

## **BONUS DEPRECIATION EXPIRES DECEMBER 31<sup>ST</sup>**

*By: Glen Stankee*

There is significant incentive to make the investment in depreciable tangible personal property such as equipment prior to the end of this year. As part of the Job Creation and Worker Assistance Act of 2002, Section 168y) was adopted to encourage investment in certain "qualified property". Subject to certain restrictions, it granted an additional first-year bonus depreciation deduction equal to 30% of the cost of that property. The entire amount of the bonus depreciation is allowed for the first year, regardless of what month it is placed in service. Regular depreciation is allowable with respect to the adjusted basis of the property remaining after taking into account the first-year bonus depreciation.

"Qualified property" includes (i) any property with a Modified Asset Cost Recovery System (MACRS) recovery period of 20 years or less, (ii) computer software, (iii) water utility property, and (iv) qualified leasehold improvement property. It must have been acquired by the taxpayer after September 10, 2001 (but only if no written binding contract was in effect prior to September 11, 2001), and before January 1, 2005 (the "acquisition requirement"). Its "original use" must commence with the taxpayer after September 10, 2001 (the "original use requirement"). Subject to an important exception for self constructed property with a long production period, (discussed below), the property must be placed in service prior to January 1, 2005. Also, property qualifies for the bonus depreciation only if it is depreciable under the MACRS rules. Property that is depreciable only under the "alternate depreciation system" of section 168(g) does not qualify.

Section 168(k) was amended by the Jobs and Growth Tax Relief Reconciliation Act of 2003 to increase the first year bonus depreciation for property acquired after May 5, 2003, and before January 1, 2005, from 30% to 50% of the cost. All of the other requirements remain the same.

In the case of "self-constructed property", temporary regulations issued September 5, 2003 and amended February 27, 2004, treat the acquisition requirement as having been satisfied if the taxpayer commences construction after September 10, 2001, and before January 1, 2005, in the case of the 30% bonus depreciation deduction, and after May 5, 2003, and before January 1, 2005 case of the 50% bonus depreciation deduction. Property is treated as self-constructed property if it is constructed for the taxpayer by another person for use by the taxpayer in his or her trade or business, but only if it is constructed pursuant to a written binding contract that is entered into prior to the commencement of the construction.

The construction of the property is deemed to commence when physical work of a significant nature begins. Physical work does not include preliminary activities such as planning or designing, securing financing, or researching. Physical work of a significant nature will not be considered to begin before the taxpayer incurs (in the case of an accrual basis taxpayer) or pays (in the case of a cash basis taxpayer) more than 10% of the total cost of the property.

Generally, the property must be placed in service prior to January 1, 2005. However, property with longer production periods will qualify if placed in service prior to January 1, 2006. Property qualifies under this rule if (i) A has a MACRS recovery period of at least 10 years or is transportation property (i.e., tangible personal property used in the trade or business of transporting persons or property, and (ii) the estimated production period for such property exceeds two years, or the estimated production period exceeds one year and the cost exceeds \$1 million. Bonus depreciation for property qualifying under this rule is deductible in 2005 when it is placed in service, but the depreciation is calculated on the amount of the taxpayer's adjusted basis in the property as of December 31, 2004.