



CERTIFIED PUBLIC ACCOUNTANTS

## *Tax News Flash*

### *In This Acuity Update:*

- **IRS Releases Important Guidance on 100% Bonus Depreciation**
  - **It Stacks with Credits**
  - **It Can Apply to Pieces of Self-Constructed Property**
  - **Avoiding Anomalies for Cars and Other Vehicles**
  - **Choices, Choices!**
  - **What If I Already Filed an Affected Return?**

### **IRS Releases Important Guidance on 100% Bonus Depreciation**

On March 29, the Internal Revenue Service released important guidance, Rev. Proc. 2011-26, that clarifies several issues related to 50% and 100% bonus depreciation.

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the Act), enacted December 17, 2010, extended 50% bonus depreciation through December 31, 2012 (December 31, 2013, for longer production period property (LPPP) and certain aircraft). Prior to this modification, bonus depreciation had been set to expire on December 31, 2010 (December 31, 2011, for LPPP and certain aircraft). For qualifying property acquired and placed in service after September 8, 2010, and before January 1, 2012 (January 1, 2013, for LPPP and certain aircraft), a new section 168(k)(5) specified that 100% bonus depreciation, rather than 50%, was to apply.

In Hawaii, as with many states, bonus depreciation isn't allowed at all for state income tax purposes, so we'll just talk about federal depreciation.

### **It Stacks with Credits**

One of the issues resolved by this guidance is whether tax credits and 100% bonus depreciation could be taken on the same property. Most business tax credits granted on investment property are not available unless the property is depreciable. When the *entire* cost of that property is written off in a single year, such as when a section 179 election is made, credits generally aren't available.

The Rev. Proc. clarifies that 100% bonus depreciation is not the same as a section 179 election, and that the two can coexist. The Rev. Proc. specifically mentions the disabled access credit, the specified energy property credit, and the grant under section 1603 of the American

Recovery and Reinvestment Act of 2009 (ARRA) and shows how the two provisions work together. *Example:* A taxpayer places into service a photovoltaic system at a cost of \$100,000, and applies for an ARRA grant of \$30,000. The property basis is first reduced by half of the grant, so it goes down to \$85,000. That \$85,000 can be recovered as a depreciation deduction in the year placed in service.

### **It Can Apply to Pieces of Self-Constructed Property**

Self-constructed property includes property that a taxpayer manufactures, constructs, or produces by itself for its own use. In addition, property that is made for the taxpayer by another person under a written binding contract that is entered into before the construction started is considered self-constructed property of the taxpayer.

For bonus depreciation purposes, self-constructed property is acquired when manufacture, construction, or production of the property begins. This date may be determined by identifying when physical work of a significant nature begins, or, under a safe harbor, when 10% of the costs have been incurred.

Under the guidance, a taxpayer that began the construction, manufacture, or production of a larger self-constructed asset prior to September 9, 2010, may choose whether to claim 100% bonus depreciation for components of the larger property acquired after September 8, 2010. *Example:* X, a calendar-year taxpayer, began constructing a ship for its own use in March 2010. Between March 2010 and June 2012, X incurred \$25 million to complete the construction of the ship. This \$25 million includes \$15 million for acquired components that were acquired by X after September 8, 2010, and before January 1, 2013. The ship would normally be 10-year property. Assuming that the ship and its components are qualified property, the \$15 million is eligible for 100% bonus depreciation. The balance is eligible for 50% bonus depreciation.

### **Avoiding Anomalies for Cars and Other Vehicles**

For passenger cars and similar vehicles used by a business, the amount of depreciation available is limited by section 280F of the Code. Normally, any basis remaining after the section 280F limit may be recovered only after the MACRS recovery period of the vehicle has ended.

*Example:* A calendar year taxpayer places in service in December 2010 a passenger automobile that cost \$20,000, is not a truck or van, and is eligible for the 100% additional first year depreciation deduction. Section 280F limits the first year depreciation deduction for this property to \$11,060. Thus, a depreciation deduction of \$11,060 can be taken in 2010, but *no* more depreciation can be taken by the taxpayer during the rest of the five year MACRS period, namely 2011 to 2015. And once we get to 2016, it is subject to an annual limit (\$1,775 for 2010, which is indexed for inflation).

