eligible Property included:

- Tangible Personal Property (machinery, equipment, signs)
- Computer Software
- Section 1245 Property (except for buildings and structural components).
- Qualified Leasehold Improvements
- Qualified Restaurant Property
- Qualified Retail Improvements

Land and Section 1250 Land Improvements **do not** qualify.

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 9

Slide 10 – New Law

Provision 13101 Section 179 Deduction

New Law

Limitation Changes:

- Dollar Limitation - $1,000,000
- Phase-out Reduction Limitation - $2,500,000
- No change to SUV limit - $25,000

Expands Eligible Property to include:

1. Changes to Qualified Real Property
   a) Qualified Improvement Property under section 168(e)(6)
   b) The following improvements made to nonresidential real property:
      i. Roofs
      ii. HVAC
      iii. Fire protection and alarm and security systems
2. Used predominantly to furnish lodging or in connection with furnishing lodging

Effective:

- Property placed in service after December 31, 2017

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 10

Slide 11 – Question 1

Provision 13101
Section 179 Deduction
Question 1

In 2018, Marilyn Pine purchased five new refrigerators to be placed in rental properties she owns as investment property. Total cost of all five refrigerators is $15,000. How much can Marilyn elect to expense under § 179?

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 11

Slide 12 – Question 1 Answer

Provision 13101
Section 179 Deduction
Question 1 Answer:

Zero. Even though refrigerators are qualifying tangible property, § 179 does not apply to investment property (income producing activities).

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 12

Slide 13 – Question 2

Provision 13101
Section 179 Deduction
Question 2

In 2018, Jane Ash purchased, installed and placed in service 8 new industrial baking ovens in her bakery business. Total cost of all 8 ovens is $2,610,000. Jane elects to expense these ovens under IRC § 179. Compute Jane's maximum IRC § 179 deduction for 2018?

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 13

Slide 14– Question 2 Answer

Provision 13101
Section 179 Deduction
Question 2 Answer:

$890,000. Total cost of the ovens are $110,000 over the $2,500,000 threshold. Jane must reduce her maximum IRC § 179 deduction to $890,000 ($1,000,000 ($1,000,000 dollar limitation) − $110,000 (over threshold amount)).

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 14

Slide 15 – Audit Tips

Provision 13101
Section 179 Deduction

Audit Tips

- Examine invoices, receipts and contracts to ensure ownership, cost, date acquired and placed in service.
- Have the taxpayer explain the purpose of the cost.
- Ensure asset is qualified property
- Determine whether listed property limitations apply (explained later in Provision 13202).
- Section 179 deduction is limited to the taxpayer's business income from all activities.
- Ensure the taxpayer made a proper IRC § 179 election.
- Consider if depreciation recapture rules apply under IRC § 280F.

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 15

Slide 16 – Summary

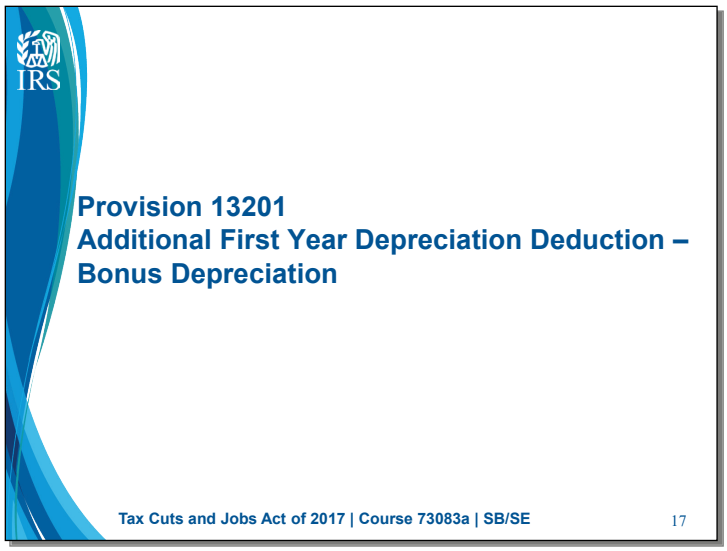
Provision 13101
Section 179 Deduction

Summary

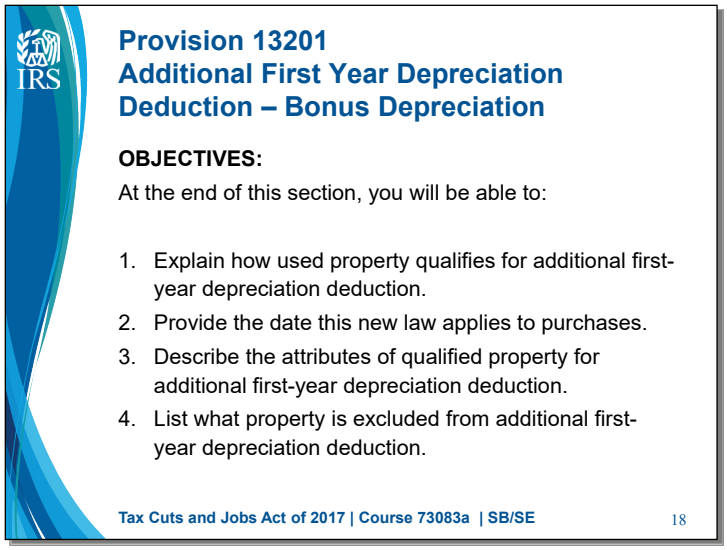
- Increased IRC § 179 deduction limit from $500,000 to $1,000,000
- Increased the IRC § 179 deduction phase-out threshold from $2,000,000 to $2,500,000
- Expands qualified property to include tangible personal property used predominantly to furnish lodging or in connection with lodging
- Expands the definition of qualified real property to include Qualified Improvement Property defined under IRC § 168(e)(6), and the following improvements to nonresidential real property placed in service after the date such property was first placed in service: **Roofs; HVAC; fire protection; alarm and security systems.**

