

## **Stimulus Act OKs additional 50% first-year depreciation for most types of new depreciable property placed in service in 2008**

The cost of most types of depreciable property is recovered by way of the MACRS (modified accelerated cost recovery) depreciation rules of Code Sec. 168. In general, the recovery period and recovery method (straight line or accelerated depreciation) is determined by the asset class of the property. For most property (other than buildings) depreciated under MACRS, Code Sec. 56 requires depreciation deductions to be calculated, for purposes of determining alternative minimum taxable income (AMTI) under Code Sec. 55, on the 150% declining balance method.

Bonus first-year depreciation was introduced as a temporary measure by the Job Creation and Worker Assistance Act of 2002, to stimulate the economy following the 9/11 terrorist acts, and was subsequently enhanced by the Jobs and Growth Tax Relief Reconciliation Act of 2003. However, under prior law, bonus first-year depreciation generally was not available for property placed in service after 2004, with exceptions for certain qualified cellulosic ethanol plant property, qualified GO Zone property, and qualified Liberty Zone property.

New law. For property placed in service after Dec. 31, 2007, in tax years ending after that date, the Stimulus Act provides an additional depreciation deduction in the placed-in-service year equal to 50% of the adjusted basis of "qualified property." (Code Sec. 168(k)(1), as amended by Act Sec. 103(a)) The property must be acquired after Dec. 31, 2007 and before Jan. 1, 2009.

RIA observation: "Qualified property" includes most types of new property other than buildings.

RIA observation: IRS issued detailed guidance, including final regs, on prior law's bonus depreciation provisions. This guidance, with appropriate adjustments for placed in service dates, etc., should apply to the additional first year depreciation allowed by the Act, unless IRS indicates otherwise.

The adjusted basis of qualified property is reduced by the additional 50% depreciation deduction before computing the amount otherwise allowable as a depreciation deduction for the tax year and any later tax year.

There is no AMT depreciation adjustment for qualified property recovered under Code Sec. 168(k), which provides for the additional 50% first-year depreciation allowance. (Code Sec. 168(k)(2)(G))

RIA observation: There is no AMT adjustment for the entire recovery period of qualified property.

RIA illustration 1: On Mar. 1, 2008, Intensive, Inc., a calendar-year business located in Pennsylvania, bought and placed in service \$500,000 of five-year MACRS property. Applying the half-year depreciation convention, the first-year depreciation allowance under pre-Act law would \$100,000 (20%).

Under the Act, Intensive may claim a first year depreciation allowance of \$300,000  $[(\$500,000 \times .50 = \$250,000) + (\$500,000 - \$250,000 \times .20 = \$50,000)]$ .

RIA observation: Because regular depreciation for the placed in service year (as well as subsequent years) is computed on adjusted basis net of the additional first-year depreciation allowance, the “true” additional first year depreciation percentage for qualified property will be less than 50%. For example, in illustration (1), above, it is 40% (the \$300,000 total first-year depreciation including the special depreciation allowance, less the \$100,000 of first year depreciation available if the assets were not qualified property divided by \$500,000). The “true” additional first-year depreciation percentage depends on the depreciation method and the recovery period of the asset.

Under preexisting regs, if Code Sec. 179 expensing is claimed on qualified property, the amount expensed “comes off the top” before the additional 50% first-year depreciation allowance is computed. Then the taxpayer computes regular first-year depreciation (and depreciation for future years) with reference to the adjusted basis remaining after expensing and after the additional 50% first-year allowance. (Reg. § 1.168(k)-1(a)(2)(iii))

RIA illustration 2: The facts are the same as in the first illustration, except that under the Stimulus Act's enhanced expensing rules (see above article), Intensive is eligible and elects to expense \$250,000 of the cost of the assets placed in service on Mar. 1, 2008. Intensive may write off \$400,000 of the cost of the assets in 2008  $[(\$250,000 \text{ expensing} + (\$500,000 - \$250,000 \times .50 = \$125,000) + (\$500,000 - \$250,000 - \$125,000 \times .20 = \$25,000)]$ .

