**Property used by governments and foreign persons.** An exception applies for property used under a lease with a term of less than six months.

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**Court Case:** The IRS contended that a kennel built by a canine officer for his specially trained police dog did not qualify for a Section 179 deduction and should be capitalized, but the court ruled in favor of the taxpayer. Before allowing the officer to keep the dog at home in connection with his work, the police department required him to construct, at his own expense, a kennel that met certain specifications. The Tax Court ruled that the kennel was depreciable personal property and not a building and therefore qualified as Section 179 property. (Le, T.C. Summary 2009-109)

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**Section 179 Carryover**

Taxpayers can carry over for an unlimited number of years the cost of any Section 179 property elected to be expensed but unable to be deducted because of the business income limit.

- If the business income limit prevents an individual taxpayer from deducting all or part of the cost of Section 179 property, the disallowed amount is reported on line 13, Form 4562, *Depreciation and Amortization of Property*, and carried over to the next tax year. That amount is entered on line 10 of Form 4562 for the next year.
- If the investment limit prevents an individual taxpayer from deducting all or part of the cost of Section 179 property, no carryover of the disallowed amount is permitted.

If a taxpayer places more than one property in service in a year, he or she can select the properties for which all or a part of the costs will be carried forward. The selections must be shown in the taxpayer’s books and records. If no selection is made, the total carryover will be allocated equally among the properties elected to expense for the year. If costs from more than one year are carried forward to a subsequent year in which only part of the total carryover can be deducted, the taxpayer must deduct the costs being carried forward from the earliest year first.

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**Did You Know?** If there is a sale or other disposition of property (including a transfer at death) before the taxpayer can use the full amount of any outstanding carryover of disallowed Section 179 deduction, neither the taxpayer nor the new owner can deduct any of the unused amount. Instead, the taxpayer must add it back to the property’s basis.

**Qualified real property Section 179 carryover limited.** No portion of any Section 179 deduction attributable to qualified real property may be carried to tax years beginning after 2014. Qualified real property includes qualified leasehold improvement property, qualified retail improvement property, and qualified restaurant property.

**Allowed deduction.** The taxpayer may carry over to 2014 a 2013 deduction attributable to qualified Section 179 real property he or she elected to expense but was unable to take because of the business income limitation. Any such 2013 carryover amounts that were not deducted in 2014, plus any 2014 disallowed Section 179 deductions attributable to qualified real property, are not carried over to 2015. Instead these amounts are treated as property placed in service on the first day of 2014 for purposes of computing depreciation (including the special depreciation allowance, if applicable).

**Note:** At the time this publication went to print, the provision allowing the Section 179 deduction for qualified real property had expired for tax years beginning after December 31, 2014. See The TaxBook Update Service at www.thetaxbook.com for any new information about extension of this provision.

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**Planning Tip:** It is often advantageous to claim the entire eligible Section 179 amount even when the deduction is reduced by the business income limit. The amount carried over is available for future years when business income may be higher. However, if the deduction is reduced by the investment limit, claim only the allowed amount (or less), and recover the remaining cost of the property through depreciation.

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**Excess Section 179 deduction from a pass-through entity.** Section 179 deduction or investment limitations may prevent an individual taxpayer from claiming the full amount of a Section 179 deduction allocated by a partnership or S corporation. In this case:

- The disallowed amount is not deductible and may not be carried over by the partner or shareholder.
- The partner or shareholder’s basis in the entity is reduced by the entire amount of the Section 179 deduction even if the deduction is unused by the partner or shareholder.
- The partnership or S corporation reduces its basis in Section 179 property by the full amount of the deduction elected.
- When interest or ownership in the entity is disposed of, the partner or shareholder’s basis for gain or loss is increased by the amount of disallowed deduction.

Partnerships and S corporations should structure Section 179 deductions so that partners or shareholders do not suffer loss of the deduction.

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**Example:** Julie is 100% shareholder in an S corporation and also has an interest in a partnership. She receives a K-1 from the S corporation showing a pass-through Section 179 deduction of $20,000 and a K-1 from the partnership showing a pass-through Section 179 deduction of $25,000. Since the deduction limit of $50,000 applies to Julie individually, the excess $5,000 Section 179 deduction is lost and does not carry over. The lost deduction does not increase Julie’s basis in the S corporation or the partnership unless she disposes of her ownership interest.

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**Section 179 Election/Revocation**

**Election.** Make the election to claim a Section 179 deduction by completing Part I, Form 4562, *Depreciation and Amortization*, and filing the form with an original or amended tax return for the year the property was placed in service.

- The Section 179 deduction may be claimed on a late original return.
- If claiming a previously-omitted Section 179 deduction on an amended return, specify the item of property to which the deduction applies and the portion of the cost of each item taken into account.

A taxpayer must keep records that show the specific identification of each piece of qualifying Section 179 property. The records must show how the property was acquired, the person the taxpayer acquired it from, and when the property was placed in service.

**Election for certain qualified Section 179 real property.** A taxpayer could elect to expense certain qualified real property placed in service as Section 179 property for tax years 2010 through December 31, 2014. If the taxpayer elected to treat this property as Section 179 property, he or she would elect the application of the special rules for qualified real property. To make the election, attach a statement indicating “electing the application of section 179(f) of the Internal Revenue Code” with an original tax return, whether or not timely filed, or an amended return filed within the time prescribed by law. The amended return must also include any adjustments to taxable income.