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 16

Slide 17 –Provision 13201, Additional First Year Depreciation Deduction – Bonus Depreciation



Slide 18 – Objectives



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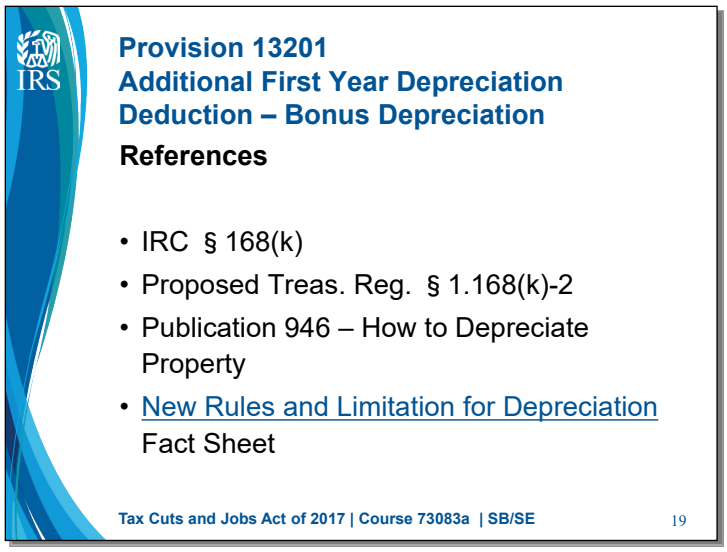
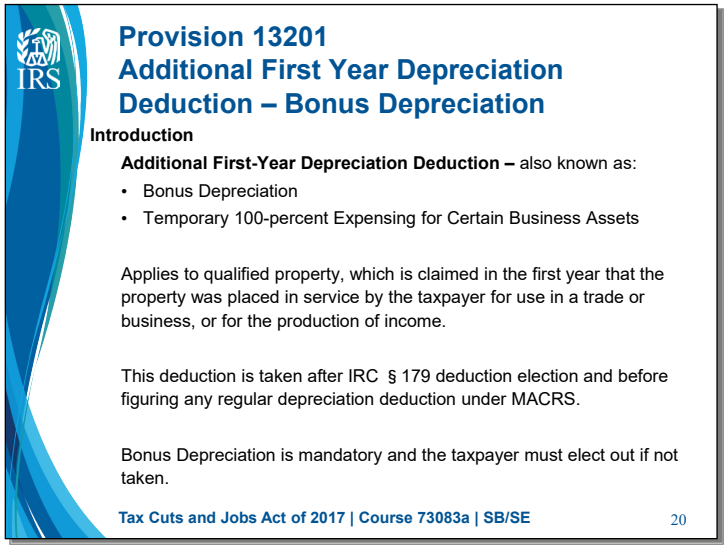


Slide 20 – Introduction



Slide 21 – Prior Law

Provision 13201
Additional First Year Depreciation Deduction – Bonus Depreciation

Prior Law

- 50% of qualified property acquired and placed in service.
- Original use must have commenced with taxpayer (no used property)
- MACRS property with 20-year life or less, including:
  - Qualified Leasehold Improvement Property (QLIP)
  - Qualified Restaurant Property (QRP)
  - Qualified Retail Improvement Property (QRIP)

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 21

Slide 22 – New Law

Provision 13201
Additional First Year Depreciation Deduction – Bonus Depreciation

New Law

- 100% for property acquired after 9/27/2017 and placed in service after 9/27/2017 and before 1/1/2023
- Removes original use requirement. Expanded to include used property if the taxpayer:
  - Or predecessor didn't use the property at any time before acquiring.
  - Didn't acquire the property from a related party.
  - Didn't acquire the property from a component member of controlled group
  - Basis of the used property is not figured in whole or in part by reference to the adjusted basis of the property in the hands of the seller or transferor
  - Basis of the used property is not figured under the provision for deciding basis of property acquired from a decedent.
  - The cost of the used property is not determined in a like-kind exchange or involuntary conversion.

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 22

Slide 23 – New Law Continued

Provision 13201
Additional First Year Depreciation Deduction – Bonus Depreciation

New Law Continued:

- Expands qualified property to include:
  - Qualified film, television and live theatrical productions
- Excludes property used to furnish or sale:
  - Electrical energy, water, or sewage disposal
  - Gas or stream distribution systems
  - Transportation of gas or steam by pipeline
  - Trade or business that provides floor plan financing indebtedness
- There are special rules for property with longer production periods and certain plants bearing fruits and nuts. See IRC § 168(k)(2)(B), (k)(2)(C), and (k)(5) for these rules.