The full 50% additional depreciation allowance is available for qualified property whether the half-year or midquarter depreciation convention applies in the placed-service year, and may be claimed even if the property is placed in service on the last day of the taxpayer's tax year.

The 50% additional 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. (Code Sec. 168(k)(2)(D)(iii))

RIA observation: Two situations in which a taxpayer might, for a tax year, consider making an election-out for one or more classes, are (1) where the taxpayer has about-to-expire net operating losses and (2) where the taxpayer anticipates being in a higher tax bracket in future years.

RIA caution: A taxpayer that "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 that 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.

Qualifying for the 50% additional first-year depreciation allowance. A taxpayer may claim the additional first year allowance:

for an asset that is "qualified property," the original use of which begins with the taxpayer after Dec. 31, 2007, and is timely acquired and timely placed in service.

Qualified property for bonus 50% depreciation. To be qualified property eligible for the 50% additional first-year depreciation allowance, an asset must fall within one of four asset classes:

- (1) property to which MACRS applies with a recovery period of 20 years or less;
- (2) water utility property (which is a class of MACRS property defined in Code Sec. 168(e)(5));

- (3) computer software other than computer software covered by Code Sec. 197; or
- (4) qualified leasehold improvement property (as defined in Code Sec. 168(k)(3) ). (Code Sec. 168(k)(2)(A))

Original use requirement. The original use of the property must commence with the taxpayer after Dec. 31, 2007. 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. (Code Sec. 168(k)(2)(A))

RIA observation: In other words, the property must be new property in the hands of the taxpayer.

RIA observation: Under preexisting Reg. § 1.168(k)-1(b)(3)(i), additional capital expenses incurred by a taxpayer to recondition or rebuild property acquired or owned by the taxpayer satisfies the original use requirement but the cost of the reconditioned or rebuilt property acquired by the taxpayer does not.

For purposes of the original use requirement, if property (1) is originally placed in service after Dec, 31, 2007, by a person, and is sold and leased back by that person within three months after the date that property was originally placed in service, the property is treated as originally placed in service not earlier than the date on which the property is used under the leaseback (the sale-leaseback rule). (Code Sec. 168(k)(2)(E)(ii)) Thus, in the case of any property that is originally placed in service by a person and that is sold to the taxpayer and leased back to that person by the taxpayer within three months after the date that the property was placed in service, the property is treated as originally placed in service by the taxpayer not earlier than the date that the property is used under the leaseback. (Committee Report)

RIA observation: As confirmed by the Committee Report's identification of "the taxpayer" as the buyer-lessor, the main effect of the sale-leaseback original use rule is to shift eligibility for 50% bonus depreciation from the seller-lessee to the buyer-lessor.

Also, for purposes of the original use requirement, property is treated as originally placed in service not earlier than the date of the last sale described at (3) below if the following requirements are met:

- (1) the property is originally placed in service after Dec. 31, 2007 by the lessor of the property,
- (2) the property is sold by the lessor or any later purchaser within 3 months after the date it is placed in service (or, in the case of multiple units of property subject to the same lease, within 3 months after the date the final unit is placed in service, so long as the period between the time the first unit is placed in service and the time the last unit is placed in service doesn't exceed 12 months), and
- (3) the user of the property after the last sale during the 3-month period remains the same as when the property was originally placed in service (the syndication rule). (Code Sec. 168(k)(2)(E)(iii))

If in the normal course of its business a taxpayer sells fractional interests in property to unrelated third parties, the original use of that property begins with the first user of the fractional interest (i.e., each fractional owner is considered the original user of its proportionate share of the property). (Committee Report)

**Purchase requirement.** The taxpayer generally must purchase the property (a) after Dec. 31, 2007, and before Jan. 1, 2009, but only if no binding written contract for the acquisition is in effect before Jan. 1, 2008, or (b) pursuant to a binding written contract which was entered into after Dec. 31, 2007, and before Jan. 1, 2009.

