DESCRIPTION OF H.R. 2510, A BILL TO MODIFY AND MAKE PERMANENT BONUS DEPRECIATION

Scheduled for Markup
by the
HOUSE COMMITTEE ON WAYS AND MEANS
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Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

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INTRODUCTION

The House Committee on Ways and Means has scheduled a committee markup of H.R. 2510, a bill to modify and make permanent bonus depreciation, on September 17, 2015. This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the bill.

[1] This document may be cited as follows: Joint Committee on Taxation, *Description of H.R. 2510, A Bill To Modify and Make Permanent Bonus Depreciation* (JCX-120-15), September 16, 2015. This document can also be found on the Joint Committee on Taxation website at www.jct.gov.

A. Bonus Depreciation Modified and Made Permanent

Present Law

In general

An additional first-year depreciation deduction is allowed equal to 50 percent of the adjusted basis of qualified property acquired and placed in service before January 1, 2015 (January 1, 2016 for certain longer-lived and transportation property).[2]

The additional first-year depreciation deduction is allowed for both the regular tax and the alternative minimum tax ("AMT"),[3] but is not allowed in computing earnings and profits.[4] 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.[5] The amount of the additional first-year depreciation deduction is not affected by a short taxable year.[6] The taxpayer may elect out of additional first-year depreciation for any class of property for any taxable year.[7]

The interaction of the additional first-year depreciation allowance with the otherwise applicable depreciation allowance may be illustrated as follows. Assume that in 2014, a taxpayer purchased new depreciable property and placed it in service.[8] The property's cost is $10,000, and it is five-year property subject to the 200 percent declining balance method and half-year convention. The amount of additional first-year depreciation allowed is $5,000. The remaining $5,000 of the cost of the property is depreciable under the rules applicable to five-year property. Thus $1,000[9] also is allowed as a depreciation deduction in 2014. The total depreciation deduction with respect to the property for 2014 is $6,000. The remaining $4,000 adjusted basis of the property generally is recovered through otherwise applicable depreciation rules.

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[2] Sec. 168(k). The additional first-year depreciation deduction is subject to the general rules regarding whether an item must be capitalized under section 263A.

[3] Sec. 168(k)(2)(G). See also Treas. Reg. sec. 1.168(k)-1(d).

[4] Treas. Reg. sec. 1.168(k)-1(f)(7).

[5] Sec. 168(k)(1)(B).

[6] *Ibid.*

[7] Sec. 168(k)(2)(D)(iii). For the definition of a class of property, see Treas. Reg. sec. 1.168(k)-1(e)(2).

[8] Assume that the cost of the property is not eligible for expensing under section 179 or Treas. Reg. sec. 1.263(a)-1(f).

[9] $1,000 results from the application of the half-year convention and the 200 percent declining balance method to the remaining $5,000.

Property qualifying for the additional first-year depreciation deduction must meet all of the following requirements.[10] First, the property must be: (1) property to which the modified accelerated cost recovery system ("MACRS") applies with an applicable recovery period of 20 years or less; (2) water utility property (as defined in section 168(e)(5)); (3) computer software other than computer software covered by section 197; or (4) qualified leasehold improvement property.[11] Second, the original use[12] of the property must commence with the taxpayer.[13] Third, the taxpayer must acquire the property within the applicable time period (as described below). Finally, the property must be placed in service before January 1, 2015. An extension of the placed-in-service date of one year (*i.e.*, before January 1, 2016) is provided for certain property with a recovery period of 10 years or longer and certain transportation property.[14]

To qualify, property must be acquired (1) before January 1, 2015, or (2) pursuant to a binding written contract which was entered before January 1, 2015. With respect to property that is manufactured, constructed, or produced by the taxpayer for use by the taxpayer, the taxpayer must begin the manufacture, construction, or production of the property before January 1, 2015.[15] Property that is manufactured, constructed, or produced for the taxpayer by another person under a contract that is entered into prior to the manufacture, construction, or production of the property is considered to be manufactured, constructed, or produced by the taxpayer.[16]

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[10] Requirements relating to actions taken before 2008 are not described herein since they have little (if any) remaining effect.

