

# Time to Pick Up the Pace for 100% Bonus Depreciation



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To claim the currently available 100% bonus depreciation deduction, taxpayers must place assets into service by December 31, 2022. In 2023, bonus depreciation decreases to 80%. This article will discuss the reduction in bonus depreciation and some pros and cons.

## Background

Generally, depreciation means the recovery of an investment over the economic useful life of an income-producing asset. For example, equipment has a useful life of five years per IRS tables. If a taxpayer purchases equipment in the amount of \$10,000 and places the equipment into service in the current year, the taxpayer's standard depreciation deduction would be \$2,000 per year.

Depreciation starts when the property is placed into service. Property is first placed into service when it is in a condition or state of readiness and availability for a specifically assigned function, whether in a trade or business, in the production of income, in a tax-exempt activity or in a personal activity.

## Bonus Depreciation

Bonus depreciation is an accelerated tax deduction on qualifying business property placed into service during the tax year. The deduction allows taxpayers to deduct the cost of the asset immediately, rather than depreciating the cost over the economically useful life of the asset. In the example above, if the taxpayer utilizes bonus depreciation, the deduction would be \$10,000 if taken in 2022 but would decrease to \$8,000 if taken in 2023 under the new IRS schedule.

Qualifying property is generally any property

that has a recovery period of 20 years or less under the Modified Accelerated Cost Recovery Systems (MACRS) rules, such as leasehold improvements, land improvements, equipment, office furniture, fixtures, computers and other assets with a life of 20 years or less.

Bonus depreciation was introduced in 2002 under the Job Creation and Worker Assistance Act. The deduction was initially 30% but gradually increased to 50% over the years. The currently available 100% bonus depreciation deduction was a result of the 2017 Tax Cuts and Jobs Act (TCJA), which also expanded qualified assets to include used property.

The 100% bonus depreciation deduction will be phased down starting in 2023 and will be eliminated after 2026 unless Congress acts to continue it.

The scheduled reduction in the bonus depreciation deduction after December 31, 2022, is as follows:

- 80% for property placed in service between January 1, 2023 and December 31, 2023.
- 60% for property placed in service between January 1, 2024 and December 31, 2024.
- 40% for property placed in service between January 1, 2025 and December 31, 2025.
- 20% for property placed in service between January 1, 2026 and December 31, 2026.

## Cost Segregation

For taxpayers to take advantage of bonus depreciation on the purchase of a building or significant qualified leasehold improvements, a cost segregation study is recommended. A cost segregation study classifies the property into different recovery periods eligible for bo-

nus depreciation, which may include recovery periods much shorter than the standard 39 years for commercial property or 27.5 years for residential property. The benefits of cost segregation and the tax savings it could generate should significantly exceed the cost of the study.

## Depreciation Recapture

Bonus depreciation can generate tax savings and free up cash for other uses. However, what the IRS giveth, it taketh with depreciation recapture. Depreciation recapture requires that depreciation deductions taken over the years are taxed when the property is disposed of. When a taxpayer sells property and a gain is realized, some of the gain may be recaptured as ordinary income, which could be taxed as high as 37%. Tax planning is recommended to minimize or avoid the tax hit.

## Net Operating Losses

Accelerated bonus depreciation deductions may also create a net operating loss (NOL) for a taxpayer. Generally, NOLs are limited and can be carried forward to offset income in future tax years.

Taxpayers should consult their tax advisor on whether to elect bonus depreciation, as the clock is ticking on the 100% percent deduction. Bonus depreciation is a wonderful way to reduce the taxpayer's current income tax bill, but a careful analysis is necessary to optimize the benefits.

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