

## IRS and Treasury Department Release Last Set of Final Regulations on Bonus Depreciation

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By: [Elizabeth L. McGinley](#)

On September 21, 2020, the IRS and Treasury Department released the last set of [final regulations](#) (the 2020 Final Regulations) under the bonus depreciation rules of Section 168(k) of the Internal Revenue Code (the Code).

### Background

Code Section 168(k) entitles businesses to a depreciation deduction equal to 100 percent of the cost of qualified property (Bonus Depreciation). Qualified property generally includes depreciable property, whether new property placed in service by the taxpayer or used property acquired from an unrelated seller, as determined under the principles of Code Section 267(b) or 707(b), in either case, if such property is subject to a recovery period of 20 years or less under the modified accelerated cost recovery system (MACRS). The deduction for Bonus Depreciation will phase out, in 20 percent increments, from 2023 to 2026.

The 2020 Final Regulations modify and finalize the [proposed regulations released on September 13, 2019](#) (the 2019 Proposed Regulations) and modify certain aspects of the [final regulations released on the same date](#) (the 2019 Final Regulations).

### Highlights from the 2020 Final Regulations

- **Withdrawal of the partnership lookthrough rule.**

The 2019 Final Regulations provided that used property is not eligible for Bonus Depreciation if the taxpayer previously owned a depreciable interest in such property. The 2019 Proposed Regulations added a partnership lookthrough rule providing that a partner is treated as having a depreciable interest in partnership property generally equal to the partner's share of such property's depreciation deductions during the current and prior five taxable years.

The 2020 Final Regulations withdraw the partnership lookthrough rule and, accordingly, a taxpayer will not be treated as having a depreciable interest in partnership property solely by virtue of being a partner in the partnership. The preamble to the 2020 Proposed Regulations (the Preamble) states that the IRS and Treasury Department believe the partnership lookthrough rule was unduly complex, and compliance with such rule would place a significant administrative burden on both taxpayers and the IRS.

The IRS and Treasury Department considered, but did not adopt, a replacement rule that would treat a taxpayer as having a depreciable interest in partnership property only if such taxpayer was a controlling partner in the partnership. The Preamble explains that such a replacement rule ultimately was deemed unnecessary given the limitation on related-party acquisitions, which would prevent a majority partner from claiming Bonus Depreciation on a direct purchase of partnership property, and given the rules governing series of related transactions (described below).

- **Series of related transactions.** The 2019 Proposed Regulations provided special rules for determining whether property transferred in a series of related transactions is eligible for Bonus Depreciation. Specifically, these rules tested relatedness after each step in a series and between the original transferor and the final transferee after the last step in the series.

The 2020 Final Regulations simplify these rules. Under the 2020 Final Regulations, each transferee in a series of related transactions is required to test its relationship with both the transferor from which it directly acquired the property and the original transferor in the series. A transferee would be treated as related to the immediate transferor or the original transferor if relatedness exists either immediately before the first step in the series or at the time the transferee acquires the property.

For purposes of testing relatedness under these rules, a transferor in a series that ceases to exist during the series is deemed to continue to exist until the end of the series. Similarly, if a transferee acquires property from a transferor that did not exist immediately prior to the first step in a series, the transferee must test its relationship with the party from which the transferor acquired the property.

- **Application to consolidated groups.** If a consolidated group member acquires property from another member in an intercompany transaction and, within 90 days, leaves the consolidated group pursuant to the same series of related transactions, the 2019 Proposed Regulations would treat the transferee member as acquiring the property one day after deconsolidation and placing the property in service no earlier than such date, thereby allowing the transferee member to claim Bonus Depreciation. The 2019 Proposed Regulations included parallel rules for a deemed asset acquisition in connection with the transfer of the stock of a consolidated group member for which a Code Section 338(h)(10) or 336(e) election was made.

The 2020 Final Regulations permit the same result, but with a different construct. In contrast to the 2019 Proposed Regulations, the 2020 Final Regulations deem the transferee member (or the target, in the case of a deemed asset acquisition) to sell the property to an unrelated third party one day after the transferee member leaves the consolidated group for an amount equal to the transferee member's basis in the property, and then immediately acquire identical, but different, property from an unrelated third party for the same amount. As a result, the transferee member (or target) could be eligible to take Bonus Depreciation equal to its actual purchase price for the property, less any interim depreciation deductions taken with respect to such

property.

To qualify for this treatment, the transferee member's acquisition must satisfy the requirements for used property (other than the limitations on related-party acquisitions and prior use within a consolidated group, which otherwise would disallow Bonus Depreciation under this construct), and the property must be eligible for Bonus Depreciation on the date the transferee member leaves the consolidated group and the following day.

#### **Further Reading**

For further reading on the Bonus Depreciation rules, Bracewell has published articles discussing the [implications](#) of the 2019 Final Regulations and 2019 Proposed Regulations for the energy and infrastructure sectors; discussing the [clarity provided](#) to the energy industry by the initial proposed regulations under Code Section 168(k), which were released on August 3, 2018; and, providing [an overview](#) of Code Section 168(k) as enacted under the Tax Cuts and Jobs Act.