

Tax Cuts and Jobs Act: Focus on Impact for Real Estate



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This is the first in a five-part series that highlights the segments of the newly enacted Tax Cuts and Jobs Act and how it impacts the real estate industry.

We will focus on the following topics:

1. Cost recovery and expensing of depreciable assets
2. 20% deduction for qualified business income
3. Excess business losses and net operating losses
4. Business interest expense limitations
5. Like-kind exchanges, rehabilitation credit, and qualified opportunity zone gain deferral

In our first installment, we will discuss highlights of the Act and how it impacts capitalization and cost recovery of assets.

First, let's discuss a section of the Act which may impact assets placed in service during the **2017 tax year**.

Bonus depreciation

Prior to September 27, 2017, new assets with modified accelerated cost recovery system (MACRS) lives of 20 years or less were eligible for 50% expensing in their first year in service. For assets acquired and placed in service after September 27, 2017, bonus depreciation has been expanded to include used assets (as long as the use is original to the taxpayer) and increased to 100% expensing. This means certain assets can be fully expensed in their year of purchase. Please note that assets that had a written binding contract prior to September 27, 2017 will not be eligible for 100% bonus depreciation. Assets purchased from a related party or controlled group, or received through gift or inheritance, are not eligible for bonus depreciation.

Bonus depreciation at 100% of cost will be available for assets placed in service from September 27, 2017 to January 1, 2023. Then it will be phased out over the period from January 1, 2023 to December 31, 2026 and will be fully eliminated after December 31, 2026. Taxpayers will still be able to elect out of bonus depreciation if they choose.

States will have to decide whether they will follow the changes to federal depreciation rules. If they do not follow the federal law, then there will be adjustments for state purposes to be considered in tax planning.

The next two changes only impact assets placed in service after December 31, 2017.

Section 179 expensing

The Section 179 election allows for 100% expensing for eligible assets up to certain annual limits. The limit for expensing annually increases to \$1 million for eligible assets placed in service after December 31, 2017. Section 179 expensing is limited based on the amount of total assets placed in service. This "phasedown" has been increased to \$2.5 million after December 31, 2017. This election is only allowable up to net taxable income.

Eligible Section 179 property is tangible personal property, computer software and a newly created "qualified real property". The inclusion of qualified real property will greatly expand the ability to expense fixed asset additions. Qualified real property includes the newly created qualified improvement property (discussed below), as well as certain

structural improvements to the **nonresidential real property**. This includes roofs, HVACs, fire protection and alarm systems, and security systems. Qualifying property has also been expanded to include certain depreciable personal property used to furnish lodging (e.g., beds, refrigerators, ranges, et cetera). There has been no change related to residential rental property's ability to take Section 179 on tangible personal property.

Qualified improvement property

Previously, there were three types of qualified improvements to real property—qualified leasehold improvements, qualified restaurant improvements, and qualified retail improvements. All three definitions varied and had different implications for the ability to currently expense improvements. The new law provides for a single **qualified improvement property**. This property is any improvement to the interior portion of a building placed in service after the original building is placed in service, and is effective for assets placed in service after December 31, 2017. Qualified improvement property has a **15-year** recovery period (20-year ADS period), which means it will be eligible for the 100% bonus depreciation from January 1, 2018 through December 31, 2022, as well as Section 179 expensing.

We have not discussed the interaction of the new cost recovery options with the tangible asset regulations that were issued in 2014 that provided guidelines on capitalization of assets versus expensing as repairs. These will need to be considered when making elections related to 100% bonus expensing versus Section 179 expensing. There will also be interaction with the 20% deduction for qualified business income and the limitation on interest expense, which we will discuss in further detail in our next installment.

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