



First-Year Expensing and Bonus Depreciation

GARY M. ZWEIG, An Accountancy Corporation

5080 Shoreham Place, Suite 201, San Diego, CA 92122-5930

gzweig@zweigaccounting.com (858) 646-0681

12/20/2019

This article will give you a better understanding of the first-year expensing (also referred to as § 179 expensing) and additional first-year depreciation (also referred to as bonus depreciation). Businesses that purchase capital assets are allowed to deduct the decline in value of the assets over their useful lives. This depreciation deduction is intended to help businesses to eventually recover the costs of capital assets.

Certain provisions in the tax code enable you to accelerate recovery of your cost of certain plants, machinery, equipment, computer software, and other qualified property that you acquire for business use, rather than having to depreciate those costs over several tax years. Expensing (immediate write-off) is the primary cost recovery vehicle for capital assets (acquired for business use) placed in service from 2018 through 2022. The two mechanisms for deducting the cost of assets in the year they are placed in service are first-year expensing under Internal Revenue Code §179 and bonus depreciation under Internal Revenue Code §168(k).

Individuals and business entities that have taxable income greater than or equal to the amount of qualified first-year expensing property placed in service during the tax year, can elect to claim a first-year expensing deduction for up to \$1 million of the cost such property. Most machinery and equipment, certain commercial building improvements, property used to furnish lodging, and certain computer software that businesses purchase (or lease under a capital lease) are qualified first-year

expensing property, but rental real estate is not. First-year expensing is available for both new and used assets, and for both purchased and leased (under a capital lease) assets. To be eligible for the first-year expensing deduction, the assets must be used in the United States.

The \$1 million annual limit on the first-year expensing deduction is reduced if you place in service more than \$2.5 million in qualified first-year expensing property during the year. No first-year expensing deduction is allowed if you place in service \$3.5 million or more in qualified first-year expensing property during the year. Because of this property cost limit, larger businesses generally claim bonus depreciation rather than first-year expensing.

In contrast to the first-year expensing deduction, there is no annual dollar limit on the bonus depreciation deduction amount, and bonus depreciation may be deducted even in a loss year. And unlike the first-year expensing deduction, the bonus depreciation deduction is not elective (except in the case of qualifying fruit- and nut-bearing plants). However, you may elect not to deduct bonus depreciation for any class of qualified property.

The bonus depreciation deduction is available to individuals, estates, trusts, and business entities that invest in new or used capital assets that have a depreciation recovery period of 20 years or less, as well as depreciable computer software, certain water utility property, qualified film, television, and live theater productions, and for farmers, specified fruit- and nut-bearing plants. Bonus depreciation is available for both purchased and leased (under a capital lease) assets. To be eligible for bonus depreciation, the assets must be used in the United States.

The percentage of the adjusted basis of qualified property that is deducted as bonus depreciation is 100% for most qualified property placed in service before 2023, but it is scheduled to be reduced by 20% per year from 2023 through 2026, and fully phased out by 2027.

Qualified improvement property — which before 2018 could qualify for both first-year expensing and bonus depreciation — now qualifies for first-year expensing only (subject to the annual dollar limit and the taxable income limit), but does not qualify for bonus depreciation. Qualified improvement property is an improvement to an interior portion of a commercial building if the improvement is

placed in service after the date the building was first placed in service. However, qualified improvement property does not include building enlargements, elevators and escalators, and the internal structural framework of a building.

Both first-year expensing and bonus depreciation are highly technical in nature and subject to limits and exceptions. To fully leverage these deductions, it is important to understand their specific requirements. It is also advisable to monitor these provisions for further legislative amendment.

This article contains general information only. It is not tax advice and it should not be used as a basis for any business or tax decision. You should consult with a qualified professional before taking any action that may affect your business or you personally.