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 23

Slide 24 – Example

Provision 13201
Additional First Year Depreciation Deduction – Bonus Depreciation

Example:

Ken Shark is a tailor. He bought two sewing machines from his father on November 9, 2017. He placed both machines in service in the same year he bought them. The machines do not qualify as additional first-year depreciation property because Ken and his father are related persons. He cannot claim additional first-year depreciation for the cost of these machines.

Had Ken acquired the machines from an un-related person he would be able to take the bonus depreciation as the law applies to property acquired and placed in service after September 27, 2017.

See Proposed Treas. Reg. § 1.168(k)-2

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 24

Slide 25 – Question 1

Provision 13201
Additional First Year Depreciation Deduction – Bonus Depreciation

Question 1:

On October 19, 2018, Pine buys a new machine for $35,000 from an unrelated party for use in Pine's business. On August 1, 2020, Birch buys that machine from Pine for $20,000 to be used in Birch's business. Birch is not related to Pine. Can Birch claim 100% additional first-year depreciation deduction? If so, how much?

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 25

Slide 26 –Question 1 Answer

Provision 13201
Additional First Year Depreciation Deduction – Bonus Depreciation

Question 1 Answer:

Birch's purchase does not satisfy the original use requirement. However, Birch does meet the requirements of "used" property in that (1) Birch did not use the property at any time prior to the acquisition, (2) there is no relationship between Birch and Pine (related taxpayer, component member of a controlled group, or decedent), and (3) the cost was not based on any like-kind exchange or involuntary conversion. Assuming all other requirements are met, Birch can deduct $20,000 as 100% additional first-year depreciation deduction.

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 26

Slide 27 – Audit Tips

Provision 13201
Additional First Year Depreciation Deduction – Bonus Depreciation

Audit Tips

- Verify that the used asset was not purchased from a related party.
- Verify both purchase date and placed in service date.
- Used property now qualifies.
- Beware of construction or produced contracts. The date the contract was entered into is the date the taxpayer acquired the property. Options and letter of intent are not binding contracts.
- Also beware of self-constructed property.
- See IRC § 168(k)(2)(B), (k)(2)(C), and (k)(5) for special rules applicable to property with longer production periods, certain aircraft, and plants bearing fruits and nuts.

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 27

Slide 28 – Summary

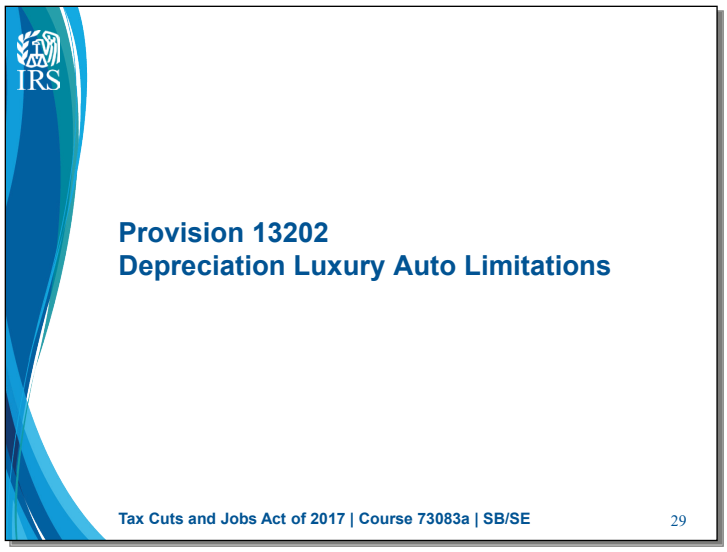
Provision 13201
Additional First Year Depreciation Deduction – Bonus Depreciation

Summary

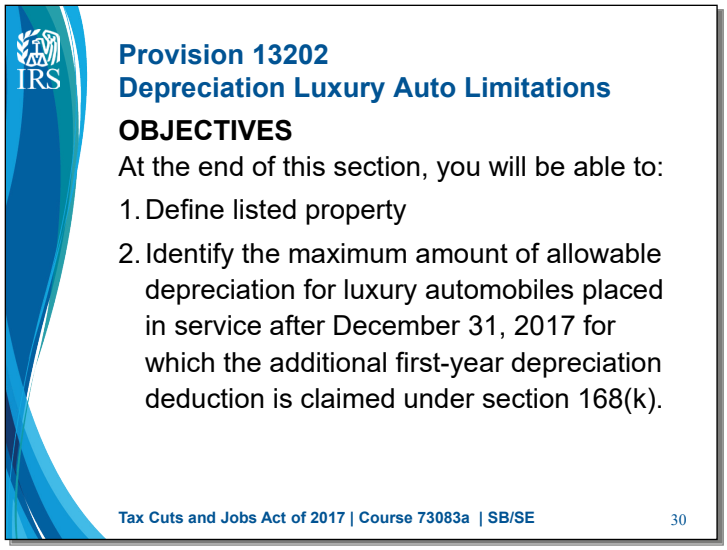
- Increases bonus depreciation from 50% to 100% for qualified property acquired after 9/27/2017 and placed in service after 9/27/2017 and before 1/1/2023.
- In additional to new qualified property, certain used property also may be qualified property.
- Expands the definition of qualified property to include qualified film, television and live theatrical productions.
- Excludes any property placed in service in any taxable year beginning after 2017, which is (1) primarily used in furnishing or sale of (a) electrical energy, water, or sewage disposal service, (b) gas or steam distribution systems, or (c) transportation of gas or steam by pipeline, or (2) used in a trade or business that has had floorplan financing indebtedness if the floor-plan financing interest was taken into account under section 163(j)(1)(C).