[11] The additional first-year depreciation deduction is not available for any property that is required to be depreciated under the alternative depreciation system of MACRS. Sec. 168(k)(2)(D)(i).

[12] The term "original use" means the first use to which the property is put, whether or not such use corresponds to the use of such property by the taxpayer. If in the normal course of its business a taxpayer sells fractional interests in property to unrelated third parties, then the original use of such property begins with the first user of each fractional interest (*i.e.*, each fractional owner is considered the original user of its proportionate share of the property). Treas. Reg. sec. 1.168(k)-1(b)(3).

[13] A special rule applies in the case of certain leased property. 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 such person by the taxpayer within three months after the date that the property was placed in service, the property would be treated as originally placed in service by the taxpayer not earlier than the date that the property is used under the leaseback. If property is originally placed in service by a lessor, such property is sold within three months after the date that the property was placed in service, and the user of such property does not change, then the property is treated as originally placed in service by the taxpayer not earlier than the date of such sale. Sec. 168(k)(2)(E)(ii).

[14] Property qualifying for the extended placed-in-service date must have an estimated production period exceeding one year and a cost exceeding $1 million. Transportation property generally is defined as tangible personal property used in the trade or business of transporting persons or property. Certain aircraft which is not transportation property, other than for agricultural or firefighting uses, also qualifies for the extended placed-in-service-date, if at the time of the contract for purchase, the purchaser made a nonrefundable deposit of the lesser of 10 percent of the cost or $100,000, and which has an estimated production period exceeding four months and a cost exceeding $200,000.

[15] Sec. 168(k)(2)(E)(i).

[16] Treas. Reg. sec. 1.168(k)-1(b)(4)(iii).

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. With respect to such property, only the portion of the basis that is properly attributable to the costs incurred before January 1, 2015 ("progress expenditures") is eligible for the additional first-year depreciation deduction.[17]

The limitation under section 280F on the amount of depreciation deductions allowed with respect to certain passenger automobiles is increased in the first year by $8,000 for automobiles that qualify (and for which the taxpayer does not elect out of the additional first-year deduction).[18] The $8,000 amount is not indexed for inflation.

Qualified leasehold improvement property

Qualified leasehold improvement property is any improvement to an interior portion of a building that is nonresidential real property, provided certain requirements are met.[19] The improvement must be made under or pursuant to a lease either by the lessee (or sublessee), or by the lessor, of that portion of the building to be occupied exclusively by the lessee (or sublessee). The improvement must be placed in service more than three years after the date the building was first placed in service. Qualified leasehold improvement property does not include any improvement for which the expenditure is attributable to the enlargement of the building, any elevator or escalator, any structural component benefiting a common area, or the internal structural framework of the building. For these purposes, a binding commitment to enter into a lease is treated as a lease, and the parties to the commitment are treated as lessor and lessee. A lease between related persons is not considered a lease for this purpose.

Special rule for long-term contracts

In general, in the case of a long-term contract, the taxable income from the contract is determined under the percentage-of-completion method.[20] Solely for purposes of determining the percentage of completion under section 460(b)(1)(A), the cost of qualified property with a MACRS recovery period of seven years or less is taken into account as a cost allocated to the contract as if bonus depreciation had not been enacted for property placed in service before January 1, 2015 (January 1, 2016 in the case of certain longer-lived and transportation property).[21]

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[17] Sec. 168(k)(2)(B)(ii). For purposes of determining the amount of eligible progress expenditures, rules similar to section 46(d)(3) as in effect prior to the Tax Reform Act of 1986 apply.

[18] Sec. 168(k)(2)(F).

[19] Sec. 168(k)(3). The additional first-year depreciation deduction is not available for qualified New York Liberty Zone leasehold improvement property as defined in section 1400L(c)(2). Sec. 168(k)(2)(D)(ii).

[20] See sec. 460.

[21] Sec. 460(c)(6). Other dates involving prior years are not described herein.

