

RIA Special Study: Depreciation and Expensing Provisions Retroactively Extended by the Tax Increase Prevention Act of 2014 Bonus First-Year Depreciation Extended

Under pre-Act law, [Code Sec. 168\(k\)](#) 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 Dec. 31, 2011, and before Jan. 1, 2014 (before Jan. 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; computer software other than computer software covered by [Code Sec. 197](#) ; qualified leasehold improvement property; or certain water utility property.
- . . . It is placed in service before Jan. 1, 2014. (Certain long-production-period property and certain transportation property may be placed in service before Jan. 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 Dec. 31, 2013 (Dec. 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 Jan. 1, 2015 (before Jan. 1, 2016 for certain longer-lived and transportation property). ([Code Sec. 168\(k\)\(2\)](#) , as amended by Act Sec. 125(a)) A conforming change is made to [Code Sec. 460\(c\)\(6\)\(B\)](#) (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).

 **RIA observation:** The Act also retroactively revives and extends through 2014 the [Code Sec. 168\(e\)\(3\)\(E\)\(iv\)](#) 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 Jan. 1, 2015.

 **RIA observation:** The Act also extends through 2014 the rules treating qualified restaurant property ([Code Sec. 168\(e\)\(3\)\(E\)\(v\)](#)) and qualified retail improvement property ([Code Sec. 168\(e\)\(3\)\(E\)\(ix\)](#)) as 15-year property. See discussion below. These types of property also are eligible for 50% bonus first-year depreciation under [Code Sec. 168\(k\)](#) 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 [Code Sec. 280F](#) , depreciation deductions (including [Code Sec. 179](#) expensing) that can be claimed for passenger autos are subject to dollar limits that 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 [Code Sec. 280F](#) 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 that is "qualified property" under the bonus depreciation rules of [Code Sec. 168\(k\)](#) 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 Dec. 31, 2013 (except for certain aircraft and certain long-production-period property that had, instead, a Dec. 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 Dec. 31, 2014 (Dec. 31, 2015 for aircraft and long-production-period property).

 **RIA observation:** Thus, for a passenger auto that is qualified property under [Code Sec. 168\(k\)](#) , (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 Dec. 31, 2013 to Dec. 31, 2014.

 **RIA illustration** T, a calendar year taxpayer, places a new \$40,000 vehicle into service in his business on Jan. 5, 2014. Assume that the vehicle is an auto that 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

Code Sec. 168(k)(4) generally permits a corporation to increase the AMT credit limitation by the bonus depreciation amount with respect to certain property placed in service after Dec. 31, 2010 and before Jan. 1, 2014 (Jan. 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 Dec. 31, 2013 (Dec. 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 Jan. 1, 2015 (Jan. 1, 2016 in the case of certain longer-lived and transportation property). For property placed in service after Dec. 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 that 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. (Act Sec. 125(c)(2)(ii)) 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 depreciation for round four extension property.

Boosted Expensing Amounts for 2014

Under **Code Sec. 179**, 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 **Code Sec. 179** 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

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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 **Code Sec. 179** 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 **Code Sec. 179** 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 **Code Sec 179** expensing if it is:

- . . . tangible property that's **Code Sec. 1245** property (generally, machinery and equipment), depreciated under the MACRS rules of **Code Sec. 168**, 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 **Code Sec. 179** and the increased \$2 million investment-based phaseout amount. These increased amounts will apply for qualified property placed in service before Jan. 1, 2015. For tax years beginning after 2014, the maximum expensing amount is again scheduled to drop to \$25,000 and the investment-based phaseout 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.

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... For any tax year beginning in 2010, 2011, 2012, 2013, 2014, 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](#).

 **RIA observation:** The expensing break is enhanced by the de minimis safe harbor in the capitalization regs that 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 Jan. 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 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.

 **RIA observation:** Under [Code Sec. 179\(d\)\(1\)\(A\)\(i\)](#), "section 179 property" generally is any tangible property to which [Code Sec. 168](#) applies. Thus, assets to which the de minimis election applies (and which aren't capitalized and depreciated) should not be counted in determining either the [Code Sec. 179](#) maximum expensing limit or the investment ceiling.

 **RIA 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 that are not eligible for the de minimis safe harbor and instead must be capitalized. MidCorp elects to apply [Reg. § 1.263A-1\(f\)](#) (i.e., the de minimis safe harbor rule) to amounts paid in tax years beginning on or after Jan. 1, 2013. Under the final regs, 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 Sec. 179](#) expensing election).

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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 Jan. 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 Dec. 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 Jan. 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 Dec. 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 Jan. 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 Dec. 31, 2013.

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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 Jan. 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 Jan. 1, 2015 (regardless of age when placed in service).
- . . . Accelerated depreciation for business property on an Indian reservation, for property placed in service before Jan. 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 Jan. 1, 2015.

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