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 28

Slide 29 – Provision 13202, Depreciation Luxury Auto Limitations



Slide 30 –Objectives



Slide 31 – References

Provision 13202
Depreciation Luxury Auto Limitations

References

- IRC § § 280F(a) and 280F(b)
- Publication 946 – How to Depreciate Property
- Publication 463 – Travel, Entertainment, Gift and Car Expenses
- Revenue Procedure 2018-25 (table with limits)
- Revenue Procedure 2019-13

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 31

Slide 32 – Introduction

Provision 13202
Depreciation Luxury Auto Limitations

Introduction

MACRS depreciation deductions, including the additional first-year depreciation deduction and section 179 expense election are limited for "listed property." Listed property includes:

1. Passenger automobiles,
2. Any other property used for transportation, unless it is an excepted vehicle,
3. Property generally used for entertainment, recreation, or amusement (including photographic, phonographic, communication, and video-recording equipment), and
4. Computers and related peripheral equipment placed in service before 2018, unless used only at a regular business establishment and owned or leased by the person operating the establishment.

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 32

Slide 33 – Prior Law

Provision 13202
Depreciation Luxury Auto Limitations

Prior Law

Maximum Depreciation Deduction for Passenger Automobiles placed in service during 2017 without regard to bonus depreciation

1st year - $3,160 for autos, $3,560 for trucks and vans

2nd year - $5,100 for autos, $5,700 for trucks and vans

3rd year - $3,050 for autos , $3,450 for trucks and vans

4th & succeeding year - $1,875 for autos, $2,075 for trucks and vans

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 33

Slide 34 – New Law

Provision 13202
Depreciation Luxury Auto Limitations

New Law

MACRS depreciation deductions for passenger automobiles placed in service in 2018 without regard to additional first year depreciation:

- 1st year - $10,000
- 2nd year - $16,000
- 3rd year - $9,600
- 4th & succeeding year - $5,760

With additional first year depreciation:

- 1st year - $18,000 ($16,400 if acquired before September 28, 2017)
- All other years are the same as without additional first year depreciation.

Removes computer or peripheral equipment placed in service after 2017 from the definition of listed property

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 34

Slide 35 – Comprehensive Example

Comprehensive Example

On March 4, 2018, Jack bought a used car for $35,000 and placed it in service. The used car is qualified property for purposes of the additional first-year depreciation deduction. Jack uses the car 100% for his business, and he elects not to take a § 179 deduction, and does not elect to opt out of the additional first-year depreciation deduction. Jack's depreciation deduction for 2018 is $18,000, which is the depreciation limit under 280F(a)(1)(A)(i). Jack's remaining adjusted depreciable basis in the car is $17,000 ($35,000 - $18,000).

Jack adopts the safe harbor method of accounting provided by Rev Proc. 2019-13. Assume business use remains at 100%, Jack's depreciation deduction for 2019 through 2023 is computed in the following table.

Taxable Year	Depreciation limits under § 280F(a)	Depreciation deduction under the safe harbor
2018	$18,000	$18,000
2019	$16,000	$5,440 ($17,000 x .32)
2020	$9,600	$3,264 ($17,000 x .1920)
2021	$5,760	$1,958 ($17,000 x .1152)
2022	$5,760	$1,958 ($17,000 x .1152)
2023	$5,760	$ 979 ($17,000 x .0576)
Total		$31,599

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 35

Slide 36 – Audit Tips:

Provision 13202
Depreciation Luxury Auto Limitations

Audit Tips:

- Check for GVW of vehicles.
- If vehicle was used 50% or less business, verify that straight line depreciation was used.
- Look for 280F recapture when business use is not greater than 50%
- Apply Rev. Proc. 2019-13, if applicable.

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 36

Slide 37 – Summary

Provision 13202
Depreciation Luxury Auto Limitations

Summary

- Additional first-year depreciation not claimed:
  - First year - $10,000
  - Second year - $16,000
  - Third year - $9,600
  - Subsequent years - $5,760
- Additional first-year depreciation claimed:
  - First year - $18,000
  - Second year - $16,000
  - Third year - $9,600
  - Subsequent years - $5,760
- Computers are no longer “listed property”

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 37

Slide 38 – Provision 13203, Modifications of Treatment of Certain Farm Property

Provision 13203
Modifications of Treatment of Certain Farm Property

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 38

Slide 39 – Objectives

Provision 13203
Modifications of Treatment of Certain Farm Property

OBJECTIVES

At the end of this section, you will be able to identify key elements of the following provision:

- Section 13203 – Modifications of Treatment of Certain Farm Property
- Communicate critical information to taxpayers related to the listed provisions

