

Extra year of 100 percent bonus depreciation for certain property

The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (2010 Tax Relief Act) increased bonus depreciation to 100 percent for qualified business property acquired and placed in service after Sept. 8, 2010, and before Jan. 1, 2012 (Jan. 1, 2013 for long production property).¹ Normally, for long production property, taxpayers get an extra year to place property in service, but only the costs incurred as of the end of the prior year are eligible for bonus depreciation (this is known as the “progress expenditure” rule). However, as a result of the new law and as confirmed in recent IRS guidance, there is a one-year window during which this rule does not apply.

Plan to act before year-end to take advantage of this generous tax break

Opportunity: The entire adjusted basis of long production property is eligible for 100 percent bonus depreciation, even if a portion of the cost is incurred in 2012, as long as the property is placed in service before Jan. 1, 2013. As a result, taxpayers have an extra year to complete construction/production of certain property and deduct the full cost immediately when the property is placed in service.

100 percent bonus: General rules

In order to be eligible for 100 percent bonus depreciation, property must meet the following requirements:

- > *Property type.* Eligible property is property with a recovery period of 20 years or less, computer software, water utility property, or qualified leasehold improvement property.
 - Note: The 15-year recovery period for qualified leasehold improvements, qualified restaurant improvements, and qualified retail improvements is set to expire after Dec. 31, 2011. Unless extended, the recovery period for these asset groups will revert to 39 years beginning in 2012. Qualified leasehold improvements will still be eligible for 50 percent bonus in 2012, as will qualified restaurant and qualified retail improvements that also meet the definition of qualified leasehold improvements.
- > *Original use.* The original use of the property must begin with the taxpayer.
- > *Written binding contract.* If property is acquired under a written binding contract, the contract must be entered into after Dec. 31, 2007, and before Jan. 1, 2012.
 - There is no hard cutoff date for written binding contracts as of Sept. 8, 2010 (the effective date of the new law). As a result, the contract window is a full four years. This is different than when bonus depreciation increased from 30 percent to 50 percent in 2003 and is a more taxpayer-favorable rule. The law in effect in 2003 stated that property acquired pursuant to a written binding contract entered into before May 5, 2003, was only eligible for 30 percent bonus depreciation. The 100 percent bonus rules do not have a similar cutoff date.
- > *Acquisition date.* Property must be acquired after Sept. 8, 2010, and before Jan. 1, 2012.
 - The general rule is that the acquisition date is when a taxpayer pays or incurs the cost of the property under its method of accounting.
 - Alternatively, the taxpayer can treat property as acquired on the date that it is provided to them or when title passes.
 - For self-constructed property, the acquisition date requirement is deemed to be met if taxpayer **begins** manufacturing, construction, or producing the property after Dec. 31, 2007, and before Jan. 1, 2013.
- > *Placed in service date.* Property must be placed in service after Sept. 8, 2010, and before Jan. 1, 2012 (Jan. 1, 2013 for long production property).

¹ The American Jobs Act of 2011, proposed by President Obama in early September 2011, would extend 100 percent bonus depreciation through the end of 2012. At the time this Alert goes to press, it is uncertain if this provision will become law.

What is long production property?

In addition to satisfying the rules listed above, long production property must have a recovery period of at least 10 years, and be **produced by** the taxpayer or **produced for** the taxpayer under contract (i.e., the property must be subject to section 263A). In addition, long production property must be:

- > Real property with an estimated production period exceeding one year and an estimated cost exceeding \$1 million, *or*
- > Tangible personal property with a class life of 20 years or more (but only if the property is not inventory in the hands of the taxpayer), *or*
- > Tangible personal property with an estimated production period exceeding two years, *or*
- > Tangible personal property with an estimated production period exceeding one year and an estimated cost exceeding \$1 million.

Effectively, then, the only types of property that meet both the bonus depreciation requirements and the long production property requirements are large qualified leasehold improvement projects and large 15-year land improvement projects.

Action steps

Projects already under construction

- > Review contracts to make sure they were executed within the 100 percent bonus window
- > Review the acquisition date rules with your Baker Tilly advisor to make sure you are acquiring property after Sept. 8, 2010, and before Jan. 1, 2012
- > If possible, finish construction and place property in service before the end of 2011, so you can claim 100 percent bonus on your 2011 return
- > If a project can be completed in phases (e.g., individual floors in a tenant build-out), place as many phases as possible in service by the end of 2011 so you can deduct the cost of those phases on your 2011 return; remaining costs will be deductible on your 2012 return
- > Finish all construction and place property in service before Jan. 1, 2013

Projects in the pipeline

- > Finish all construction and place property in service before Jan. 1, 2013; long production property placed in service before Jan. 1, 2013, will be eligible for 100 percent bonus, while other property will be eligible for 50 percent bonus in 2012
- > Execute contracts for large projects and begin construction before Jan. 1, 2012

For more information or any questions you might have on this topic, we encourage you to contact your Baker Tilly tax advisor or send an e-mail to tax@bakertilly.com.