DEPRECIATION AND EXPENSING PROVISIONS RETROACTIVELY EXTENDED BY THE TAX INCREASE PREVENTION ACT OF 2014

On December 16, 2014, Congress passed the "Tax Increase Prevention Act of 2014" (TIPA, or "the Act"), which the President is expected to sign into law. As explained in this Hot Topic, the Act extends through 2014 a host of depreciation and expensing provisions for businesses that had expired at the end of 2013, including generous asset expensing and phase-out limits; 15-year writeoff for qualifying leasehold improvements, restaurant buildings and improvements, and retail improvements; and 50% bonus first-year depreciation.

> **Note**: The extender package, consists of two Divisions - Division A (the "Tax Increase Prevention Act of 2014") and Division B (the "Achieving a Better Life Experience Act of 2014").

- For a Hot Topic that explains the individual income tax provisions which were extended by the Act, see http://www.facpa.com/documents/web_1214.pdf.

- For a Hot Topic which explains other business tax provisions which were extended by the Act, see http://www.facpa.com/documents/web_1214A.pdf.

The Appropriations Act, i.e., the Consolidated and Further Continuing Appropriations Act of 2015, which was passed by Congress on December 13th and is expected to be signed by the President, contains items of multi-employer pension reform as well as an exclusion from provisions of the Affordable Care Act for expatriate health plans.

Bonus First-Year Depreciation Extended

Under pre-Act law, the Code generally allows an additional first-year depreciation deduction (also called bonus first-year depreciation) equal to 50% of the adjusted basis of qualified property acquired and placed in service after December 31, 2011, and before January 1, 2014 (before January 1, 2015 for certain longer-lived and transportation property). The additional first-year depreciation deduction is allowed for both regular tax and alternative minimum tax (AMT) purposes, but is not allowed for purposes of computing earnings and profits. The basis of the property and the depreciation allowances in the year of purchase and later years are appropriately adjusted to reflect the additional first-year depreciation deduction. A taxpayer may elect out of additional first-year depreciation for any class of property for any tax year.

In general, an asset qualifies for the bonus depreciation allowance if:

- It falls into one of the following categories: property to which the modified accelerated cost recovery system (MACRS) rules apply with a recovery period of 20 years or less; certain computer software; qualified leasehold improvement property; or certain water utility property.

- It is placed in service before January 1, 2014. (Certain long-production-period property and certain transportation property may be placed in service before January 1, 2015)

- Its original use commences with the taxpayer. Original use is the first use to which the property is put, whether or not that use corresponds to the taxpayer's use of the property.

Under pre-Act law, these bonus depreciation provisions didn't apply to property placed in service after December 31, 2013 (December 31, 2014 for certain longer-lived and transportation property).

New law. TIPA extends 50% first-year bonus depreciation for one year so that it applies to qualified property acquired and placed in service before January 1, 2015 (before January 1, 2016, for certain longer-lived and transportation property). A conforming change is made to the Code Section relating to 50% bonus depreciation not being taken into account as a cost in applying the percentage of completion method for certain federal long-term contracts).

Observation: The Act also retroactively revives and extends through 2014 the Code Section rule treating qualified leasehold improvement property as 15-year property. (See discussion below.) Thus, such property is eligible for a bonus 50% first-year depreciation deduction if placed in service before January 1, 2015.

Note: The Act also extends through 2014 the rules treating qualified restaurant property and qualified retail improvement property as 15-year property. (See discussion below.) These types of property are also are eligible for 50% bonus first-year depreciation under the Code if they also meet the definition of qualified leasehold improvement property.

- **First-Year Depreciation Cap for 2014 Autos and Trucks Boosted by $8,000**

Under the luxury auto dollar limits of the Code, depreciation deductions (including asset expensing) which can be claimed for passenger autos are subject to dollar limits which are annually adjusted for inflation. For passenger automobiles placed in service in 2014, the adjusted first-year limit is $3,160. For light trucks or vans, the adjusted first-year limit is $3,460. Light trucks or vans are passenger automobiles built on a truck chassis, including minivans and sport-utility vehicles (SUVs) built on a truck chassis that are subject to the limits because they are rated at 6,000 points gross (loaded) vehicle weight or less.

The applicable first-year depreciation limit is increased by $8,000 (not indexed for inflation) for any passenger automobile which is "qualified property" under the bonus depreciation rules and which isn't subject to a taxpayer election to decline bonus depreciation.

Under pre-Act law, qualified property didn't include property placed in service after December 31, 2013 (except for certain aircraft and certain long-production-period property that had, instead, a December 31, 2014, placed-in-service deadline). Thus, under pre-Act law, the $8,000 boost in first-year depreciation allowances wasn't available for new cars and trucks purchased after 2013.

New law. TIPA provides that the placed-in-service deadline for "qualified property" is December 31, 2014 (December 31, 2015 for aircraft and long-production-period property).

