Using Sage Fixed Assets' new features for Tax Compliance

Conforming to the 163(j) rules for fixed asset depreciation

Background

A tax provision in the Tax Cuts and Jobs Act (TCJA) of 2017 resulted in the addition of two new depreciation methods to Sage Fixed Assets—Depreciation 2019.1. These methods depreciate property on a straight-line basis over their remaining lives after switching from a shorter life to a longer life.

When a real property trade or business elects out of the interest deduction limits under Section 163(j), they must use the MACRS Alternative Depreciation System (ADS) to depreciate any non-residential real property, residential rental property or qualified improvement property. This includes existing properties – as of the fiscal year the election is made. Meaning that assets already placed-in-service need to change to the new method and life as of the year of the election; not retroactively. As of the date of the change, the remaining value of the asset is spread evenly over its new remaining life. Similar rules apply to farming businesses and property with a 10-year or greater life.

The IRS Change in Use rules (Reg. §1.168(i)-4(d)) require the change to be applied prospectively, as of the beginning of the tax year of the change. The same averaging convention, as was in use before the change, must be retained after the change. Tangible property uses either a midmonth, half-year, or midquarter convention.

This provision, in Section 163(j) of the Internal Revenue tax code, is effective for tax years beginning after December 31, 2017.

New depreciation methods

Two new depreciation methods are available as of the 2019.1 release:

- **RM** – Remaining value over remaining life – with the midmonth convention

- **RH** – Remaining value over remaining life – with the half-year and midquarter convention

These methods spread the remaining value of an asset over its remaining life, on a straight-line basis, for each period of depreciation. When changing an existing asset's life, *after* it has been placed in service for one or more years, RM or RH must be used for tax compliance. Method AD (ADS Straight-line MACRS) cannot be used for mid-recovery life changes, as it calculates period depreciation based on the acquired value and current life of the asset, not the remaining value and remaining life. RM and RH are considered ADS methods for classification purposes on Form 4562, Depreciation and Amortization; however, both can be useful for non-tax depreciation also.

> *Tip: Learn more about these methods in-product Help for Sage Fixed Assets—Depreciation. Start with the topic "RH and RM Methods Overview" and view related topics in the 'More Information' links.*

New Bulk Edit feature

If numerous assets require the *Depreciation Method* and/or *Estimated Life* to be modified, the **Bulk Edit** feature is available in version 2019.1.2 to streamline the process. It replaces the tedious task of changing multiple assets individually to new methods and lives.

Bulk Edit is flexible and can be used for many needs:

- Correction of an error on the estimated life assigned to multiple assets in their placed-in-service year,

- Changes in accounting estimates under generally accepted accounting principles (GAAP),

- Creation of an ADS book to comply with various tax law changes, such as Section 250 (for more information, see the Sage City article "Using your Assets to Generate a Section 250 Deduction)",

- Or, to change assets already placed-in-service to comply with the Section 163(j) rules as we will see below.

> *Tip: Learn more about Bulk Edit in the in-product Help for Sage Fixed Assets—Depreciation. A good starting point is the help topic titled "Performing a Bulk Edit"; which can be located using Search in Help.*

Please note that Bulk Edit is only available for U.S. Companies. If you would like to have it added to Canadian and Government/Non-Profit entities, please give an *up vote* and comment on this idea in Sage City.

Adjusting existing assets

For compliance with Section 163(j), change the Depreciation Method and Estimated Life for assets that were placed in service in tax years before the tax year in which the 163(j) election is made. The changes should be done in the depreciation book used for Federal U.S. taxation purposes (usually the Tax book). There is no need to change assets that *are fully depreciated* as of the election year.