Election to accelerate AMT credits in lieu of bonus depreciation

A corporation otherwise eligible for additional first-year depreciation may elect to claim additional AMT credits in lieu of claiming additional depreciation with respect to "eligible qualified property."[22] In the case of a corporation making this election, the straight line method is used for the regular tax and the AMT with respect to eligible qualified property.[23]

Generally, an election under this provision for a taxable year applies to subsequent taxable years. However, each time the provision has been extended, a corporation which has previously made an election has been allowed to elect not to claim additional minimum tax credits, or, if no election had previously been made, to make an election to claim additional credits with respect to property subject to the extension.[24]

A corporation making an election increases the tax liability limitation under section 53(c) on the use of minimum tax credits by the bonus depreciation amount.[25] The aggregate increase in credits allowable by reason of the increased limitation is treated as refundable.[26]

The bonus depreciation amount generally is equal to 20 percent of bonus depreciation[27] for eligible qualified property that could be claimed as a deduction absent an election under this provision. As originally enacted, the bonus depreciation amount for all taxable years was limited to the lesser of (1) $30 million, or (2) six percent of the minimum tax credits allocable to the adjusted net minimum tax imposed for taxable years beginning before January 1, 2006.[28] However, extensions of this provision have provided that this limitation applies separately to property subject to each extension.

All corporations treated as a single employer under section 52(a) are treated as one taxpayer for purposes of the limitation, as well as for electing the application of this provision.[29]

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[22] Sec. 168(k)(4). Eligible qualified property means qualified property eligible for bonus depreciation with minor effective date differences having little (if any) remaining significance.

[23] Sec. 168(k)(4)(A).

[24] Secs. 168(k)(4)(H), (I), (J), and (K).

[25] Sec. 168(k)(4)(B)(ii).

[26] Sec. 168(k)(4)(F).

[27] For this purpose, bonus depreciation is the difference between (i) the aggregate amount of depreciation determined if section 168(k)(1) applied to all eligible qualified property placed in service during the taxable year and (ii) the amount of depreciation that would be so determined if section 168(k)(1) did not so apply. This determination is made using the most accelerated depreciation method and the shortest life otherwise allowable for each property. Sec. 168(k)(4)(C).

[28] Sec. 168(k)(4)(C)(iii).

[29] Sec. 168(k)(4)(C)(iv).

In the case of a corporation making an election which is a partner in a partnership, for purposes of determining the electing partner's distributive share of partnership items, bonus depreciation does not apply to any eligible qualified property and the straight line method is used with respect to that property.[30]

Preproductive period costs of orchards, groves, and vineyards

An orchard, vineyard or grove generally produces annual crops of fruits (*e.g.*, apples, avocadoes, or grapes) or nuts (*e.g.*, pecans, pistachios, or walnuts). During the development period of plants, a farmer generally incurs costs to cultivate, spray, fertilize and irrigate the plants to their crop-producing stage (*i.e.*, preproductive period costs).[31] Preproductive period costs may be deducted or capitalized, depending on the preproductive period of the plant,[32] as well as whether the farmer elects to have section 263A not apply.[33] After the plants start producing fruit or nuts, a farmer can depreciate the capitalized costs of the plants (*i.e.*, the acquisition costs of the seeds, seedlings, or plants and their original planting which were capitalized when incurred, as well as the preproductive period costs if section 263A applied).[34] A 10-year recovery period is assigned to any tree or vine bearing fruits or nuts.[35] A seven-year recovery period generally applies to other plants bearing fruits or nuts.[36]

Description of Proposal

Bonus depreciation

The proposal modifies and makes permanent the 50-percent additional first-year depreciation deduction.[37]

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[30] Sec. 168(k)(4)(G)(ii).

[31] See section 263A(e)(3), which defines the "preproductive period" of a plant which will have more than one crop or yield as the period before the first marketable crop or yield from such plant.

[32] See section 263A(d)(1)(A)(ii). Section 263A generally requires certain direct and indirect costs allocable to real or tangible personal property produced by the taxpayer to be included in either inventory or capitalized into the basis of such property, as applicable.

[33] See section 263A(d)(3).