For a taxpayer manufacturing, constructing or producing property for the taxpayer's own use, the requirements of Code Sec. 168(k)(2)(A)(iii) are treated as met if the taxpayer begins manufacturing, constructing, or producing the property after Dec. 31, 2007 and before Jan. 1, 2009. (Code Sec. 168(k)(2)(E)(i))

Property is considered manufactured, constructed or produced by the taxpayer if it is manufactured, constructed or produced for the taxpayer by another person under a contract that is entered into before the manufacture, construction or production of the property. (Committee Report)

The Committee Report says property won't fail to qualify for additional first year depreciation merely because a binding written contract to acquire a component of the property was in effect before Jan. 1, 2008.

Placed-in-service requirement. The property generally must be placed in service after Dec. 31, 2007, and before Jan. 1, 2009. An extension of the placed in service date of one year (i.e., to Jan. 1, 2010) applies to certain property with a recovery period of ten years or longer and certain transportation property. The property must have an estimated production period exceeding one year and cost more than \$1 million. Transportation property is tangible personal property used in the trade or business of transporting persons or property. Special rules, including an extension of the placed in-service date of one year (i.e., to Jan. 1, 2010) also apply to certain aircraft. (Code Sec. 168(k)(2)(B), Code Sec. 168(k)(2)(C))

If property is manufactured, constructed, or produced by the taxpayer for its own use, the taxpayer must begin the manufacture, construction, or production of the property after Dec. 31, 2007, and before Jan. 1, 2009. Property that is manufactured, constructed, or produced for the taxpayer by another person under a contract that is entered into before the manufacture, construction, or production of the property is considered to be manufactured, constructed, or produced by the taxpayer. For property eligible for the extended placed in service date, a special rule limits the amount of costs eligible for the additional first year depreciation: only the portion of the basis that is properly attributable to the costs incurred before Jan. 1, 2009 (progress expenditures) is eligible for the additional first-year depreciation. (Code Sec. 168(k)(2)(B)(iii), Committee Report)

Property ineligible for additional depreciation allowance. The following types of property are ineligible for the 50% additional first year depreciation allowance:

property that must be depreciated under the alternative depreciation system (e.g., tangible personal property used predominantly outside the U.S. );  
listed property (such as a passenger auto) that isn't used more than 50% for business; and  
qualified New York Liberty Zone leasehold improvement property. (Code Sec. 168(k)(2)(D))

First-year depreciation dollar cap for new passenger autos raised by \$8,000  
The amount of depreciation that may otherwise be claimed on a passenger auto is limited by the Code Sec. 280F(a) inflation-adjusted dollar caps. For autos placed in service in 2007, the dollar cap on first-year depreciation (i.e., for the placed-in-service year) is \$3,060. The dollar caps for light trucks or vans (passenger autos built on a truck chassis, including minivans and sport-

utility vehicles (SUVs) built on a truck chassis) is \$3,260 for the placed in service year. The inflation-adjusted dollar caps for 2008 have not been released yet by IRS. The dollar caps are reduced proportionately to the extent that the vehicle is used for non-business purposes.

New law. The Stimulus Act increases by \$8,000 the first-year depreciation dollar limit for a passenger auto that is “qualified property” (see discussion above) that meets the original use and acquisition and placed-in-service requirements. (Code Sec. 168(k)(2)(F)(i), as amended by Act Sec. 103(c)(4))

RIA observation: In other words, assuming that the inflation-adjusted dollar caps for 2008 are the same as for 2007, the maximum first-depreciation allowance is \$11,060 (\$3,060 plus \$8,000) for a new passenger auto acquired and placed in service in 2008, and used entirely for business; for a light truck or van the limit is \$11,260 (\$3,260 plus \$8,000).

RIA caution: A passenger auto must be used more than 50% for trade or business purposes in order to be eligible for the additional first-year depreciation amount (see discussion above).

The boosted depreciation limit is reduced to the extent of non-business use and doesn't apply if the taxpayer “elects out” of bonus first year depreciation.

Listed property recapture. The additional first-year deduction allowed on qualified property that is “listed property” (which includes passenger autos) is taken into account for purposes of computing the recapture amount under Code Sec. 280F(b)(2) (which provides for recapture where business use of listed property is more than 50% in the placed-in-service year, but declines to 50% or less of total use after the placed-in-service year). (Code Sec. 168(k)(2)(F)(ii))