

## **YEAR-END PLANNING - MAKING THE MOST OF QUICK WRITEOFFS FOR CAPITAL GOODS PURCHASES (PART I)**

Depreciation deductions under Code Sec. 168 and expensing deductions under Code Sec. 179 are far more generous this year than they will be next year. In short, for those businesses confident enough to expand in these challenging economic times, now is an excellent time to buy machinery and equipment and make expensing-eligible qualified real estate purchases.

This is the first installment of a multi-part *Hot Topic* on how businesses may be able to lock in accelerated deductions by buying qualifying assets this year and placing them in service before year-end. It examines the bonus first-year depreciation allowance - 100% for qualified assets placed in service this year, but declining to 50% for qualified assets placed in service next year. Part II will examine the increased Code Sec. 179 expensing (\$500,000 limit, with \$2 million phaseout threshold) which applies for tax years beginning in 2010 and 2011, but will then decline substantially (\$125,000 limit, as adjusted for inflation, with \$500,000 phaseout threshold). Part III will examine the qualified real property expensing allowance (\$250,000 limit) which applies for tax years beginning in 2010 and 2011.

- ***Buy Depreciable Property and Place It in Service This Year to Lock in 100% Bonus First-Year Depreciation***

The 100% bonus depreciation allowance under Code Sec. 168(k) applies only for qualified property acquired and placed in service after September 8, 2010, and before January 1, 2012, (placed in service before January 1, 2013, for certain aircraft and long-production-period property). For qualified property acquired and placed in service after December 31, 2011, and before January 1, 2013 (before January 1, 2014, for certain aircraft and long-production-period property), the first-year bonus depreciation allowance is scheduled to drop to 50%. Thus, enterprises planning to purchase new depreciable property this year or the next should try to accelerate their buying plans, if doing so makes sound business sense.

**Observation:** The 100% first-year bonus depreciation deduction is permitted without any proration based on the length of time an asset is in service during the tax year. As a result, a 100% first-year writeoff is available even if qualifying assets are in service for only a few days in 2011.

**Illustration 1:** Widget, Inc., a calendar-year business, needs to buy an additional \$500,000 of new five-year MACRS property. It is not eligible for expensing. If Widget makes the purchase before January 1, 2012, and places the property in service before that date, it may write off the entire \$500,000 cost in 2011. If it waits to buy the property and place it in service until 2012, it may only claim a first-year depreciation allowance of \$300,000 [ $(\$500,000 \times .50 = \$250,000$  bonus first-year allowance) +  $(\$500,000 - \$250,000 \times .20$  table percentage for 5-year MACRS property = \$50,000)].

**Caution:** Accelerating a purchase into 2011 may not always be a good idea. For example, it may not produce good results for a taxpayer who has an about-to-expire net operating loss.

■ ***How to qualify for bonus depreciation for 2011***

In general, an asset purchased in 2011 qualifies for the 100% bonus first-year depreciation allowance if:

- (1) It is property to which the modified accelerated cost recovery system (MACRS) rules apply with a recovery period of 20 years or less; computer software other than computer software covered by Code Sec. 197; qualified leasehold improvement property; or certain water utility property;
- (2) It is acquired and placed in service after September 8, 2010, and before January 1, 2012 (placed in service before January 1, 2013, for certain long production property and aircraft); and,
- (3) Its original use commences with the taxpayer.

■ ***Limited exception for components***

Prior to September 9, 2010, a taxpayer may have begun manufacturing, building or producing a larger self-constructed property which is qualified property for use in its trade or business or for its production of income. If this larger self-constructed property meets the placed in service and original use requirements, the taxpayer may elect to treat any acquired or self-constructed component of that larger self-constructed property as being eligible for the 100% additional first-year depreciation deduction if the component is qualified property and is acquired or self-constructed by the taxpayer after September 8, 2010, and before January 1, 2012 (before January 1, 2013, for certain long production property and aircraft).

In general, the election must be made by the due date (including extensions) of the Federal tax return for the taxpayer's tax year in which it placed in service the larger self-constructed property, and by attaching a statement to that return indicating the taxpayer is making the election, and whether the taxpayer is making the election for all or some of the components.

■ ***Reconditioned property***

Additional capital expenses incurred by a business to recondition or rebuild property it acquired or owned satisfies the original use requirement, but the cost of reconditioned or rebuilt property acquired by the taxpayer does not.

**Illustration 2:** On Nov. 1, 2011, ABX Inc. buys a used machine for \$50,000 and reconditions it for \$15,000. The purchase price is ineligible for bonus

depreciation but the \$15,000 reconditioning cost is eligible (assuming the other requirements are met), whether or not it is added to the cost of the machine or capitalized as a separate asset.

The issue of whether property is reconditioned or rebuilt generally is a question of fact. However, a safe harbor provides that property containing used parts isn't treated as reconditioned or rebuilt if the cost of the used parts doesn't exceed 20% of its total cost.

**Observation:** In other words, for example, a taxpayer that buys a machine consisting of 80% new parts and 20% reconditioned parts is treated as having bought a new machine, not a reconditioned one.

