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.
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.
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.
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.
<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>5-year asset purchased in 2017</td>
<td>$10,000</td>
</tr>
<tr>
<td>Code §170 claimed</td>
<td>$10,000</td>
</tr>
<tr>
<td>Adjusted basis</td>
<td>$0</td>
</tr>
<tr>
<td>Normal depreciation would have been</td>
<td>$3,600</td>
</tr>
<tr>
<td><strong>RECAPTURE AMOUNT</strong></td>
<td><strong>$6,400</strong></td>
</tr>
</tbody>
</table>

In June 2018, asset given to kids. Business use drops below 50%.
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 with 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?
Thank you!

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