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Issue Contents

Bankruptcy

Chapter 12

Plan **147**

Federal Tax

Setoff **148**

Federal Estate and Gift Taxation

Power of appointment **148**

Federal Farm Programs

Market Facilitation Program **148**

Federal Income Taxation

Corporations

Related parties **149**

Depreciation **149**

Disaster losses **149**

Discharge of indebtedness **150**

Family and medical leave **150**

Innocent spouse relief **150**

Moving expenses **151**

Pension plans **151**

Returns **151**

Safe harbor interest rates

October 2018 **151**

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New Proposed Regulations On “Bonus” Depreciation

by Robert P. Achenbach, Jr.*

The Tax Cut and Jobs Act 2017 (TCJA 2017)¹ amended I.R.C. § 168(k) to continue the additional first year depreciation deduction, also known as “bonus” depreciation, at 100 percent for qualified property placed in service after September 27, 2017 and before January 1, 2023. After 2022, the additional depreciation is reduced to 80 percent for property placed in service in 2023, 60 percent for property placed in service in 2024, 40 percent for property placed in service in 2025, 20 percent for property placed in service in 2026.²

Specified Plants

If a taxpayer makes the election to apply I.R.C. § 168(k)(5),³ the additional first year depreciation deduction is allowed for a specified plant⁴ planted or grafted after September 27, 2017, and before January 1, 2023.⁵

Qualified Property

“Qualified property” is property (1) to which I.R.C. § 168 (MACRS) applies that has a recovery period of 20 years or less;⁶ (2) the original use of which begins with the taxpayer or the acquisition of which by the taxpayer meets the requirements of I.R.C. § 168(k)(2) (E)(ii);⁷ and (3) which is placed in service by the taxpayer before January 1, 2027.⁸ I.R.C. § 168(k)(2)(D) provides that qualified property does not include any property to which the alternative depreciation system under I.R.C. § 168(g) applies, determined without regard to I.R.C. § 168(g)(7),⁹ and after application of I.R.C. § 280F(b)¹⁰

For property placed in service after December 31, 2017, the TCJA 2017 amended I.R.C. § 168(e) to eliminate the 15-year MACRS property classification for qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property, and amended section 168(k) to eliminate qualified improvement property as a specific category of qualified property.¹¹ For purposes of determining the eligibility of MACRS property as qualified property, the proposed regulations retain the rule in Treas. Reg. § 1.168(k)-1(b)(2)(i)(A) that the recovery period applicable for the MACRS property under I.R.C. § 168(c) of the general depreciation system (GDS) is used, regardless of any election made by the taxpayer to depreciate the class of property under the alternative depreciation system (ADS) of I.R.C. § 168(g).¹²

Used Property

The TCJA 2017¹³ expanded the property eligible for “bonus” depreciation to include used depreciable property if the property meets the original use requirements¹⁴ or if the

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property meets the used property acquisition requirements.¹⁵ “Original use” means the first use to which the property is put, whether or not that use corresponds to the use of the property by the taxpayer. Additional capital expenditures incurred by a taxpayer to recondition or rebuild property acquired or owned by the taxpayer also satisfy the original use requirement. However, the cost of reconditioned or rebuilt property does not satisfy the original use requirement but may satisfy the used property acquisition requirements.¹⁶

For converted property, the proposed regulations provide: “If a taxpayer initially acquires new property for personal use and subsequently uses the property in the taxpayer’s trade or business or for the taxpayer’s production of income, the taxpayer is considered the original user of the property. If a person initially acquires new property for personal use and a taxpayer subsequently acquires the property from the person for use in the taxpayer’s trade or business or for the taxpayer’s production of income, the taxpayer is not considered the original user of the property.”¹⁷ The proposed regulations also allow “bonus” depreciation for inventory property converted to a business use¹⁸ and fractional interests in business property.¹⁹

Property Not Qualified

The proposed regulations²⁰ provide that qualified property does not include—

- (1) property excluded from the application of I.R.C. § 168 as a result of I.R.C. § 168(f);
- (2) property that is required to be depreciated under the ADS;
- (3) any class of property for which the taxpayer elects not to deduct the additional first year depreciation under I.R.C. § 168(k)(7);
- (4) a specified plant placed in service by the taxpayer in the taxable year and for which the taxpayer made an election to apply I.R.C. § 168(k)(5) for a prior year under I.R.C. § 168(k)(5)(D);
- (5) any class of property for which the taxpayer elects to apply I.R.C. § 168(k)(4);²¹ or
- (6) property described in I.R.C. § 168(k)(9)(A) or (B).²²

Electing Out of “Bonus” Depreciation

The proposed regulations provide rules for making the election out of the additional first year depreciation deduction pursuant to I.R.C. § 168(k)(7)²³ and for making the election to apply I.R.C. § 168(k)(5) to a specified plant.²⁴ The election must be made by the due date, including extensions, of the federal tax return for the taxable year in which the qualified property is placed in service by the taxpayer.²⁵