Below is one recommended approach to adjust your assets. An *example* is provided after each step for illustration purposes. Consult with your company's Sage Fixed Assets power user(s) and tax experts to customize the steps to fit your situation. The Sage Professional Services team is also available if you would like to engage their services.
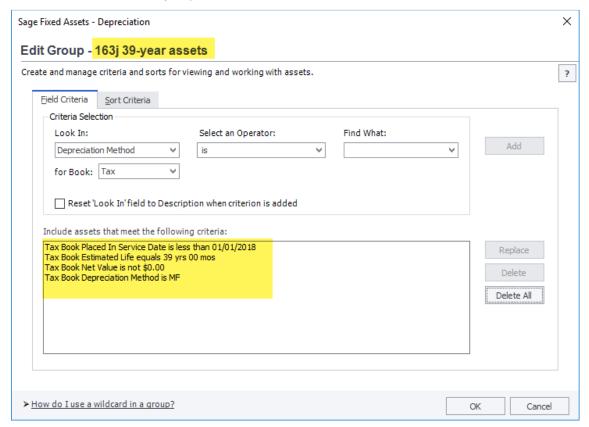
Initial Steps

1. Identify the assets to be changed, the desired new method and life, and the effective date of the change. For the ADS method and life for common types of property that must be changed under Section 163(j), see *Common ADS and GDS methods and lives* below.

   For our example, the election is made for the 2018 tax year, which ends December 31, 2018. The assets' method and life change must be effective as of the beginning of the tax year, which is 1/1/2018, so assets will be depreciated through the fiscal year end of 12/31/2017 before they are changed.

   The company has determined that it has MF100 39-year property and MF100 15-year property to be changed to RM 40-years; RH 20-years, respectively. The changes will be made in the Tax book.

2. Use **Group Manager** to locate the assets that must be changed.

   For the 39-year property, the company locates the specific assets by creating an asset group (KB ID: 16919 How to Create a Group) to find all MF 39-year property that was placed in service before 2018 and is not fully depreciated as of 12/31/2017.
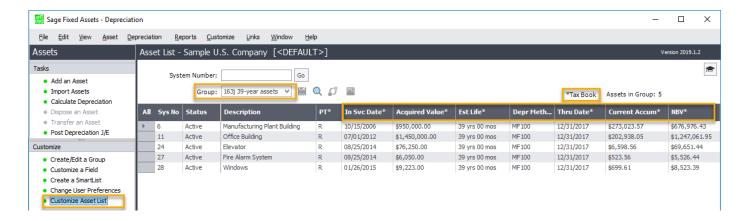
The company next creates a group of MF100 15-year property in the same manner.

3. Depreciate the group(s) of assets as of the tax year-end before the year of change. This is important for two reasons:

    a. Net Book Value changes each period for which an asset is depreciated, so depreciation must be calculated for the group to exclude assets that are fully depreciated.

    b. The Current Thru Date of the assets will be the effective date of the change to the new method and life.

    The company calculates depreciation on the Tax book of the two groups of assets through 12/31/2017.

TIP: *View the group(s) in the Asset List using Customize Asset List to see the assets and their relevant book fields quickly.*

Next Steps

Either change multiple assets at the same time using **Bulk Edit or** individually adjust the assets in **Asset Detail**.

Using Bulk Edit

Perform the Initial Steps first.

Use **Bulk Edit**; found on the Depreciation menu, to change the selected assets to the appropriate new depreciation method and life. The Panels below refer to the screens in the Bulk Edit dialog. See KB ID: 95694 How to perform Bulk Edit of Critical Depreciation Fields if you need more information.
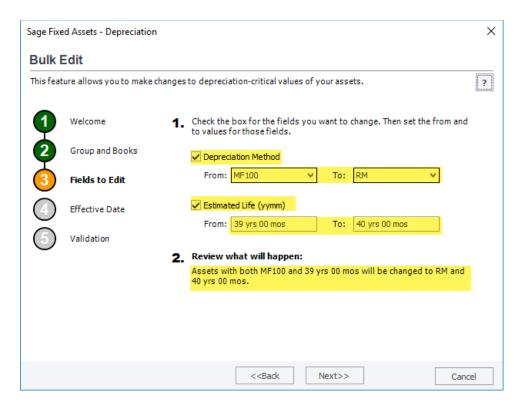
1. **Panel 1 – Welcome.** If you have not already done so, make a backup of your company first (File>Company Utilities>Backup Companies…).