Observation: Thus, for a passenger auto which is qualified property under the Code, (and isn't subject to the election to decline bonus depreciation and AMT depreciation relief), the Act extends the placed-in-service deadline for the $8,000 increase in the first-year depreciation limit from December 31, 2013 to December 31, 2014.

Illustration: T, a calendar year taxpayer, places a new $40,000 vehicle into service in his business on January 5, 2014. Assume the vehicle is an auto which is "qualified property" (and an election to decline bonus depreciation and AMT depreciation relief doesn't apply to the vehicle). T is allowed first-year depreciation for 2014 of $11,160 ($3,160 general first-year allowance for 2014 plus $8,000). If the vehicle were instead a light truck or van, T is allowed first-year depreciation for 2014 of $11,460 (the $3,460 general first-year allowance for 2014 plus $8,000).

- **Extended Choice to Forego Bonus Depreciation and Claim Credits Instead**

The Code generally permits a corporation to increase the AMT credit limitation by the bonus depreciation amount with respect to certain property placed in service after December 31, 2010, and before January 1, 2014 (January 1, 2015, in the case of certain longer-lived and transportation property) if it forgoes bonus depreciation on that property.

Under pre-Act law, the above provision didn't apply to such property placed in service after December 31, 2013 (December 31, 2014, in the case of certain longer-lived and transportation property).

New law. TIPA Act extends for one year the election to increase the AMT limitation in lieu of bonus depreciation so that it applies to property placed in service before January 1, 2015 (January 1, 2016, in the case of certain longer-lived and transportation property). For property placed in service after December 31, 2013, in tax years ending after that date, the Act provides a similar option to corporations with respect to "round four extension property," generally, property newly eligible for 50% bonus first-year depreciation under the Act's one-year extension provision, i.e., property placed in service after 2013 and before 2015 (before 2016 for the aircraft and long-production-period property).

The Act further provides a corporation that has an election in effect to claim minimum tax credits in lieu of bonus depreciation with respect to round three extension property (generally, property that was newly eligible for 50% bonus first-year depreciation under the 2012 Taxpayer Relief Act) is treated as having an election in effect for round four extension property, unless the corporation chooses otherwise. A corporation that does not have an election in effect with respect to round three extension property may also elect to claim minimum tax credits in lieu of bonus deprecation for round four extension property.

■ Boosted Expensing Amounts for 2014

Under the Code, a taxpayer, other than an estate, a trust or certain noncorporate lessors, may elect to deduct as an expense, rather than to depreciate, up to a specified amount of the cost of new or used tangible personal property placed in service during the tax year in the taxpayer's trade or business. The maximum annual expensing amount generally is reduced dollar-for-dollar by the amount of eligible property placed in service during the tax year in excess of a specified investment ceiling. Amounts ineligible for expensing due to excess investments in expensing-eligible property can't be carried forward and expensed in a subsequent year. Rather, they can only be recovered through depreciation. The amount eligible to be expensed for a tax year can't exceed the taxable income derived from the taxpayer's active conduct of a trade or business. And any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding tax years.

For tax years beginning in 2013: (1) the dollar limitation on the expensing deduction was $500,000; and (2) the investment-based reduction in the dollar limitation began to take effect when property placed in service in the tax year exceeds $2,000,000 (the investment ceiling). Under the 2013 limits, the expensing deduction didn't phase out completely until the cost of expensing-eligible property exceeded $2,500,000 ($2,000,000 (investment ceiling) + $500,000 (dollar limit)).

Under pre-Act law, for tax years beginning after 2013, the maximum expensing limit dropped to $25,000, and the investment ceiling dropped to $200,000. Thus, the expensing deduction phased out completely when the cost of expensing-eligible property exceeded $225,000 ($200,000 (investment ceiling) + $25,000 (dollar limit)).

In general, under pre-Act law, property is eligible for expensing if it is:

- Tangible property that's not real property (generally, machinery and equipment), depreciated under the MACRS rules of the Code, regardless of its depreciation recovery period;

- For any tax year beginning in 2010, 2011, 2012 or 2013, up to $250,000 of qualified real property (qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property); or

- Off-the-shelf computer software, but only if placed in service in a tax year beginning before 2014.

Under pre-Act law, for tax years beginning before 2014, an expensing election or specification of property to be expensed may be revoked without IRS's consent, but, if revoked, can't be reelected.

New law TIPA retroactively extends for one year the increased $500,000 maximum expensing amount under the Code and the increased $2 million investment-based phase-out amount. These increased amounts will apply for qualified property placed in service before January 1, 2015. For tax years beginning after 2014, the maximum expensing amount is again scheduled to drop to $25,000 and the investment-based phase-out amount is scheduled to drop to $200,000.