The statement should indicate the taxpayer’s election to expense certain qualified real property under Section 179 on the return.
Section 179 Recapture

Business use below 50%. If business use of property falls below 50% during the regular MACRS recovery period, all or part of the Section 179 deduction must be recaptured as excess depreciation.

- Include the recapture amount as ordinary income in Part IV, Form 4797, Sales of Business Property. See Recapture amount, below.
- The recapture amount is carried to “Other Income” on the same form or schedule on which the original Section 179 deduction was claimed. Note: This may cause the recapture amount to be subject to SE tax.
- Increase the basis of the property by the recapture amount.

Disposition of property. Recapture rules do not apply if property is sold, exchanged, or otherwise disposed of. Instead, see Depreciation Recapture, page 8-3.

Recapture amount:

1) Figure depreciation that would have been allowable on the property under regular MACRS. Begin with the year the property was placed in service and include the year of recapture.
2) Subtract the depreciation in (1) from the Section 179 deduction actually claimed. The result is the recapture amount.

Listed property recapture. If business use of listed property falls to 50% or less during the assets ADS recovery period, the excess depreciation (including any Section 179 expense) must be recaptured. The recapture amount is the amount of depreciation (including special depreciation) and Section 179 expense actually claimed over the depreciation that would have been allowed using the SL method minus the assets ADS recovery period. See Tab 5 for more information about listed property.

Did You Know? Conversion of property from trade or business use to investment or income-producing use is considered a conversion to personal use. For example, a truck initially used 100% in a landscaping business, but later used 100% in a residential rental activity, is treated as having been converted to personal use. Recapture rules would apply. See IRS Regulation Section 1.179-1(e)(2).

Did You Know? Used equipment qualifies for the Section 179 deduction, but does not qualify for the special depreciation allowance.

Special Depreciation Allowance

<table>
<thead>
<tr>
<th>Purchased and Placed-in-Service</th>
<th>Special Depreciation Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Before January 1, 2008</td>
<td>0%</td>
</tr>
<tr>
<td>January 1, 2008 – September 8, 2010</td>
<td>50%</td>
</tr>
<tr>
<td>September 9, 2010 – December 31, 2011*</td>
<td>100%</td>
</tr>
<tr>
<td>January 1, 2012 – December 31, 2014*</td>
<td>2019*</td>
</tr>
<tr>
<td>After December 31, 2014*</td>
<td>0%</td>
</tr>
</tbody>
</table>

* Certain long production period property and transportation property qualifies for 100% special depreciation allowance if purchased and placed in service from September 9, 2010 through December 31, 2012, and 50% special depreciation allowance if purchased and placed in service during 2013, 2014, or 2015.

Special Depreciation Limitations

Unlike the Section 179 deduction, there is no maximum deduction limit for the special depreciation allowance. While the Section 179 deduction generally provides enough first-year depreciation for most small business needs, the special depreciation allowance was designed to encourage larger corporations to spend huge amounts of money on new assets. Additionally, the Section 179 deduction provides a benefit for purchasing used equipment, while the special depreciation allowance requires the equipment to be purchased new. The special depreciation allowance of 50% (for tax years 2012–2014) of the property’s depreciable basis was figured after any Section 179 deduction and before figuring any regular depreciation deduction.

Depreciation limits on business vehicles. The total depreciation deduction (including the Section 179 expense deduction) a taxpayer could take for a passenger vehicle used for business and first placed in service in 2014 was $11,160 for vehicles for which the special depreciation allowance applied. The maximum deduction a taxpayer could take for a truck or van used for business and first placed in service in 2014 was $11,460 for trucks or vans for which the special depreciation allowance applied.

See Vehicle Depreciation Limitations (Section 280F), page 5-1, for further information on passenger vehicle limitations.

Related Topics

- Reporting on Form 4797, page 8-11
- Listed Property and Automobiles, Tab 5

Special Depreciation

At various times since September 11, 2001, 30%, 50%, and 100% special depreciation has been allowed to encourage investment and assist in disaster recovery. The original use of the property must begin with the taxpayer. The purchase of used property does not qualify for the special depreciation allowance. The allowance applies only for the first year the taxpayer places the property in service and can be taken after any Section 179 deduction and before regular depreciation is figured. The adjusted basis of qualified property is reduced by the special depreciation allowance before figuring the regular depreciation deduction for the first tax year and all subsequent tax years.

Note: At the time this publication went to print, the Special Depreciation Allowance had not been extended for tax years beginning after 2014. See TheTaxBook Update Service at www.thetaxbook.com for any new information about extension of this provision.

Revocation. A Section 179 deduction may be revoked or modified without IRS approval by filing an amended return. Once revoked, the election cannot be reinstated.

Cross References

- Form 4562, Depreciation and Amortization
- IRS Pub. 946, How to Depreciate Property
- IRS Pub. 954, Tax Incentives for Empowerment Zones and Other Distressed Communities
- Rev. Proc. 2011-26

Related Topics

- Reporting on Form 4797, page 8-11
- Listed Property and Automobiles, Tab 5