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Personal Property Tax Fix

The Tax Cuts and Jobs Act of 2017 changed the way trades of equipment will be handled on tax returns for all taxpayers starting in 2018. The deferral of gain will continue to be allowed for real property (such as land) but it will no longer be allowed on personal property (tractors, pivots, vehicles, etc.). The trade off for this change was a change to the Section 179 Expense Election and Bonus Depreciation. The annual expense limit for Section 179 was raised to $1 Million per year with a purchase limit of $2.5 Million of assets. This raise has no expiration date set in the tax code or is essentially permeant (until Congress changes it again). The Bonus Deprecation has been limited to new property in the past, but the new law took that requirement away and made the election 100% through 2023. There is no maximum limit on this so we essentially have unlimited depreciation for the next 6 years. After 2023, the bonus depreciation percentage allowed will phase out through 2026.

The importance of all this background is that while we will be forced to recognize the gain on traded equipment, we will be able to take enough depreciation to offset that income. Essentially, we will be transferring income from Schedule F (Farm Income) to the Form 4797 (Sale of Business Property) since the gain will be on Form 4797 and the depreciation expense will be on Schedule F. This will likely lower Self-Employment Taxes for many sole-proprietors and will be a good thing in the long run.

The real problem this change caused was at the state level. In Nebraska, the law states that personal property taxes will be assessed at the "adjusted basis of property as determined by the Internal Revenue Code" prior to taking any Section 179 expense. In other words, this was typically the "boot" paid or trade difference plus any remaining value of the traded asset. If the prior asset was older than 7 years (typically) or if Section 179 or Bonus had been used to reduce the value of that first asset, the adjusted basis was just the trade difference. After the federal change, the adjusted basis will be the full value of the new asset with no adjustment for the trade. This mean the value that will be used to assess personal property taxes will be higher than what we've been used to in the past.

During the 2018 legislative session, a change was made to the wording that "fixed" this issue for two years. When you are preparing your 2019 and 2020 personal property tax returns, you will need to recalculate the Federal Depreciable Basis under the old rules. The other catch is that the new wording change puts a requirement that this is only allowed if there is an election to use Section 179 on that asset. In other words, if you don't use Section 179 expense on that asset, you will have to use the full value of the new asset. While this is a win for taxpayers, there will certainly be more work involved in the filing of these returns with potentially a second depreciation schedule needing to be kept to handle the trades one way for the Federal return and another way for the State return. As it seems with most of these law changes the “simplification” of the tax code has lead to much more complexity in preparing returns accurately.