The Act also provides that:

- Off-the-shelf computer software is expensing-eligible property if placed in service in a tax year beginning before 2015 (a 1-year extension).

- For tax years beginning before 2015 (also a 1-year extension), an expensing election or specification of property to be expensed may be revoked without IRS's consent. But, if such an election is revoked, it can't be made again.

For any tax year beginning in 2010, 2011, 2012, 2013 or 2014, up to $250,000 of qualified real property (qualified leasehold improvement property, qualified restaurant property and qualified retail improvement property) is eligible for expensing under Code Sec. 179.

Note: The expensing break is enhanced by the de minimis safe harbor in the capitalization regulations which allows businesses to elect to expense their outlays for "lower-cost" business assets. Under this safe harbor, which applies to an amount paid during the tax year to acquire or produce a unit of property (UOP), or acquire a material or supply and generally applies to amounts paid in tax years beginning on or after January 1, 2014, qualifying businesses with an applicable financial statement (AFS) can expense eligible property if the amount paid doesn't exceed $5,000 per invoice (or per item as substantiated by the invoice). If the taxpayer does not have an AFS, the same rule applies except that the amount paid for eligible property can't exceed $500 per invoice (or per item as substantiated by the invoice). Both the $5,000 and $500 amounts can be changed by published IRS guidance.

Illustration: MidCorp, a calendar year corporation that has an AFS, has a written accounting policy at the beginning of 2014, which it follows, to expense amounts paid for property costing $5,000 or less. In 2014, it pays $750,000 to buy 500 computers at $1,500 each, and $250,000 to buy 50 high-speed network printers at $5,000 each. Each computer and printer is a UOP, and the amounts paid for them meet the requirements for the de minimis safe harbor. During 2014, MidCorp also spends a total of $1,000,000 on other equipment and business assets not eligible for the de minimis safe harbor and instead must be capitalized. MidCorp elects to apply the de minimis safe harbor rule) to amounts paid in tax years beginning on or after January 1, 2013. Under the final regulations, MidCorp should be able to deduct $1.5 million of the total cost of its machinery and equipment purchases during 2014 ($1 million under the de minimis safe harbor, and $500,000 under the Code's expensing election).

■ 15-Year Writeoff for Qualified Leasehold and Retail Improvements and Restaurant Property Extended

Qualified leasehold improvement property, qualified restaurant property and qualified retail improvement property that was placed in service before January 1, 2014, was included in the 15-year MACRS class for depreciation purposes - that is, such property was depreciated over 15 years under MACRS.

Under pre-Act law, the above rules didn't apply to property placed in service after December 31, 2013.

New law. TIPA retroactively extends for one year the inclusion of qualified leasehold improvement property, qualified restaurant property and qualified retail improvement property in the 15-year MACRS class. Such property qualifies for 15-year recovery if it is placed in service before January 1, 2015.

- **7-Year Writeoff for Motorsport Racing Track Facilities Extended**

A short 7-year cost recovery period applies to property used for land improvement and support facilities at motorsports entertainment complexes.

Under pre-Act law, the short writeoff period only applied for property placed in service on or before December 31, 2013.

New law. TIPA retroactively extends for one year the 7-year straight line cost recovery period for motorsports entertainment complexes. The quick writeoff applies to qualifying motorsports entertainment complexes placed in service before January 1, 2015.

- **Expensing Election for Costs of Film and TV Production Extended**

Taxpayers may elect to expense production costs of qualified film and television (TV) productions in the U.S. Expensing doesn't apply to the part of the cost of any qualifying film or TV production that exceeded $15 million for each qualifying production. The limit is $20 million if production expenses were "significantly incurred" in areas (1) eligible for designation as a low-income community or (2) eligible for designation by the Delta Regional Authority (a federal-state partnership covering parts of certain states) as a distressed county or isolated area of distress.

Under pre-Act law, these rules didn't apply to qualified film and TV productions beginning after December 31, 2013.

New law TIPA retroactively extends for one year the expensing election for costs of film and TV production. The election applies to qualified film and TV productions beginning before January 1, 2015.

- **Miscellaneous Other Provisions Extended**

In addition to the above, TIPA retroactively extends the following provisions for one year:

- Classification of certain race horses as 3-year property, for horses placed in service before January 1, 2015 (regardless of age when placed in service).

- Accelerated depreciation for business property on an Indian reservation, for property placed in service before January 1, 2015.

- Election to treat 50% of the cost of any qualified mine safety equipment as an expense in the tax year in which the equipment is placed in service, for property placed in service before January 1, 2015.

This Hot Topic is an informative publication for our clients and friends of the Firm. It is designed to provide accurate information on the subject matter covered. We recommend you consult with your legal and other advisors to determine if the information is applicable in your specific circumstances. If these advisors are not available to you, please feel free to contact Barry N. Finkelstein, CPA at 903/473-3540.