The proposed regulations provide rules for making the election under I.R.C. § 168(k)(10) to deduct 50 percent, instead of 100 percent, additional first year depreciation for qualified property acquired after September 27, 2017, by the taxpayer and placed in service or planted or grafted, as applicable, by the taxpayer during its taxable year that includes September 28, 2017.²⁶

Revocation of Electing Out of “Bonus” Depreciation

The election out of “bonus” depreciation may be revoked only by filing a request for a private letter ruling and obtaining the Commissioner’s written consent to revoke the election.²⁷

Automatic Extension. An automatic extension of 6 months from the due date of the taxpayer’s federal tax return, excluding extensions, for the placed-in-service year or the taxable year in which the specified plant is planted or grafted is granted to revoke

an election, provided the taxpayer timely filed the taxpayer’s federal tax return for the placed-in-service year or the taxable year in which the specified plant is planted or grafted, as applicable, and, within this 6-month extension period, the taxpayer, and all taxpayers whose tax liability would be affected by the election, file an amended federal tax return for the placed-in-service year or the taxable year in which the specified plant is planted or grafted, as applicable, in a manner that is consistent with the revocation of the election.²⁸

Other Rules

Calculating Otherwise Allowable Depreciation. The proposed regulations²⁹ provide that the depreciation deduction, except where the property is disposed of in the same tax year,³⁰ is determined by multiplying the unadjusted depreciable basis of the qualified property by the applicable percentage.

Alternative Minimum Tax. Additional first year depreciation is allowed for alternative minimum tax purposes.³¹

Exchanges and Conversions. As under pre-2018 rules, if the replacement MACRS property or the replacement computer software meets the original use requirement and all other requirements of I.R.C. § 168(k), the remaining exchanged basis for the year of replacement and the remaining excess basis, if any, for the year of replacement for the replacement MACRS property or the replacement computer software are eligible for the additional first year depreciation deduction.³²

Recapture. The proposed regulations provide that under I.R.C. § 1245 and its regulations, the additional first year depreciation deduction is an amount allowed or allowable for depreciation.³³ For purposes of I.R.C. § 1250(b) and its regulations, the additional first year depreciation deduction is not a straight line method.³⁴

ENDNOTES

¹ Pub. L. No. 115-97, §§ 12001(b)(13), 13201, 13204, 131 Stat. 2054, 2092, 2105, 2108 (2017).

² See I.R.C. § 168(k)(6).

³ See N. 25 below and accompanying text.

⁴ See I.R.C. § 168(k)(5)(B): “Specified plant.--For purposes of this paragraph, the term “specified plant” means—(i) any tree or vine which bears fruits or nuts, and (ii) any other plant which will have more than one yield of fruits or nuts and which generally has a pre-productive period of more than 2 years from the time of planting or grafting to the time at which such plant begins bearing fruits or nuts.”

⁵ The 100 percent amount is reduced to 80 percent in 2023, 60 percent in 2024, 40 percent in 2025, and 20 percent in 2026. I.R.C. § 168(k)(6)(C).

⁶ The proposed regulations list the following additional qualified property: “(B) Computer software as defined in, and depreciated under, section 167(f)(1) and the regulations under section 167(f)(1); (C) Water utility property as defined in section 168(e)(5) and depreciated under section 168; (D) Qualified improvement property as defined in § 1.168(b)-1(a)(5)(i)(C) and (a)(5)(ii) and depreciated under section 168; (E) Qualified film or television production, as defined in section 181(d) and § 1.181-3, for which a deduction would have been allowable under section 181 without regard to section 181(a)(2) and (g), or section 168(k); (F) Qualified live theatrical production, as defined in section 181(e), for which

a deduction would have been allowable under section 181 without regard to section 181(a)(2) and (g), or section 168(k).”

⁷ I.R.C. § 168(k)(2)(E)(ii) requires that the acquired property was not used by the taxpayer at any time prior to such acquisition and the acquisition of such property meets the requirements of I.R.C. § 179(d)(2)(A), (B), and (C) and I.R.C. § 179(d)(3).

⁸ I.R.C. § 168(k)(2)(A).

⁹ I.R.C. § 168(g)(7) (election to have the alternative depreciation system apply).

¹⁰ I.R.C. § 280F(b) (listed property with limited business use).

¹¹ Pub. L. No. 115-97, § 13204, 131 Stat. 2108 (2017).

¹² Prop. Treas. Reg. § 1.168(k)-2(b)(2)(i)(A).

¹³ Pub. L. No. 115-97, § 13201, 131 Stat. 2092 (2017).

¹⁴ See Prop. Treas. Reg. § 1.168(k)-2(b)(3)(ii).

¹⁵ See Prop. Treas. Reg. § 1.168(k)-2(b)(3)(iii).

¹⁶ See Prop. Treas. Reg. § 1.168(k)-2(b)(3)(ii).

¹⁷ See Prop. Treas. Reg. § 1.168(k)-2(b)(3)(ii)(B).