[34] In the case of any tree or vine bearing fruits or nuts, the placed in service date does not occur until the tree or vine first reaches an income-producing stage. Treas. Reg. sec. 1.46-3(d)(2). See also, Rev. Rul. 80-25, 1980-1 C.B. 65, 1980; and Rev. Rul. 69-249, 1969-1 C.B. 31, 1969.

[35] Sec. 168(e)(3)(D)(ii).

[36] Sec. 168(e)(3)(C)(v).

[37] Due to the passage of time since the provision's original enactment, the proposal eliminates the various acquisition date requirements as no longer relevant. The proposal also repeals as deadwood the provision relating to property acquired during certain pre-2012 periods (or certain pre-2013 periods for certain longer-lived and transportation property).

The proposal allows additional first-year depreciation for qualified improvement property without regard to whether the improvements are property subject to a lease, and also removes the requirement that the improvement must be placed in service more than three years after the date the building was first placed in service.

The $8,000 increase amount in the limitation on the depreciation deductions allowed with respect to certain passenger automobiles is indexed for automobile price inflation. The increase does not apply to a taxpayer who elects to accelerate AMT credits in lieu of bonus depreciation for a taxable year.

The proposal also makes permanent the special rule for the allocation of bonus depreciation to a long-term contract.

Expansion of election to accelerate AMT credits in lieu of bonus depreciation

The proposal makes permanent and modifies the election to increase the AMT credit limitation in lieu of bonus depreciation. Under the proposal, the bonus depreciation amount for a taxable year (as defined under present law with respect to all qualified property) is limited to the lesser of (1) 50 percent of the minimum tax credit for the first taxable year ending after December 31, 2014 (determined before the application of any tax liability limitation), or (2) the minimum tax credit for the taxable year allocable to the adjusted net minimum tax imposed for taxable years ending before January 1, 2015 (determined before the application of any tax liability limitation and determined on a first-in, first-out basis).

The proposal also provides that in the case of a partnership having a single corporate partner owning (directly or indirectly) more than 50 percent of the capital and profits interests in the partnership, each partner takes into account its distributive share of partnership depreciation in determining its bonus depreciation amount.

Special rules for certain plants

The proposal provides an election for certain plants bearing fruits and nuts. Under the election, 50 percent of the adjusted basis of a specified plant is deductible for regular tax and AMT purposes in the year planted or grafted by the taxpayer, and the adjusted basis is reduced by amount of the deduction.[38] A specified plant is any tree or vine that bears fruits or nuts, and any other plant that will have more than one yield of fruits or nuts and generally has a period of more than two years from planting or grafting to the time it begins bearing fruits or nuts.[39] The election is revocable only with the consent of the Secretary, and if the election is made with respect to any specified plant, such plant is not treated as qualified property eligible for bonus depreciation in the subsequent taxable year in which it is placed in service.

[38] Any amount deducted under this election is not subject to capitalization under section 263A.

[39] A specified plant does not include any property that is planted or grafted outside of the United States.

Effective Date

The proposal is effective for property placed in service after December 31, 2014, in taxable years ending after such date.

The proposal relating to the election to accelerate AMT credits in lieu of claiming bonus depreciation generally applies to taxable years ending after December 31, 2014.[40] For a taxable year beginning before January 1, 2015, and ending after December 31, 2014, a transitional rule applies for purposes of determining the amount eligible for the election to claim additional AMT credits. The transitional rule applies the present-law limitations to property placed in service in 2014 and the revised limitations to property placed in service in 2015.

The proposal relating to certain plants bearing fruits and nuts is effective for specified plants planted or grafted after December 31, 2014.

The budgetary effects of the bill are not entered on either PAYGO scorecard maintained under section 4(d) of the Statutory Pay-As-You-Go Act of 2010.

[40] The partnership rule added by the proposal applies to property placed in service after December 31, 2014.

B. Estimated Revenue Effects

Fiscal Years [Millions of Dollars]											
2016	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2016-20**	**2016-25**
-97,532	-43,362	-33,977	-26,345	-20,657	-16,827	-12,043	-6,341	-6,283	-6,489	-221,872	-280,659

NOTE: Details do not add to totals due to rounding.