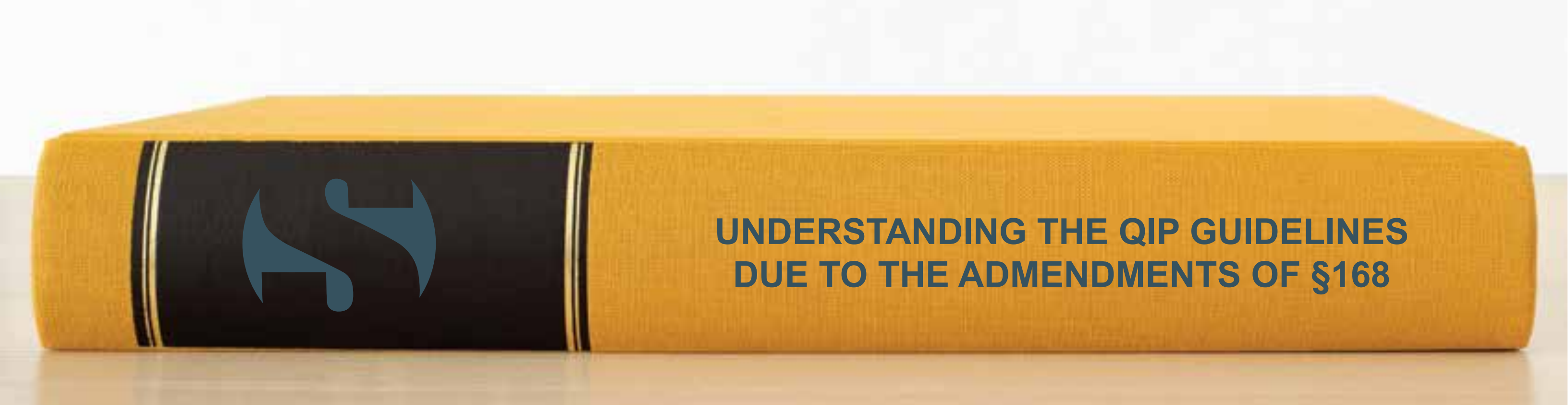

UNDERSTANDING THE QIP GUIDELINES DUE TO THE ADMENDMENTS OF §168

Recently there has been some confusion about QIP recovery periods due to the amendments to §168. The Committee Comments for the Tax Cuts & Jobs Act discussed altering the recovery period. However, actual changes did not make it into the final bill.

Recovery periods and depreciation percentages remain as follows:

QIP placed in service between September 28 and December 31, 2017

39-yr recovery period

Bonus depreciation percentage will depend on when the property was acquired:

If acquired prior to 9/28/17, the property will qualify for 50% bonus depreciation.
If acquired after 9/27/17, the property will qualify for 100% bonus depreciation.

This QIP will most likely be ineligible for §179 since the tax year presumably ends on 12/31/17. However, for taxable years ending after 12/31/17, QIP is Qualified Real Property for purposes of §179.

QIP placed in Service before September 28, 2017

This QIP will be 39-yr property eligible for 50% bonus depreciation.

This QIP will most likely be ineligible for §179 since the tax year presumably ends on 12/31/17. However, for taxable years ending after 12/31/17, QIP is Qualified Real Property for purposes of §179.

QIP placed in Service after December 31, 2017

This QIP will be 39-yr property but will be ineligible for bonus depreciation since it was placed in service after 12/31/17.

It will qualify for §179 at the election of the tax payer, but you have to make an election under §179(d)(1)(B)(ii) to consider Qualified Real Property for expensing.

SCARPELLO CONSULTING

scarpelloconsulting.com • 877.410.5040 • info@scarpelloconsulting.com

THE INTENT

From its inception on 1/1/2016, QIP has always had, and continues to have, a 39-yr recovery period. The only benefit of classifying an asset as QIP was the ability to claim bonus depreciation.

The Tax Cuts & Jobs Act did nothing to change the recovery period. Even though the Committee Comments clearly indicate that the intention was to reduce the GDS recovery period to 15 yrs. and the ADS recovery period to 20 yrs., **they did not put the language in the actual bill**. Since it's not in the amended §168 statute, Congressional intent is irrelevant.

