



Proposed Section 168(k) regulations—Opportunity summary

The U.S. Treasury Department and IRS recently released proposed Section 168(k) regulations (Proposed Regulations),¹ which provide guidance for claiming the expanded additional first-year depreciation deduction (bonus depreciation) that was enacted as part of the 2017 U.S. tax legislation. **The Proposed Regulations clarify a number of issues associated with bonus depreciation, including the requirements for determining the acquisition date for qualified property.**

To be eligible for 100 percent bonus depreciation, qualified property must be acquired and placed in service after September 27, 2017. Property acquired before September 28, 2017 may be subject to the provisions of former Section 168(k)—generally, 40 percent bonus depreciation if placed in service in 2018 and 30 percent bonus depreciation if placed in service in 2019.

As provided in the tax legislation and the Proposed Regulations, property acquired under a written binding contract (WBC), including property constructed for a taxpayer under a WBC, is treated as acquired on the date the contract was executed. Therefore, determining the acquisition date requires a detailed analysis to determine whether contracts are properly considered binding. A WBC has to have the following factors, all of which would need to be properly analyzed to determine the applicable bonus percentage:

- Be binding under state law
- Not limit damages to an amount less than 5 percent of the purchase prices
- Not be subject to a condition within the control of either party
- Not be an option or a letter of intent
- Be specific as to the design specifications and amounts of assets being acquired.

Companies within the following industries are expected to be most heavily impacted: building construction, retail, upstream/midstream/downstream oil and gas, and manufacturing. Such companies that have incurred expenditures for the manufacture, production, or construction of property placed in service in 2018 (or future years) pursuant to a contract entered into prior to September 28, 2017 (includes master service agreements, purchase orders, etc.) will need to determine whether the contract was binding based on the factors listed above. This includes reviewing the contract for the following examples of criteria:

- The execution date of the contract(s), master service agreement(s), and/or purchase order(s)
- The scope of the contract with respect to design specification and payment amount
- The contractual language governing enforcement, termination rights, breach clauses, and liability payments
- Determination of whether certain component assets (e.g., security system or HVAC system of a building) are acquired or constructed via a binding contract even if the contract for the larger asset is not a WBC.

¹ These regulations are proposed to be effective for qualified property placed in service by a taxpayer during or after the taxpayer's tax year that includes the date the final regulations are issued. Pending the issuance of the final regulations, taxpayers may choose to apply these proposed regulations to qualified property acquired and placed in service after September 27, 2017, and prior to the tax year in which the final regulations are issued.

If property is not acquired, manufactured, produced, or constructed pursuant to a WBC, the acquisition date is generally the date the property is within the taxpayer's physical possession or control, but not earlier than the date the cost of the property is incurred under Section 461. Determining the proper acquisition date for these assets may require review of contractual acceptance provisions and, for staged deliveries, review of invoice receipt and payment.

As the rules and required analysis covered above display, the assumption of 100 percent bonus depreciation for assets placed in service after September 27, 2017 is not a safe or accurate one. For assets being acquired, manufactured, produced, or constructed pursuant to a contract, a thorough and detailed contract analysis should be completed to accurately determine the appropriate bonus depreciation percentage since misapplication of the rules under the Proposed Regulations could cause a significant difference in a taxpayer's current year depreciation deduction for tax years where 100 percent bonus applies.



How KPMG can help

Depending on a company's facts, the contract review analysis for property acquired or constructed via a contract can be extensive and require a specialist. KPMG LLP (KPMG) offers the assistance of professionals with specialized knowledge in this area who can work with your company to:

- Develop methodology to efficiently identify the population of contracts for review
- Identify a population of contracts for review
- Analyze the contracts to determine the applicable acquisition date under the WBC rules
- Assist in documenting the technical basis and underlying support for specific bonus depreciation determinations.

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