



March 2020

If You Don't Want 100 Percent Depreciation, Elect Out or Else

As you likely know, the Tax Cuts and Jobs Act increased bonus depreciation to 100 percent.

Unlike most tax provisions that involve a tax election, this one requires you to elect out if you don't want it.

For example, you (or your corporation) buy two \$50,000 trucks, each with a gross vehicle weight rating of 6,500 pounds and a bed length of 6.5 feet. You use the trucks 100 percent for business. Because of the weight and bed size, the trucks are exempt from the luxury passenger vehicle depreciation limits.

You have five choices on how to deduct the vehicles:

1. Do nothing. This forces you to use bonus depreciation and deduct the entire \$100,000 cost in year one.¹ In addition, you deduct your operating expenses such as gas, oil, insurance, etc.
2. Elect out, choose Section 179 expensing of any amount of your \$100,000 cost of the trucks, and depreciate the balance.² For example, you could elect to deduct \$30,000 of Section 179

expensing on each truck and then depreciate the remainder using MACRS. In addition, you deduct your operating expenses such as gas, oil, insurance, etc. (**Note.** The trucks are not subject to the \$25,000 SUV ceiling because of their weight and bed length.)

3. Elect out, don't use Section 179, and depreciate the trucks using the five-year MACRS depreciation schedule (which takes six years).
4. Elect out, don't use Section 179, and depreciate the trucks using the five-year straight-line depreciation schedule (which also takes six years).
5. Use the 57.5 cent IRS standard mileage rate for each business mile driven. The 57.5 per mile rate includes operating expenses and 27 cents a mile for depreciation.³

Okay, you get the big picture. Two trucks, each with a cost of \$50,000 and both exempt from the luxury vehicle limits. Five choices as to the deduction. And one easy way to make a major mistake.

The Mistake That Did Not Bite

In April 2018, Joey, a self-employed plumber, bought two \$50,000 trucks and used them 100 percent for business. He classified the trucks as office supplies in his books of account. In April 2019, Joey's CPA unknowingly prepared Joey's tax return with the trucks as deductible office supplies.

In January 2020, Joey hires a new CPA who notes that the trucks are in the wrong category and that they need treatment as five-year assets. Joey had treated the trucks as office supplies and did not capitalize or depreciate them (let's say he did this by mistake).

The new CPA finds the trucks and amends the returns. He has to use bonus depreciation because the taxpayer did not elect out on time (explained below). Here, Joey was lucky. His new CPA's amended return did not trigger any new taxes. Whereas Joey had incorrectly deducted 100 percent, so the amended return gives Joey a 100 percent deduction because of the required bonus depreciation.

The Mistake That Did Bite

In 2018, Sammy's corporation bought an \$80,000 SUV that had the necessary weight to avoid the luxury depreciation limits. The corporation used MACRS depreciation and deducted \$16,000 on its 2018 tax return. Sammy was happy with the \$16,000 deduction. It fit with his tax planning program.

But Sammy was about to be unhappy. His tax preparer failed to elect out of bonus depreciation. The IRS audited his 2018 tax return and noted Sammy's failure to elect out. Presto! The IRS increased the corporation's 2018 depreciation on that SUV from \$16,000 to \$80,000 and tacked on some penalties for good measure.

Sammy fired his tax preparer.

Rule Book for Electing Out

In general, personal property with a class life of 20 years or less is Section 168(k) property (bonus-depreciation property).⁴ The trucks and the SUVs discussed above are five-year Section 168(k) property.

In September 2019, the IRS announced new final regulations under Section 168(k). The information release describing the new regulations states:⁵

Taxpayers who elect out of the 100 percent depreciation deduction must do so on a timely-filed return. Those who have already timely filed their 2018 return and did not elect out but still wish to do so have six months from the original deadline, without an extension, to file an amended return.

In other words, the final regulations provide a general rule of making the election by the due date of your tax return up to the final date of any extension⁶ (such as October 15 for an April 15 Form 1040).

If you fail this electing-out rule and want to elect out, you must use the IRS private letter ruling process to ask for mercy.⁷ This is not an inexpensive process, and it comes with no guarantees.

The IRS in its regs states that you make the elect-out election in the manner prescribed on Form 4562, “Depreciation and Amortization,” and its instructions for the tax year the property is placed in service.⁸ This sounds hard, but it’s not. Here are the words the IRS uses in its Form 4562 instructions for tax year 2019 (the tax return you are likely filing as you read this):⁹

To make an election, attach a statement to your timely filed return (including extensions) indicating the class of property for which you are making the election and that, for such class, you are not to claim any special depreciation allowance.

Here's a sample election that we created for your use:

Election Out of the Special Depreciation Allowance (Bonus Depreciation) Under IRC Section 168(k)(7)

Taxpayer name and taxpayer ID number

Taxpayer address

Tax year ending

Taxpayer elects under IRC Section 168(k)(7) to not claim the additional 100 percent first-year bonus depreciation deduction for five-year property placed in service during the tax year ended 20XX.

Luxury Vehicles

Because of their gross vehicle weight, the vehicles mentioned above were exempt from the luxury vehicle depreciation limits that apply to¹⁰

- cars with **curb weight** of 6,000 pounds or less, and

- SUVs, pickups, and crossover vehicles with a **gross vehicle weight rating** of 6,000 pounds or less.

Had the vehicles failed the weight test, their bonus depreciation for 2019 would have been limited to \$18,100.¹¹

For more on how bonus depreciation interacts with vehicles subject to the luxury limits, see *IRS Saves Many Vehicles from the TCJA Bonus Depreciation Debacle*.

Takeaways

Elect out of bonus depreciation—or else.

In an unusual twist to tax elections, to avoid this 100 bonus depreciation deduction, you have to formally elect out as the rules specify.

Fail to elect out? Whack! You deducted 100 percent. The fact that your tax return shows some lower number, such as MACRS depreciation, means nothing.

If your property is eligible for bonus depreciation and you want to spread your depreciation deductions over many years, you must elect out of bonus depreciation.

There's one exception to the 100 percent bonus depreciation deduction when you fail to elect out, and it applies often. It's the luxury vehicle depreciation limit. This limit, if it applies in your situation, spreads your depreciation over time automatically.

[Client Letter on This Article for Use by Tax Pros. Click Here.](#)

- 1 IRC Section 168.
 - 2 IRC Section 179.
 - 3 Notice 2020-05.
 - 4 IRC Section 168(k).
 - 5 IR 2019-156.
 - 6 Reg. Section 1.168(k)-2(f)(1)(ii).
 - 7 Reg. Section 1.168(k)-1(e)(7)(i).
 - 8 Reg. Section 1.168(k)-1(e)(3)(ii).
 - 9 2019 Instructions for Form 4562, Dated Jan. 27, 2020.
 - 10 IRC Section 280F(d)(5).
 - 11 Rev. Proc. 2019-26, Table 2.
-