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 39

Slide 40 – References

Provision 13203
Modifications of Treatment of Certain Farm Property

References

- IRC § 168(b)(2) and IRC § 168(e)(3)(B)(vii)
- Publication 225, Farmer's Tax Guide
- Publication 946, How To Depreciate Property
- What a Farmer Should Know for 2018 Fact Sheet on IRS.gov

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 40

Slide 41 – Introduction

Provision 13203
Modifications of Treatment of Certain Farm Property

Introduction

- For MACRS purposes, a farming business is a trade or business involving the cultivation of land or the raising or harvesting of any agricultural or horticultural commodity. IRC § 263A(e)(4)
- Examples (non-inclusive list):
  - Animals held for breeding (e.g., cattle, horses, chickens)
  - Beef cattle ranching
  - Dairy farm
  - Fish farm
  - Growing crops (e.g., fruits, vegetables, grains, nuts, vineyard)
  - Nursery
  - Sod farm
  - Vineyard

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 41

Slide 42 – Prior Law

Provision 13203
Modifications of Treatment of Certain Farm Property

Prior Law

150% declining balance required:

- **All** property used in a farming business, except real property
- Nonfarm 15 and 20-year property
- Election to use method for 3, 5, 7, and 10-year nonfarm property

Generally, 7 years recovery period for farming and machinery equipment

- Examples: Machinery and equipment used in the production of crops or vines, trees, livestock, the operation of farm dairies, etc.

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 42

Slide 43– New Law – 150% Declining Balance Method

Provision 13203
Modifications of Treatment of Certain Farm Property

New Law – 150% Declining Balance Method

150% declining balance method

- No longer required for 3, 5, 7 and 10 year farm property (includes used property)
- Continues to apply to **all** 15 or 20 year property when the straight-line method does not apply
- Continues to apply to property the taxpayer elects to use 150% declining balance method

Applies to property placed in service after Dec. 31, 2017, in taxable years ending after this date.

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 43

Slide 44 – Example 1: 150% Declining Balance Method

Provision 13203
Modifications of Treatment of Certain Farm Property

Example 1

150% Declining Balance Method

A farmer purchased **used** 10-year property on May 30, 2017. The farmer placed the property in service on February 1, 2018 in the farming business.

The taxpayer placed the property in service after December 31, 2017, therefore, the taxpayer is not required to use 150% declining balance and may use another permissible method to depreciate the 10-year property.

Note: This example does not consider depreciation deduction rules (e.g., IRC 179 and bonus depreciation) discussed earlier. The emphasis here is the proper depreciation method allowed under the new law.

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 44

Slide 45 – New Law – Recovery Period

Provision 13203
Modifications of Treatment of Certain Farm Property

New Law – Recovery Period

Farm machinery and equipment (some exclusions apply)

- Recovery period reduced from 7 to 5 years, if the original use of the property begins with the taxpayer after Dec. 31, 2017
- Does not include used property
- Excludes grain bins, cotton ginning assets, fences, and other land improvements

Applies to farming machinery and equipment placed in service after Dec. 31, 2017

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 45

Slide 46 – Example 2: Farm machinery and equipment

Provision 13203
Modifications of Treatment of Certain Farm Property

Example 2

Farm machinery and equipment

A farmer purchased **used** equipment on December 31, 2017. The equipment was not a grain bin, cotton ginning asset, fence or other land improvement. The farmer placed the equipment in service on the farm on January 2, 2018. Should the property be treated as 5-year or 7-year property?

Although, the equipment was placed in service after December 31, 2017, the used property should be treated as 7-year property instead of 5-year property, because the property was used. The farmer was not the original user of the property.

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 46

Slide 47 – Audit Tips

Provision 13203
Modifications of Treatment of Certain Farm Property

Audit Tips

- Verify the date the asset was placed in service
- Review acquisition documents to identify whether property was used or new
- Review the depreciation schedule to determine whether the correct depreciation method(s) and recovery periods are used
- Review the Form 4562, Depreciation and Amortization, Including Information on Listed Property, to determine whether the taxpayer made any elections
- Inquire whether the taxpayer made any elections in prior years
- Reconcile the taxpayer's depreciation schedule to the Form 4562