2. **Panel 2 – Group and Books**. Select the assets identified in the Initial Steps and select the book(s) to be changed.

   Continuing the example, the company selects the first group created, "163j 39-year assets", for the Asset group and the "Tax" book for Book(s).

3. **Panel 3 – Fields to Edit.** Select the From and To values for the changes needed.
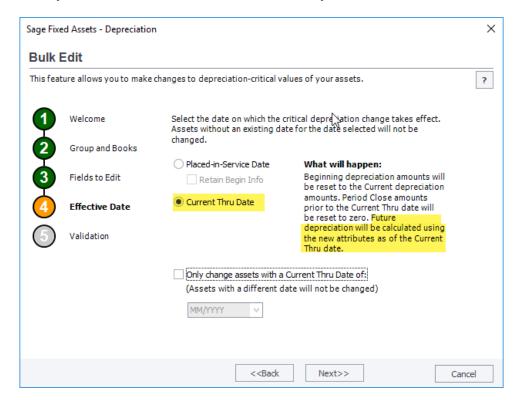
   MF100 and RM are selected for the From and To fields for the Depreciation Method. 39 00 and 40 00 are entered for the From and To fields for the Estimated Life.
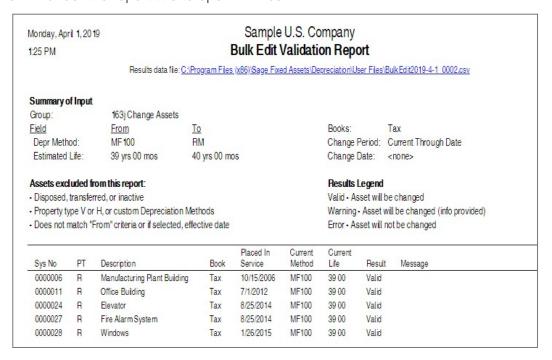

4. **Panel 4 – Effective Date.** Select "Current Thru Date" to retain the depreciation values taken in prior tax years for each asset. This option calculates depreciation using the new method and life going forward.

Since the selected assets are currently calculated through 12/31/2017, depreciation calculations for January 2018 and later will be based on the RM 40 years.

5. **Panel 5 – Validation.** Select Validate to generate a report of the assets to be changed. Note that you can also view the results in Excel – if Excel is installed on your computer, click on the link under the report title to open in Excel.

6. **Panel 5 – Validation.** Select Execute to perform the change on the assets. The application changes the Depreciation Method and Estimated Life values for each asset. Additionally, each asset's Beginning Date, Beginning YTD and Beginning Accum are updated to the values in the Current Through Date, Current YTD, and Current Accum, respectively. An execution report, similar to the validation report, is generated.

Future depreciation calculations will use the new method and life, based on the net value of the asset as of the effective date.

> *The company calculates depreciation as of 12/31/2018 and views the Depreciation Expense Report. The report shows the prior accumulated depreciation, as of 12/2017, is the same as before the change. The Current YTD Depreciation expense for 2018 is correct for the increase in the life of 1 year (39 to 40 years).*
>
> *Proof: See asset #28 below.*
> > *The net book value at 12/31/17 is $8,523.39 ($9,223.00 – 699.61).*
> > *The remaining life is 444.5 months (40 years x 12 months/yr = 480 months less 35.5 months expired since the In Svc Date) Note: The ½ month is due to the mid-month convention.*
> > *The 2018 depreciation expense is $230.10 ($8,523.39 ÷ 444.5 months x 12 months)*

Depreciation Expense Report
As of December 31, 2018

Book = Tax
FYE Month = December

Sys No	Ext	In Svc Date	Acquired Value	P T	Depr Meth	Est Life	Salv/168 Allow Sec 179	Depreciable Basis	Prior Thru	Prior Accum Depreciation	Depreciation This Run	Current YTD Depreciation	Current Accum Depreciation	Key Code
000028	000	01/26/15	9,223.00	R	RV-MM	40 00	0.00	9,223.00	12/31/17	699.61	230.10	230.10	929.71	

Editing in Asset Detail

Perform the Initial Steps (from above) first.