*Safe Harbor:* Under the guidance, the taxpayer is allowed to elect into 50% bonus depreciation. On the above facts, for 2010, the total depreciation allowable for the passenger automobile is deemed to be \$12,000, which is the amount computed under 50% bonus. The limit is still \$11,060 for 2010, but the unrecovered basis for the passenger automobile for 2010, which is deferred to 2016 and perhaps beyond, is only \$940. For 2011, the total depreciation allowable for the passenger automobile is deemed to be \$3,200 (the second year amount computed under 50% bonus). In years 2012 through 2015, the depreciation amount computed under 50% bonus can be taken, and the remaining \$940 can be taken in 2016.

To illustrate:

<u>Without Safe Harbor</u>		<u>Safe Harbor Method</u>	
20,000	Cost of car	20,000	Cost of car
-11,060	Year 1 Deduction	-11,060	Year 1 Deduction
0	Year 2 Deduction	-3,200	Year 2 Deduction
0	Year 3 Deduction	-1,920	Year 3 Deduction
0	Year 4 Deduction	-1,152	Year 4 Deduction
0	Year 5 Deduction	-1,152	Year 5 Deduction
-1,775	Year 6 Deduction	-1,516	Year 6 Deduction
-1,775	Year 7 Deduction	0	Year 7 Deduction
-1,775	Year 8 Deduction	0	Year 8 Deduction
-1,775	Year 9 Deduction	0	Year 9 Deduction
-1,775	Year 10 Deduction	0	Year 10 Deduction
-65	Year 11 Deduction	0	Year 11 Deduction
0	Net remaining basis	0	Net remaining basis

The safe harbor method can be elected by claiming the 50% bonus amount on the taxpayer's tax return for the year *following* the year the vehicle is placed in service (2011 in our example). Nothing needs to be done in the initial year.

### Choices, Choices!

In general, bonus depreciation is *mandatory* for eligible property. A taxpayer can opt out of it, but must make an affirmative election to do so. This election is made each year for each class of MACRS property (e.g., 5-year property, 7-year property) by each legal entity that owns eligible property (e.g., each member of a consolidated group).

The guidance says that a taxpayer may make an election to claim 50% bonus depreciation instead of 100% bonus depreciation in the tax year that includes September 9, 2010. A taxpayer, therefore, has *three* choices per asset class for that one year: 100% bonus, 50% bonus, or straight MACRS.

Note: This choice is available *only* for the tax year that includes September 9, 2010. Thus, for qualified property placed in service in any other year, downgrading to 50% bonus depreciation is not an option. If a taxpayer elects to *forgo* bonus depreciation for a year, the election applies to the *entire asset class* for assets placed in service by that entity that year.

### What If I Already Filed an Affected Return?

The Small Business Jobs Act of 2010 retroactively extended bonus depreciation into the fall of 2010. That may have had a significant impact on fiscal-year taxpayers or short year taxpayers. Some of these taxpayers might have elected out of bonus depreciation or might not have claimed bonus depreciation for qualified property, given the information available at the time. The guidance allows a taxpayer to file either an amended return or a change in accounting method application to catch up on missed bonus depreciation for qualified property. A taxpayer that didn't take bonus depreciation and still doesn't want it can do nothing and be deemed to have made the election to forgo bonus depreciation. A taxpayer that elected to forgo bonus depreciation may revoke the election and claim bonus depreciation, provided the taxpayer complies with the requirements of the revenue procedure.

These are just a few of the corrections and clarifications made in the guidance. There are other, more technical fixes, but we will leave them to those who *really* want to know about them.

If you have questions about any of these news items, your client service team at Acuity can bring you the resources that you may need.

Please do not hesitate to contact your client service team for more information or Tom Yamachika at ([thomas.yamachika@acuityllp.com](mailto:thomas.yamachika@acuityllp.com))



First Hawaiian Center, 999 Bishop Street, Suite 1900, Honolulu, HI 96813

**Ph:** (808) 531-3400 | **Fax:** (808) 531-3433

Pursuant to the provisions of Treasury Circular 230 and comparable State law, any tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or any comparable state law, or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.