¹⁸ See Prop. Treas. Reg. § 1.168(k)-2(b)(3)(ii)(B).

¹⁹ See Prop. Treas. Reg. § 1.168(k)-2(b)(3)(ii)(B).

²⁰ Prop. Treas. Reg. § 1.168(k)-2(b)(2)(ii).

²¹ This exclusion applies to property placed in service in any taxable year beginning before January 1, 2018, because Section 12001(b)(13) of the TCJA 2017 repealed I.R.C. § 168(k)(4) for taxable years beginning after December 31, 2017.

²² I.R.C. § 168(k)(9) provides that qualified property does not include any property that is primarily used in a trade or business described in I.R.C. § 163(j)(7)(A)(iv), or (B) any property used in a trade or business that has had floor plan financing indebtedness (as defined in I.R.C. § 163(j)(9)) if the floor plan financing interest related to such indebtedness was taken into account under I.R.C. § 163(j)(1)(C). I.R.C. § 163(j) applies to taxable years beginning after December 31, 2017. Thus, the exclusion of property described in I.R.C. § 168(k)(9) from the additional first year depreciation

deduction applies to property placed in service in any taxable year beginning after December 31, 2017.

²³ Prop. Treas. Reg. § 1.168(k)-2(e)(1).

²⁴ Prop. Treas. Reg. § 1.168(k)-2(e)(2).

²⁵ Prop. Treas. Reg. § 1.168(k)-2(e)(1) (election out); § 1.168(k)-2(e)(2) (election for plants). The election is to be made in the manner prescribed on Form 4562, *Depreciation and Amortization*, and its instructions. The election is made separately by each person owning qualified property (for example, for each member of a consolidated group by the common parent of the group, by the partnership (including basis adjustments in the partnership assets under section 743(b)), or by the S corporation).

²⁶ Prop. Treas. Reg. § 1.168(k)-2(e)(3). Because I.R.C. § 168(k)(10) does not state that the election may be made “with respect to any class of property” as stated in I.R.C. § 168(k)(7) for making the election out of the additional first year depreciation deduction, the proposed regulations provide that the election under I.R.C. § 168(k)(10) applies to all qualified property.

²⁷ Prop. Treas. Reg. § 1.168(k)-2(e)(5). Under Treas. Reg. § 301.9100-3, the Commissioner may grant a request to revoke the election if the taxpayer acted reasonably and in good faith, and the revocation will not prejudice the interests of the government. An election may not be revoked through a request under I.R.C. § 446(e) to change the taxpayer’s method of accounting.

²⁸ Prop. Treas. Reg. § 1.168(k)-2(e)(5)(ii).

²⁹ Prop. Treas. Reg. § 1.168(k)-2(d)(ii).

³⁰ Prop. Treas. Reg. § 1.168(k)-2(f)(i).

³¹ Prop. Treas. Reg. § 1.168(k)-2(d).

³² Prop. Treas. Reg. § 1.168(k)-2(d).

³³ Prop. Treas. Reg. § 1.168(k)-2(f)(3).

³⁴ Prop. Treas. Reg. § 1.168(k)-2(f)(3).

CASES, REGULATIONS AND STATUTES

BANKRUPTCY

CHAPTER 12

PLAN. The debtor filed for Chapter 12 in March 2018 and filed a plan in July 2018. The plan provided for payment of secured loans from the CCC and FSA. The debtor testified as to the anticipated income and expenses during the life of the plan but did not present cash flow statements or other written evidence to support the debtor’s expected income and expenses. The trustee and USDA filed objections to the plan based on its lack of feasibility and failure of the debtor to correctly state the amount of the CCC and FSA loans. Section 1225(a)(6) provides that “the court shall confirm a plan if . . . the debtor will be able to make all payments under the plan and to comply with the plan.” The court found that, although the debtor testified as to how the debtor planned to meet the Chapter 12 plan payments, the debtor did not provide specific details as to factors that could allow or prevent the debtor from

meeting the income requirements for making all plan payments. The court noted that the debtor had no provision for reserves to meet shortfalls in income and that much of the income exceeded the income of previous years. Although the debtor had plans to increase income, most of these plans, such as increased irrigation also required additional expenses. Thus, the court held that the plan could not be confirmed for lack of sufficient evidence that the plan payments could be made on a timely basis. ***In re Morris*, 2018 Bankr. LEXIS 2803 (Bankr. N.D. Miss. 2018).**

The debtor was an LLC owned by two individuals who also owned another LLC. The debtor filed for Chapter 12 in February 2018 and filed a plan in July 2018 which was objected to by several creditors and the trustee as not proposed in good faith, not feasible, and as not providing creditors with at least the amount received in a Chapter 7 case as required by Section 1225. The debtor’s plan estimated income from several sources: (1) income from the sale of crops, (2) federal farm program payments, (3) funds provided by the other LLC, and income from custom grain storage and drying. The court found that (1) the income from the crops was too uncertain because a portion of the debtor’s land was subject to