

New bonus depreciation rules – what you need to know



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The tax compromise passed by Congress at the end of last year, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the Act), increased bonus depreciation to 100 percent for investments in qualified business property acquired and placed in service after September 8, 2010, and before January 1, 2012. The Act also extended 50 percent bonus depreciation for qualified property placed in service from January 1, 2012 through December 31, 2012. Both of these deadlines are extended an extra year for certain long-production and transportation property.

This is an expansive benefit for businesses and may result in substantial tax savings for taxpayers that already had plans to purchase qualified property. Unlike section 179 expensing, you do not need net income to take bonus depreciation deductions. Further, bonus is not limited to smaller businesses or capped at a certain dollar level. However, bonus is not available for property used outside of the US, tax-exempt use property or tax-exempt financed property. Also, many (if not most) states are likely to opt out of this provision for state income tax purposes.

There have been many questions about implementation of 100 percent bonus depreciation since the Act was signed into law in December, particularly regarding the placed in service dates in order to qualify for the 100 percent deduction. Treasury has recognized the importance of this issue to many taxpayers and has said that it plans to issue guidance in the near future. In the meantime, here is what we know about these new rules as we go to press.

Acquisition and placed in service dates

Fifty percent bonus applies for property acquired and placed in service from January 1, 2010 through September 8, 2010, but only if no written binding contract for the acquisition was in place before January 1, 2008. Then, the new law increases the bonus percentage to 100 percent for property acquired and placed in service after September 8, 2010 and before January 1, 2012. The bonus percentage drops back down to 50 percent for property acquired and placed in service during 2012.

There is some uncertainty surrounding the written binding contract requirement for purposes of the 100 percent bonus depreciation. While the report issued by the Joint Committee on Taxation states that property acquired under a written binding contract entered into after December 31, 2007 is eligible for 100 percent bonus, it is possible that the IRS will impose tighter contract date requirements. For example, based on the Committee report if a taxpayer enters into a contract to acquire qualified property on August 18, 2010 and places the property in service on October 14, 2010 the property would qualify for 100 percent bonus. However, Treasury may decide to align the contract date requirements with the 100 percent bonus dates, so that only property contracted for between September 8, 2010 and January 1, 2012 would qualify for 100 percent bonus. In the example above that would mean the taxpayer could only claim 50 percent bonus because the contract date is before September 8, 2010.

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Extended placed in service dates

The placed in service dates for long production property and transportation property generally are extended an extra year (i.e., before January 1, 2013 for 100 percent bonus and before January 1, 2014 for 50 percent bonus). However, only the costs incurred before the original placed in service deadline are eligible for bonus – this is known as the progress expenditure rule. For example, a building owner contracts for \$2 million of qualified tenant improvements and begins construction in 2012, during the 50 percent bonus window. By the end of 2012 they have incurred \$1.2 million. Construction is completed in 2013 and the improvements are placed in service in June of that year. Under the progress expenditure rule, \$1.2 million is eligible for 50 percent bonus.

Long production property is property that has a recovery period of at least 10 years, an estimated production period of more than two years, or an estimated production period of more than one year and a cost of over \$1 million. Transportation property is tangible personal property used in the trade or business of transporting persons or property.

Qualified property

Property with a recovery period of 20 years or less, qualified leasehold improvements, certain computer software, and water utility property are eligible for bonus depreciation. Qualified leasehold improvements generally are improvements made under a lease to the interior portion of a building occupied by a tenant, and that are placed in service more than three years after the building was first placed in service.

Qualified restaurant property and qualified retail improvement property are not eligible for bonus depreciation. However, taxpayers may expense up to \$250,000 of the cost of these improvements – as well as qualified leasehold improvements – under section 179. This benefit applies to property placed in service in 2010 or 2011, and is the first time that the cost of real property can be expensed under section 179.

Original use requirement

Only new property is eligible for bonus depreciation.

Self constructed property

Property that is manufactured, constructed or produced by a taxpayer for their own use also is eligible for bonus if the taxpayer begins production after December 31, 2007 and before January 1, 2013.

It is not clear how this long window of time to start production interacts with the acquisition and placed in service date requirements for 100 percent bonus depreciation. The language in the statute for self constructed property seems to parallel the written binding contract date requirements for purchased assets. However, Treasury has stated that it is not sure this is the case, but they have yet to provide specific commentary. This issue will be addressed in the upcoming guidance and it is possible that the IRS will restrict the eligibility dates for self constructed assets.

Can you elect 50 percent or 100 percent?

2003 was the last time there was a change in the bonus depreciation percentage in the middle of a tax year. The Jobs Growth and Tax Relief Reconciliation Act of 2003 increased 30 percent bonus to 50 percent for property placed in service after May 5, 2003. Under that law, the regulations specifically allowed taxpayers to choose either 30 percent or 50 percent bonus for eligible property placed in service after the May 5 cutoff date.

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These regulations have not been updated for the most recent law changes; however, it does not appear that the new law allows taxpayers to elect 50 percent bonus instead of 100 percent bonus for property placed in service after September 8, 2010 and before January 1, 2012. Of course, taxpayers can elect out of bonus for a class of property, but the election applies to the entire year, not to specific dates. This means that you can't take 50 percent on property placed in service before September 8, 2010 and elect out of 100 percent for the rest of the year.

For taxpayers that want to spread out their cost recovery deductions, one alternative would be to elect out of bonus depreciation and selectively expense the cost of eligible acquisitions under section 179. You need to keep in mind that many, if not most, states have not adopted the recent higher federal section 179 limits, plus there are other restrictions on the 179 deduction you need to be aware of.