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 47

Slide 48 –Summary

Provision 13203
Modifications of Treatment of Certain Farm Property

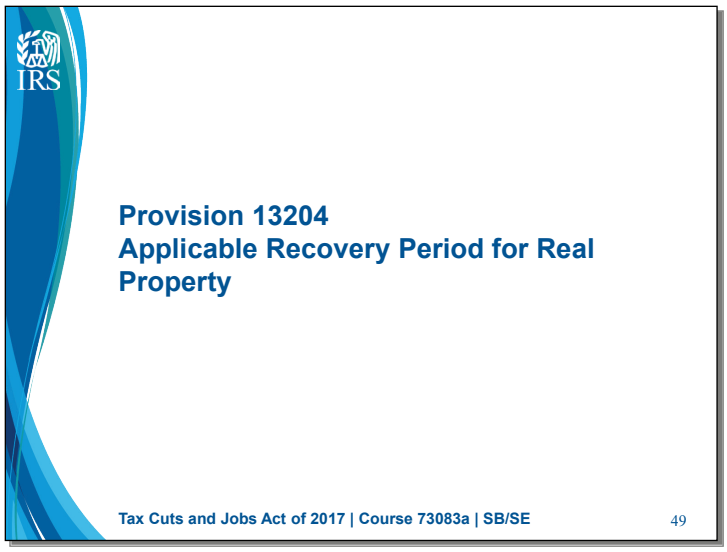
Summary

Property placed in service after December 31, 2017

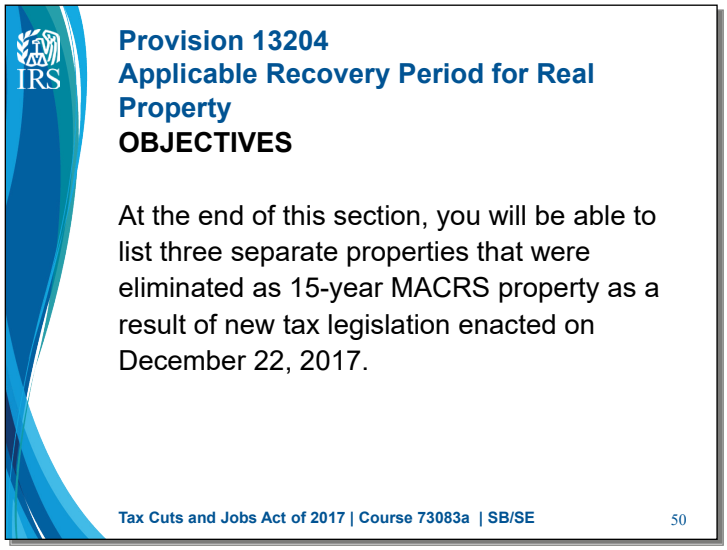
- Farmers are no longer required to use 150% declining balance for 3, 5, 7, and 10-year property (this method continues to apply to certain property)
- The recovery period for new machinery and equipment is reduced from 7 to 5 years (certain limitations apply)

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 48

Slide 49 – Provision 13204: Applicable Recovery Period for Real Property



Slide 50 – Objectives



Slide 51 – References

Provision 13204
Applicable Recovery Period for Real Property

References

- IRC § § 168(e), 168(b), 168(k)
- Publication 946 – How to Depreciate Property
- Revenue Procedure 2019-08 (Rev. Proc. 87-57 and Rev. Proc. 2018-31 are modified)

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 51

Slide 52 – Introduction

Provision 13204
Applicable Recovery Period for Real Property

Introduction

Nonresidential Property – 39 year recovery period
Residential Property – 27.5 year recovery period

Other things to consider:

- Additions and improvements to a building.
- Structural components
- Cost segregation studies

Electing Real Property Trade or Business – ADS required for certain property held

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 52

Slide 53 – Prior Law and Current Law

Provision 13204
Applicable Recovery Period for Real Property

Prior Law

168(e)(3)(E) 15-year property. The term "15-year property" includes--
(i) any municipal wastewater treatment plant,
(ii) any telephone distribution plant and comparable equipment used for 2-way exchange of voice and data communications,
(iii) any section 1250 property which is a retail motor fuels outlet,
(iv) any qualified leasehold improvement property
(v) any qualified restaurant property…,
(vi) initial clearing and grading land improvements with respect to gas utility property,
(vii) any section 1245 property used in the transmission at 69 or more kilovolts of electricity for sale and the original use of which commences with the taxpayer,
(viii) any natural gas distribution line the original use of which commences with the taxpayer, and
(ix) any qualified retail improvement property

Current Law

168(e)(3)(E) 15-year property. The term "15-year property" includes--
(i) any municipal wastewater treatment plant,
(ii) any telephone distribution plant and comparable equipment used for 2-way exchange of voice and data communications,
(iii) any section 1250 property which is a retail motor fuels outlet,
(iv) initial clearing and grading land improvements with respect to gas utility property,
(v) any section 1245 property used in the transmission at 69 or more kilovolts of electricity for sale and the original use of which commences with the taxpayer and
(vi) any natural gas distribution line the original use of which commences with the taxpayer]

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Slide 54 – New Law

Provision 13204
Applicable Recovery Period for Real Property

New Law:

Qualified Improvement Property (QIP) is now defined under IRC § 168(e)(6) –

"In general. The term "qualified improvement property" means any improvement to an interior portion of a building which is nonresidential real property if such improvement is placed in service after the date such building was first placed in service."

"Certain improvements not included. Such term shall not include any improvement for which the expenditure is attributable to (i) the enlargement of the building, (ii) any elevator or escalator, or (iii) the internal structural framework of the building."

Also see Proposed Treas. Reg. § 1.168(b)-1(a)(5).

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Slide 55 – Question 1

Provision 13204
Applicable Recovery Period for Real Property

Question 1:

In February 2018, Maple Appliance Centers added a stairway and loft to its retail building to increase its selling space. Costs to build the stairway and loft are improvements and Maple claimed first-year "bonus" depreciation for these improvement costs. Do you have an audit issue?

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Slide 56 – Question 1 Answer

Provision 13204
Applicable Recovery Period for Real Property

Question 1 Answer:

Yes. Because qualified retail improvements are no longer 15-year property. Qualified improvement property (QIP) has a 39-year recovery period, which does not qualify for first-year depreciation deduction.

