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Depreciation Changes 2023

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It is important to understand the challenges facing tax preparers when it comes to accelerated depreciation and equipment purchases with trade-ins. The Tax Cuts and Jobs Act (TCJA) passed in 2018 had three significant changes to capital purchases and trade-ins.

First, Section 179 increased to $1,000,000 and is indexed for inflation. For 2023 a deduction is allowed for up to $1,160,000 of capital purchases in the year they are placed in service. The deduction is limited if total capital purchases are greater than $2,890,000. It can only be used for capital items with a useful life of less than 20 years. The deduction is also limited to taxable income. In other words, it cannot be used to push the Schedule F negative. The decision to use Section 179 can be made on each piece of equipment individually and items can be partially accelerated.

The second change was to Bonus Depreciation. Bonus Depreciation allows for an 80% deduction for any new or used capital assets with a useful life of 20 years or less and placed in service in 2023. There is no limit to the amount of Bonus Depreciation that can be taken regardless of how much total capital purchases are or what the taxable income is. However, the decision to take Bonus Depreciation is made on a class-by-class basis. This means the equipment gets grouped by age and Bonus Depreciation is taken on all capital items in that class or none. It is important for tax planning purposes to note that Bonus Depreciation will decrease to 60% in 2024, 40% in 2025 and will be 20% in 2026.

The TCJA also changed how trade-ins were reported on a tax return. Previously, trade-ins were handled as a like-kind exchange. The purchase price of the new piece was the difference between the cost and trade value. Any basis left on the traded piece continued to depreciate. The ability to report equipment trades as like-kind exchanges was eliminated with the TCJA. Now, the trade-in is reported as a sale of equipment and any depreciation recapture or gain is reported on Form 4797 on the tax return.

From a tax management standpoint, it has not been uncommon since the TCJA to see a tax return that had significant gains reported on Form 4797 due to large ticket items being traded-in and Bonus Depreciation being used to offset those gains. This results in a negative Schedule F. However, as mentioned before, Bonus Depreciation will continue to decrease over the next 3 years. Remember, Section 179 cannot be used to run the Schedule F negative. The task lies in helping clients manage their taxes with large gains reported on Form 4797 but at the same time not having the bonus depreciation as a tool to manage their overall taxable income levels. Make sure to seek tax planning advise before the end of the year to avoid surprises.

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