Knueven, Schroeder & Co.
CERTIFIED PUBLIC ACCOUNTANTS

Jerome B. Schroeder, CPA
Douglas E. Schleucher, CPA
Ann E. Woolum, CPA
Timothy J. Gephart, CPA
Mark L. Schroeder, CPA
Angela L. Bursby, CPA
Jeffrey C. Quinlan, CPA

Balance sheet

Bonus Depreciation

By Mark L. Schroeder, CPA

As you are probably aware, the 100% bonus depreciation is available for a wide variety of qualifying property. Below are some important points about this powerful cost-cutting tool.

Bonus depreciation is scheduled for phase out. 100% bonus depreciation will be phased out in steps for property placed in service in calendar years 2023 through 2027. Thus, an 80% rate will apply to property placed in service in 2023, 60% in 2024, 40% in 2025, and 20% in 2026, and a 0% rate will apply in 2027 and later years. For certain aircraft (generally, company planes) and for the pre-January 1, 2027 costs of certain property with a long production period, the phase-out is scheduled to take place a year later, from 2024 to 2028.

Bonus depreciation is available for new and most used property. Used property qualifies unless (1) the taxpayer previously used the property and (2) the property was acquired in certain forbidden transactions (generally acquisitions that are tax free or from a related person or entity).

Taxpayers should sometimes make the election to turn down bonus depreciation. Taxpayers can elect to reject bonus depreciation for one or more classes of property (an "election-out"). The election out is useful for sole-proprietorships and business entities taxed under the rules for partnerships and S corporations that want to prevent "wasting" depreciation deductions by applying them against lower-bracket income in the year property was placed in service instead of against anticipated higher bracket income in later years.

Bonus depreciation is available for certain building improvements. Before the 2017 Tax Cuts and Jobs Act (TCJA), bonus depreciation was available for two types of real property: (1) land improvements other than buildings, for example fencing and parking lots, and (2) "qualified improvement property," a broad category of internal improvements made to non-residential buildings after the buildings are placed in service. The TCJA inadvertently eliminated bonus depreciation for qualified improvement property. However, the 2020 Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") made a retroactive technical correction to the TCJA. The correction makes qualified improvement property placed in service after December 31, 2017 eligible for bonus depreciation.

100% bonus depreciation has reduced the importance of "section 179 expensing." If you are a smaller business, you have surely benefited from "section 179 expensing." Section 179 expensing is an elective benefit that subject to dollar limits, allows an immediate deduction of the cost of equipment, machinery, "off-the-shelf" computer software, and some building improvements. Section 179 expensing has in fact been enhanced by the TCJA, but the availability of 100% bonus depreciation is economically equivalent and thus has greatly reduced the cases in which section 179 expensing is useful.

The above discussion touches only on some major aspects of bonus depreciation. Bonus depreciation is a complicated area with tax implications for transactions other than simple asset acquisitions.

Please contact our office at your convenience to discuss all aspects of bonus depreciation and any other tax matters.