However, because TCJA changed the definition of qualified real property for section 179 purposes, Maple could elect to claim up to $1,000,000 as section 179 expenses if the cost of all section 179 property placed in service by Maple in 2018 does not exceed $2,500,000, and the section 179 taxable income limitation is met. (Section 179(e)(1) and section 168(e)(6)).

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Slide 57 – Audit Tip

Provision 13204
Applicable Recovery Period for Real Property

Audit Tip

With this 15-year recovery period glitch taxpayers may attempt to segregate structural components of a building in order to enjoy significant depreciation benefits (additional first-year depreciation deduction if not shorter recovery periods). Taxpayers may engage tax professionals, usually working with architects, builders or engineers, to produce a "cost segregation study". If you see a cost segregation study, please consult a technical advisor.

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Slide 58 – Electing Real Property Trade or Business – Provision Section 13204(a)(3)(A)(i)

Provision 13204
Applicable Recovery Period for Real Property

Electing Real Property Trade or Business – Provision Section 13204(a)(3)(A)(i)

- Applies to tax years beginning after Dec. 31, 2017
- IRC § 163(j) – discussed in another lesson
- Amends IRC § 168(g)(1)
- A real property trade or business can elect out of the interest limitation of IRC § 163(j)
- The following assets held must be depreciated using ADS and are not eligible for a bonus depreciation deduction under IRC § 168(k):
  - nonresidential real property,
  - residential rental property, and
  - qualified improvement property held.
- Small business taxpayers (other than a tax shelter, that meets the gross receipts test under IRC § 448(c))

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Slide 59 – Who is an electing real property trade or business?

Provision 13204
Applicable Recovery Period for Real Property

Who is an Electing Real Property Trade or Business?

- A taxpayer who is **not** a small business taxpayer (IRC § 448(c) and is not a tax shelter as defined in IRC § 448(d)(3))
- Any trade or business which is described in section 469(c)(7)(C), as any real property:
  - Development / Redevelopment
  - Construction / Reconstruction
  - Acquisition
  - Conversion
  - Rental
  - Operation
  - Management
  - Leasing or
  - Brokerage trade or business

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Slide 60 – Example: Electing Real Property Trade or Business

Provision 13204
Applicable Recovery Period for Real Property

Example – Electing Real Property Trade or Business

Taxpayer A operates a real property development business as defined in IRC § 469(c)(7)(C). The taxpayer is not a small business taxpayer.

A real property trade or business can make an election not to limit its business interest expense deduction. The taxpayer must follow the election procedures and use ADS depreciation for nonresidential real property, residential rental property, and qualified improvement property that it owns. Therefore, the taxpayer is allowed to deduct business interest expense without limitation.

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Slide 61 – Summary

Provision 13204
Applicable Recovery Period for Real Property

Summary

- Maintains the present MACRS recovery periods of 39 and 27.5 years for nonresidential real property and residential rental property.
- Changes the ADS recovery period from 40 to 30 years for residential rental property placed in service after 2017.
- Eliminates the three separate 15-year property definitions, Qualified Leasehold Improvement Property, Qualified Restaurant Property and Qualified Retail Improvement.
- Creates a separate definition for Qualified Improvement Property, which is not 15-year property.
- Creates a requirement for real property trades or businesses that elect out of the interest deduction limit under IRC § 163(j), to use ADS to depreciate certain property.

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Slide 62 – Provision 13205: Use of Alternative Depreciation System for Electing Farming Businesses

Provision 13205
Use of Alternative Depreciation System for Electing Farming Businesses

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Slide 63 – Objectives

Provision 13205
Use of Alternative Depreciation System for Electing Farming Businesses

OBJECTIVES

At the end of this section, you will be able to:

- Identify key elements of the following provision:
  - Section 13205 – Use of Alternative Depreciation System for Electing Farming Businesses
- Communicate critical information to taxpayers related to the listed provisions

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Slide 64 – References

Provision 13205
Use of Alternative Depreciation System for Electing Farming Businesses

References

- IRC § 168(g)(1)(G), IRC § 163(j)(7), Proposed Treas. Reg. § 1.163(j)-9
- Rev. Proc. 2019-08 (Rev. Proc. 87-57 and Rev. Proc. 2018-31 are modified)
- Form 8990 and Instructions - Limitation on Business Interest Expense Under Section 163(j)
- Publication 225, Farmer's Tax Guide
- Publication 946, How To Depreciate Property
- What a Farmer Should Know for 2018 Fact Sheet on IRS.gov

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Slide 65 – Introduction

Provision 13205
Use of Alternative Depreciation System for Electing Farming Businesses

Introduction

- Applies to tax years beginning after Dec. 31, 2017
- IRC § 163(j) – discussed in another lesson
- Amends IRC § 168(g)(1)
- Farming businesses can elect out of the interest limitation of IRC § 163(j)
- Electing farming businesses must use ADS and is not eligible for a bonus depreciation deduction under IRC § 168(k) for any property held with a recovery period of 10 years or more
- Small business taxpayers (other than a tax shelter, that meets the gross receipts test under IRC § 448(c))

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Slide 66 – Prior Law

Provision 13205
Use of Alternative Depreciation System for Electing Farming Businesses

Prior Law

Prior to the Act, IRC § 163(j) disallowed a deduction for disqualified interest paid or accrued by a corporation in a taxable year if certain tests were satisfied. The prior law primarily applied to large corporations. An election and depreciation requirement for farmers did not exist.

