

## 2017 TAX CUTS AND JOBS ACT

### CHANGES TO INTERNAL REVENUE CODE SECTION 179: ELECTION TO EXPENSE CERTAIN DEPRECIABLE BUSINESS ASSETS

#### I. JOINT EXPLANATORY STATEMENT OF THE COMMITTEE OF CONFERENCE

Prior Law. A taxpayer may elect under Internal Revenue Code Section (Section) 179 to deduct (“expense”) the cost of qualifying property, rather than recover such costs through depreciation deductions, subject to limitation. The maximum amount a taxpayer could expense was \$500,000 of the cost of qualifying property placed in service for the taxable year. Section 179(b)(1). The \$500,000 amount was reduced by the amount by which the cost of qualifying property placed in service during the taxable year exceeded \$2 million. Section 179(b)(2).

In general, qualifying property was defined as depreciable tangible property that was purchased for use in the active conduct of a trade or business. Per Section 179(b)(3), the amount eligible to be expensed for a taxable year could not exceed the taxable income for such taxable year that is derived from the active conduct of a trade or business.

New Law. The Tax Cuts and Jobs Act (the Act) increases the maximum amount a taxpayer may expense under Section 179 to \$1 million and increases the phaseout threshold to \$2,500,000. Thus, the Act provides that the maximum amount a taxpayer may expense, for taxable years beginning after 2017, is \$1 million of the cost of qualifying property placed in service for the taxable year. The \$1 million amount is reduced by the amount the cost of qualifying property placed in service during the taxable year exceeds \$2.5 million.

The new provisions expand the definition of Section 179 property to include certain depreciable tangible personal property used predominantly to furnish lodging or in connection with furnishing lodging. As defined in Section 50(b)(2), property used predominantly to furnish lodging or in connection with furnishing lodging generally includes beds and other furniture, refrigerators, ranges, and other equipment used in the living quarters of a lodging facility such as an apartment house, dormitory, or other facility (or part of us facility) where sleeping accommodations are provided. Treas. Reg. Sec. 1.48-1(h).

The Act also expands the definition of qualified real property eligible for Section 179 expensing to include any of the following improvements to nonresidential real property placed in service after the date such property was first placed in service: roofs, heating, ventilation, and air-conditioning property, fire protection and alarm system, and security systems.

The effective date of the Act applies to property placed in service in taxable years beginning after December 31, 2017.

## II. CCH LAW, EXPLANATION AND ANALYSIS

Summary: The Section 179 limitation is increased to \$1 million and the investment limitation is increased to \$2.5 million for tax years beginning after 2017. The definition of qualified real property eligible for expensing is redefined to include improvements to the interior of any nonresidential real estate (“qualified improvement property”), as well as roofs, heating, ventilation, and air-conditioning property, fire protection and alarm systems, and security systems installed on such property. The prior prohibition against expensing for tangible personal property used in connection with lodging facilities (such as residential rental property) is eliminated.

New Law: The definition of qualified real property that taxpayers may elect to treat as Section 179 property is significantly expanded. Effective for tax years beginning after 2017, qualified real property is defined as:

- Qualified improvement property and
- Any of the following improvements to nonresidential real property that are placed in service after the nonresidential real property was first placed in service, such as roofs, heating, ventilation, etc.

Exclusion for property used in connection with lodging repealed. Effective for property placed in service and tax years beginning after December 31, 2017, property that is used predominantly to furnish lodging or in connection with the furnishing of lodging qualifies for expensing. Section 179(d)(1). The primary impact of this provision is to allow expensing of Section 1245 property purchased for use with residential rental building.

Practical analysis. The Act increases both the annual and the phaseout limits. The annual limit has been raised from \$500,000 to \$1 million, and the phaseout limitation has been increased from \$2 million to \$2.5 million. Property eligible for Section 179 expensing has also been expanded to include items related to building and structures. By expanding the definition of Section 179 to include building equipment, owner operators are now incentivized to make investments into their properties and no preferential treatment is given to tenants on an operating lease.

It should be noted however that Section 179(d)(4) prevents estates and trusts from utilizing Section 179. This prohibition could impact S corporations that have a trust as a shareholder. Reg. Sec. 1.179-1(f)(3) provides that a trust or estate may not deduct its allocable share of the Section 179 expense elected by the S corporation (and the S corporation’s basis in Section 179 property shall not be reduced to reflect any portion of the Section 179 expense that is allocable to a trust or estate).

## III. DEDUCTION LIMITED TO TAXABLE INCOME FROM TRADE OR BUSINESS

Section 179(b)(3), which existed before the Act, has remained unchanged. For a taxpayer to utilize Section 179’s expensing, the taxpayer must have taxable income. If a taxpayer does not have sufficient taxable income to utilize Section 179’s immediate write-off, then Section

170(b)(3)'s carryforward provisions provide that any unused deductions can be carried forward, but the amount to be expensed in a carryforward year is limited to the maximum annual Section 179 write-off or, if lesser, the taxable income for the taxable year. Section 179(b)(3)'s income limitation is a limitation based on income from the "active conduct of a trade or business during such taxable year". The term trade or business generally includes any activity carried on for the production of income from selling goods or performing services. This would seem to exclude applying Section 179 write-offs against income from interest, dividends, pension, annuities, IRAs or social security.

The actual language of subsections (A) and (B) of Section 179(b)(3) are as follows:

179(b)(3) LIMITATION BASED ON INCOME FROM TRADE OR BUSINESS -

(A) IN GENERAL. – The amount allowed as a deduction under subsection (a) for any taxable year (determined after the applicable paragraphs of (1) and (2)) shall not exceed the aggregate amount of taxable income of the taxpayer from such taxable year which is derived from the active conduct by the taxpayer of any trade or business during such taxable year.

(C) COMPUTATION OF TAXABLE INCOME. For purposes of this paragraph, taxable income derived from the conduct of a trade or business shall be computed without regard to the deduction allowable under this section.