Fourth Quarter Alert: 100% Bonus Depreciation Deduction Expires December 31, 2022

By: Jared R. Johnson
Tax Alert
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As we move into the final quarter of 2022, it is critical to take note of an expiring tax benefit in the Tax Cuts and Jobs Act (TCJA). Passed in 2017, it allows for 100% bonus depreciation on a wide variety of capital assets that are considered "qualified property."

Originally, the bonus depreciation rules were set to expire at the end 2019. The TCJA extended the rules and increased the top deduction benefit to 100% for certain assets placed into service between September 27, 2017 and January 1, 2023. Unless Congress changes the law (which we don't expect at the moment), the amount will reduce by 20% annually until reaching 0% in 2027.

Qualified Property

Depreciation is available for property that is acquired for use in a business or another income-producing activity and is expected to last more than one year. The TCJA allows businesses to accelerate the depreciation so that the full cost may be taken in the year in which it is placed into use. Property that qualifies for bonus depreciation includes assets with a 20-year recovery period, such as vehicles, furniture, manufacturing equipment, and heavy machinery. Further, many building interior upgrades are eligible for bonus depreciation as "qualified improvement property."

Placement Into Service

Not only must the property be qualified, it must also be placed into service before the end of the year. The IRS generally considers that property is placed in service when it is ready and available for a specific use, regardless of whether or not it is actually used at the time. For example, a house purchased for use as rental property is placed in service when it is ready and available to rent, even if it is not actually rented at that time.

Cost Segregation

To maximize available bonus depreciation, it is beneficial for companies to use a cost segregation study that updates fixed asset components into classes that have recovery periods of less than 20 years. A cost segregation study brings multiple benefits. First, it makes the component eligible for bonus depreciation that was available for the year it was placed in service. Naturally, that is desirable for qualified component assets placed into service between 2017-2022. Second, the shorter depreciable period allows companies to recover costs over a shorter period of time versus the longer building depreciation period.

Section 179 Expensing

Although less attractive than bonus depreciation for small businesses are the Internal Revenue Code (IRC) Section 179 rules. This section permits an expense deduction of up to $1,080,000 of business use personal property and certain real property improvements in the year they are placed into service. There is a total equipment purchase limit of $2.7 million.

Post-2022

Finally, excess losses generated from utilizing the bonus depreciation this year don't magically disappear, but are carried forward. In that case, those losses can be carried forward and applied to capital gains in future years.

As I've indicated, bonus depreciation will reduce by 20% each year until 2027. A 100% deduction can generate significant tax savings or a refund as well as simplify a business's bookkeeping. By that token, the reduction of 20% from December 2022 to January 2023 can significantly impact a company's current bottom line.

If you want to take advantage of this expiring tax advantage or learn more, feel free to contact Jared R. Johnson (johnsonj@whiteandwilliams.com; 215-864-6290).