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Slide 67 – New Law

Provision 13205
Use of Alternative Depreciation System for Electing Farming Businesses

New Law

- Applies to tax years beginning after December 31, 2017
- Small business taxpayers are exempt from IRC § 163(j)
  - Not a tax shelter (IRC § 448(d)(3))
  - Average annual gross receipts of $25 million or less for 3 prior tax years (IRC § 448(c) – gross receipts test and aggregation rules)
- Farming businesses are excepted if:
  - Make an election out of IRC § 163(j) and
  - Use ADS for any property held with a recovery period of 10 years or more (this property is not eligible for bonus depreciation deduction under IRC § 168(k))
- Election is made by attaching a statement to a timely filed return (Proposed Treas. Reg. § 1.163(j)-9 and Instructions to Form 8990)

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Slide 68 – Who is an electing farming business?

Provision 13205
Use of Alternative Depreciation System for Electing Farming Businesses

Who is an Electing Farming Business?

- A farmer who is **not** a small business taxpayer (IRC § 448(c) and is not a tax shelter as defined in IRC § 448(d)(3))
- Farming business (IRC § 263A(e)(4))
- Specified agricultural and horticultural cooperatives (IRC § 199A(g)(4))
- Examples of an electing farming business (not all inclusive list):
  - Livestock, poultry, fish
  - Fruit, nuts, plant nursery
  - A specified cooperative that manufactures, produces, grows, or extracts any agricultural or horticultural product, or has marketed agricultural or horticultural products.

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Slide 69 – Example

Provision 13205
Use of Alternative Depreciation System for Electing Farming Businesses

Example

Farmer A operates a farming business as defined in IRC § § 263A(e)(4) and 199A(g)(4), and meets the gross receipts test of IRC § 448(c) and is not a tax shelter as defined in IRC § 448(d)(3). Farmer A is not required to elect out of IRC § 163(j) and is allowed to deduct business interest expense without limitation.

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Slide 70 – Question 1

Provision 13205
Use of Alternative Depreciation System for Electing Farming Businesses

Question 1

Farmer A operates a farming business as defined in IRC § 263A(e)(4). The farmer is not a small business taxpayer. Can Farmer A make an election not to limit business interest expense?

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Slide 71 – Question 1 Answer

Provision 13205
Use of Alternative Depreciation System for Electing Farming Businesses

Question 1 Answer :

Yes. Farmer A can make an election not to limit its business interest expense deduction. Farmer A must follow the election procedures and use ADS depreciation for any property that it owns that has a recovery period of 10 years or more. Therefore, Farmer A is allowed to deduct business interest expense without limitation.

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Slide 72 – Audit Tips

Provision 13205
Use of Alternative Depreciation System for Electing Farming Businesses

Audit Tips

- Determine whether the taxpayer meets the gross receipts test of IRC § 448(c) and is not a tax shelter as defined in IRC § 448(d)(3). If so, the taxpayer is not required to limit its business interest expense deduction.
  - Review prior years' returns for gross receipts test calculation
- Determine whether the taxpayer's business activities meet the definition of a farming business under IRC § 263A(e)(4) or a specified agricultural or horticultural cooperative under IRC § 199A(g)(4).
  - Review farming business return(s) for business activity
  - Interview the taxpayer and request additional information as needed
- If the taxpayer meets the definition of a farming business under IRC § 263A(e)(4) or a specified agricultural or horticultural cooperative under IRC § 199A(g)(4), verify whether an election was made and the taxpayer is using ADS for all property used in the farming business with a recovery period of 10 years or more. Verify that the taxpayer has not taken bonus depreciation deduction for these assets.
  - Review the Form 4562 and depreciation schedules

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Slide 73 – Summary

Provision 13205
Use of Alternative Depreciation System for Electing Farming Businesses

Summary

- Applies to tax years beginning after Dec. 31, 2017
- Farming businesses can elect out of the interest limitation of IRC § 163(j)
- Electing farming businesses must use ADS and are not eligible for bonus depreciation deduction under IRC § 168(k) for any property held with a recovery period of 10 years or more
- Small business taxpayers (other than a tax shelter, that meets the gross receipts test under IRC § 448(c))

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Slide 74 – Summary

Summary

In this course, you learned to:

- Identify key elements of the following provisions:
  - Section 13101 – Section 179 Deduction
  - Section 13201 – First Year Depreciation Deduction – Bonus Depreciation
  - Section 13202 – Depreciation Luxury Auto Limitations
  - Section 13203 – Modifications of Treatment of Certain Farm Property
  - Section 13204 – Applicable Recovery Period for Real Property
  - Section 13205 – Use of Alternative Depreciation System for Electing Farming Businesses
- Communicate critical information to taxpayers related to the listed provisions

Tax Cuts and Jobs Act of 2017 | Course 73083a | SB/SE 74

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