Most jurists would not allow the Committee Comments to override the text of the statute. **Without a technical correction, QIP is going to remain 39-yr property.** And it is unlikely Senate Democrats will provide the support needed to get to the 60-vote threshold necessary to get a technical correction past a filibuster. Republicans cannot use the reconciliation procedure they used to get the TCJA passed because the technical corrections would add to the already increasing deficit. For changes to be made under reconciliation procedures, they would need to be revenue neutral.

WHAT CHANGES DID GET MADE

Unfortunately, while the drafters of the bill forgot to include the clauses providing for the 15/20-yr recovery periods, they did remember to make what they believed to be a conforming amendment to remove QIP as an explicit qualifying property type for bonus depreciation effective for property placed in service after 12/31/17. See §§13204(a)(4)(A)(iii) & (b)(1) of the TCJA.

Additionally, the drafters put substantive language in the bill concerning what property will qualify for the new bonus rules that did not make it to the statute, so anyone who hasn't read the bill could miss it.

Under §13201(h)(1), all the amendments made under §13201 (100% deduction, used property qualifies, etc.) apply to property which is acquired after 9/27/17, and is placed in service after such date. Unfortunately, the language goes on to specify that property shall not be treated as acquired after the date on which a written binding contract is entered into for such acquisition.

WHAT DOES 'WRITTEN BINDING CONTRACT" MEAN?

On 8/3/2018, the Treasury Department released proposed regulations regarding the additional first year depreciation deduction under the TCJA.

The proposed regulations retain the rules in §1.168(k)-1(b)(4)(ii) defining a binding contract. Under §1.168(k)-1(b)(4)(ii) (A), a contract is binding only if it is enforceable under State law against the taxpayer or a predecessor and does not limit damages to a specified amount. A contractual provision that limits damages to an amount equal to at least 5% of the total contract price will not be treated as limiting damages to a specified amount.

So, if there was an enforceable contract executed before 9/28/17 that did not limit damages to less than 5% of the total contract price, the property will be considered as having been acquired before 9/28/17, and therefore, it be ineligible for the new bonus depreciation regulations.

The proposed regulations provide that property that is manufactured, constructed, or produced for the taxpayer by another person under a written binding contract that is entered into prior to the manufacture, construction, or production of the property for use by the taxpayer in its trade or business or for its production of income is acquired pursuant to a written binding contract. However, a letter of intent for an acquisition is not a binding contract.

If the written binding contract states the date on which the contract was entered into and a closing date, delivery date, or other similar date, the date on which the contract was entered into is the date the taxpayer acquired the property.

If a taxpayer manufactures, constructs, or produces property for its own use, the Treasury Department and the IRS recognize that the written binding contract rule in §13201(h)(1) of the Act does not apply. In such case, the proposed regulations provide that the acquisition rules in §13201(h)(1) of the TCJA are treated as met if the taxpayer begins manufacturing, constructing, or producing the property after September 27, 2017.

SCARPELLO CONSULTING

scarpelloconsulting.com • 877.410.5040 • info@scarpelloconsulting.com

The proposed regulations provide rules similar to those in §1.168(k)-1(b)(4)(iii)(B) [physical work of a significant nature] for defining when manufacturing, construction, or production begins, including the safe harbor [incurs/pays more than 10% of the total cost of the property excluding land & preliminary activities], and in §1.168(k)- 1(b)(4)(iii)(C) for a contract to acquire, or for the manufacture, construction, or production of, a component of the larger self-constructed property [i.e., a binding contract to acquire one or more components of a larger self-constructed property will not preclude the larger self-constructed property from satisfying the acquisition rules].

ADDITIONAL DISCUSSIONS

While no official changes have been made concerning reducing recovery periods, the proposed regulations provide that Qualified Improvement Property acquired after 9/27/17, and placed in service after 9/27/17 but before 1/1/18, is qualified property for purposes of the additional first year depreciation deduction.

By implication, Qualified Improvement Property placed in service after 12/31/17 is not qualified property for purposes of the additional first year depreciation deduction. Therefore, as property that has a recovery period of 20 years or less is generally qualified property for purposes of the additional first year depreciation deduction, Treasury cannot have considered Qualified Improvement Property placed in service after 12/31/17 as having a 15-year recovery period as some commentators would like to believe. (See AICPA letter dated 7/23/18 to Treasury/IRS requesting clarification that Qualified Improvement Property is treated as 15-year property.)