1. Go to detail view for *each asset* that needs to be changed.
2. Change the method to RM or RH, as needed.
   a. The 'Critical Depreciation Change' dialog will appear. Click Yes to the message and then OK for "Current Thru Date."
3. Change the Estimated life to the proper ADS life (i.e., 40 years).
   a. The 'Critical Depreciation Change' dialog will appear. Click Yes to the message and then OK for "Current Thru Date."
4. Perform steps 2 and 3 on other books, if needed.

Adding newly acquired assets

For new assets (i.e., PIS in 2019 and later in the example) that need to comply with 163(j) depreciation treatment, it is suggested to use method AD (ADS Straight-line MACRS). Method AD determines the proper averaging convention based on the Property Type and the Estimated Life for the asset.

Note: Method AA should not be used, because it is a +168 Allowance method which calculates first-year bonus deprecation. If making the Section 163(j) election, the Alternative Depreciation System (ADS) is required. Rules in Section 168(k) of the code preclude taking the first-year bonus when ADS is required.

Alternatively, method RM and RH can be used. However, the benefit of the system applying the appropriate averaging convention is lost. Method RM applies the midmonth convention. Method RH will default to the half-year convention and can be changed to midquarter with the MACRS Convention Switch feature.

The four methods, AD, AA, RM, and RH, are reported in the ADS section of Form 4562 for the place-in-service year of the asset.

Common ADS and GDS methods and lives

When changing an existing asset to use the ADS system, use method RM or RH. The key is to be sure the averaging convention originally used for the asset is retained. Therefore, use RM for property that must use the midmonth (MM) convention; use RH for property that is required to use the half-year (HY) or midquarter (MQ) convention.

Description	GDS			ADS		
	Method	Life	Averaging Convention	Method	Life	Averaging Convention
Residential rental real estate (Placed in service before 2018)	MF100	27.5	MM	RM	40	MM
Residential rental real estate (Placed in service after 2017)	MF100	27.5	MM	RM	30	MM
Qualified Leasehold Improvements (Placed in service before 2018)	MF100 or MA100**	15	HY / MQ	RH	39	HY / MQ
Commercial real estate	MF100	39	MM	RM	40	MM

** If MA100 was used, please see the below section about special handling of Assets with First-year Bonus.

Assets with First-year Bonus (168 Allowance)

The RM and RH methods are not "+168 Allowance" methods. Therefore, when changing an asset from a +168 Allowance method (method MA, MR, AA, or SB), to RM or RH, the application changes the bonus amount to $0.

An edit is needed for each asset that took bonus depreciation. The Beginning Accum field must be increased by the 168 Allowance Amount, so the system will not spread the amount over the asset's remaining life after the change to RH or RM. First, make a note of each assets' 168 Allowance Amount before changing the method and life. Then change the method and life using either process (Bulk Edit or Editing in Asset Detail) described above. The final step is to edit the Beginning Accumulated Depreciation field to increase the existing amount by the bonus amount.

> *Tip: Use one of the general information fields to store the 168 Allowance Amount for historical reference purposes. For efficiency, perform a Custom Export of the existing 168 Allowance amount. Then use Custom Import (update existing assets option) to import the amount into a general information field for each asset.*

Would you like to see a feature in the application for handling this process? If yes, please let Sage know, by voting up this Idea in Sage City, or adding your idea.