- ***Converted property***

New property initially used by a taxpayer for personal use and then subsequently used by him in a trade or business meets the original use requirement.

**Illustration 3:** In 2010, an individual bought a new pickup truck and used it for personal driving only, but in 2011, he began using it exclusively for his landscaping business. The truck is qualified properly eligible for bonus depreciation.

The 100% bonus first-year depreciation allowance applies to qualified property unless the taxpayer "elects out." The election out may be made for any class of property for any tax year, and, if made, applies to all property in that class placed in service during that tax year. Note, a step-down election from 100% to 50% bonus depreciation was permitted for property placed in service in a tax year which includes September 9, 2010.

**Caution:** There is no alternative minimum tax (AMT) depreciation adjustment for property written off under the bonus depreciation rules of Code Sec. 168(k). However, a taxpayer who "elects out" of additional first-year depreciation for a specific class of property is subject to the AMT depreciation adjustment for property in that class. That means AMT depreciation is computed using the 150% declining balance method (switching to straight-line in the year necessary to maximize the allowance), except straight line is used for property for which straight line depreciation must be used for regular tax purposes. The recovery period is the same for AMT and regular tax purposes.

- ***Special rule***

For property placed in service after December 31, 2010, in tax years ending after that date, a corporation may elect to forego bonus depreciation and accelerated depreciation and instead increase its AMT credit limitation with respect to certain property placed in service after December 31, 2010, and before January 1, 2013,

(before January 1, 2014, in the case of certain longer-lived and transportation property). This option applies for "round 2 extension property," namely property which is eligible qualified property solely because it meets the requirements under the extension of the additional first-year depreciation deduction for certain property placed in service after December 31, 2010.

■ ***Qualified Restaurant Property and Qualified Retail Improvement Property***

Under Code Sec. 168(k)(2)(A)(i)(IV), qualified leasehold improvement property is eligible for 100% bonus first-year depreciation (if all the statutory conditions are met). By contrast, Code Sec. 168(e)(7)(B) and Code Sec. 168(e)(8)(B) provide qualified restaurant property and qualified retail improvement property are not treated as qualified property for purposes of the bonus depreciation rules in Code Sec. 168(k) and thus aren't eligible for the 100% bonus depreciation allowance. The IRS's interpretation is that an asset which is qualified restaurant property or qualified retail improvement property also may fall within the definition of qualified leasehold improvement property under Code Sec. 168(e)(6), which is eligible for bonus depreciation. If it does, such "dual character" property qualifies for 100% bonus first-year depreciation in 2011 if it is qualified property under Code Sec. 168(k)(2), and is placed in service by end of 2011.

■ ***100% First-Year Writeoff for Heavy SUVs***

Under Code Sec. 280F, depreciation deductions (including Code Sec. 179 expensing) which can be claimed for passenger autos are subject to dollar limits that are adjusted annually for inflation. For example, for passenger autos first placed in service in 2011, the adjusted first-year limit is \$3,060. For light trucks or vans, the adjusted first-year limit is \$3,260. Light trucks or vans are passenger autos built on a truck chassis, including minivans and sport-utility vehicles (SUVs) built on a truck chassis that are subject to the Code Sec. 280F limits because they are rated at 6,000 pounds gross (loaded) vehicle weight or less. For passenger autos, light trucks or vans which are eligible for bonus first-year depreciation under Code Sec. 168(k), (i.e., generally, new vehicles acquired and placed in service after December 31, 2007, and before January 1, 2013), the regular first-year dollar cap on depreciation and Code Sec. 179 expensing is increased by \$8,000.

Heavy SUVs - those built on a truck chassis and are rated at more than 6,000 pounds gross (loaded) vehicle weight - are exempt from the luxury-auto dollar caps because they fall outside of the Code Sec. 280F(d)(5) definition of a passenger auto. As 5-year MACRS property, heavy SUVs are eligible for 100% bonus first-year depreciation (if they are otherwise qualified property and business use exceeds 50% of total use). Thus, for example, a calendar-year taxpayer who buys and places in service a new \$50,000 heavy SUV during 2011, and uses it 100% for business, may write off the entire cost on its 2011 tax return.

If the heavy SUV is bought and placed in service in 2012 instead of 2011, less generous rules will apply. Under Code Sec. 179(b)(6), not more than \$25,000 of the cost of a heavy SUV may be expensed under Code Sec. 179. And in the placed-in-service year, a taxpayer may claim a 50% bonus depreciation allowance for the cost of the heavy SUV which wasn't expensed and depreciate the balance of the cost under the regular 5-year MACRS rules.

**Illustration 4:** If a calendar year taxpayer buys and places in service a \$50,000 heavy SUV in 2012, and uses it 100% for business, it may write off \$40,000 of the cost of the vehicle on its 2012 return, as follows:

- (I) \$25,000 expensing deduction, plus
- (II) \$12,500 of bonus first-year depreciation ( $\$50,000 - \$25,000$  of expensing  $\times .50 = \$12,500$ ), plus
- (III) \$2,500 of regular first-year depreciation ( $\$50,000 - \$25,000$  of expensing  $- \$12,500$  bonus depreciation  $\times .20 = \$2,500$ ).

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