

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).

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.

Example #1: In January 2014, Jerry purchased a \$10,000 piece of equipment (5-year property) which he claimed a Section 179 deduction for the full amount. He used it exclusively in his business until 2016 when the business use dropped to 40%. Jerry calculates his recapture amount as follows.

Section 179 deduction claimed	\$10,000
Minus: Allowable depreciation using the MACRS percentage chart on page 9-1	
2014	\$2,000
2015	\$3,200
2016 ($\$1,920 \times 40\%$).....	\$768
2016 recapture amount.....	<u>\$5,968</u>
	<u>\$4,032</u>

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 10 for more information about listed property.

Example #2: Assume the same facts as Example #1, except that the piece of property is listed property.

Section 179 deduction claimed	\$10,000
Minus: Allowable depreciation using the straight-line method.	
2013	\$1,000
2014	\$2,000
2015 ($\$2,000 \times 40\%$).....	\$800
2015 recapture amount.....	<u>\$3,800</u>
	<u>\$6,200</u>

Special Depreciation Allowance

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

- Form 4797, *Sales of Business Property*, Tab 6
- Alcohol and Cellulosic Biofuel Fuel Credits, Tab 30, *Small Business Edition*

Special Depreciation Allowance (Bonus Depreciation)

At various times since 2001, 30%, 50%, and 100% special depreciation allowances have been available to recover the cost of qualified property. The property must be new property, and the original use of the property must have begun with the taxpayer. Used property does not qualify for the special depreciation allowance.

New Law: The special depreciation allowance was an extender item for several years, being allowed to expire then retroactively extended by Congress. Legislation passed in December of 2015 extended the 50% bonus depreciation through 2019 (2020 for certain longer-lived and transportation property). The percentage is phased down 10% per year beginning in 2018.

Qualifying property. The following types of property qualify for the 50% special depreciation allowance.

- MACRS property with a recovery period of 20 years or less.
- Water utility property.
- Off-the-shelf computer software that is not a Section 197 intangible asset.
- Qualified improvement property. See the *Qualified Real Property* chart, page 9-10.
- Certain long production period and transportation property.
- Qualified cellulosic biofuel plant property.
- Qualified reuse and recycling property.



Election out of special depreciation. Special depreciation is the default method for qualifying property in the year placed in service. An election is required to opt out of special depreciation.

Making the election. Elect out for all property in a class by attaching a statement to a timely-filed return (including extensions), indicating the class of property and stating that the taxpayer elects not to use special depreciation for any property in that class.

An omitted election may be made on an amended return filed within six months of the due date of the return (excluding extensions). Write "Filed pursuant to section 301.9100-2" on the amended return.

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. 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). The new law extends the special rule for the allocation of bonus depreciation to a longterm contract for five years to property placed in service before January 1, 2020 (January 1, 2021, in the case of certain longer-lived and transportation property).

Alternative minimum tax. If special depreciation has been used, no AMT adjustment is required for any depreciation figured on the remaining basis of the property.

Ordering rules for special depreciation. The special depreciation allowance is claimed the year the property is placed in service, in addition to regular depreciation and any Section 179 deductions. Claim the deductions in the following order.

- 1) Section 179 deduction, then
- 2) Special depreciation allowance, then
- 3) Regular depreciation allowance.

Any remaining basis is recovered in subsequent years using regular MACRS.


Section 179 vs. Special Depreciation

Provision	Special Depreciation Allowance	Section 179 Deduction
New property requirement?	Yes ¹	No
Specific date range for eligibility	Yes	No
Annual limits ²	No	Yes
Rental activity property	Yes	No
Property qualifies if used 50% or less for business purposes	Yes ³	No
Recapture if business use of property decreases to 50% or less	No ³	Yes
Property may be acquired from related party	Yes	No
AMT adjustment	No	No

¹ Property converted from personal use to business use in the same or later tax year may qualify.

² Additional section 280F limits apply to passenger vehicles, and \$25,000 SUV limit.

³ Listed property does not qualify if used 50% or less for business and special depreciation must be recaptured if listed property use falls to 50% or less.

 **Author's Comment:** Check state law prior to claiming either the special depreciation allowance or Section 179. In many states it may be more advantageous to claim one over the other.

Qualified Real Property

Cross References

- IRS Pub. 946, *How to Depreciate Property*
- Form 4562, *Depreciation and Amortization*
- IRC §168, *Accelerated Cost Recovery System*
- IRC §179, *Election to Expense Certain Depreciable Business Assets*



Related Topics

- Depreciation Recapture, Tab 6
- Repairs and Improvements, Tab 7

Cost Recovery for Qualified Real Property

Under the general rule, costs of nonresidential real estate and structural components are depreciated under MACRS using the straight-line method over 39 years. However, qualified improvements, qualified leasehold improvements, qualified retail improvements, and qualified restaurant property may be eligible for a Section 179 deduction, a 15-year recovery period, or special depreciation allowance.

The special rules for qualified real property have been included several times in "extender" legislation, where the provisions expired and were retroactively reinstated at a later date. In December 2015, legislation made several of these rules permanent and extended other provisions.

Note: The 15-year recovery period for qualified real property is not elective. However, the taxpayer may elect to use the ADS for all 15-year property placed in service during the year and depreciate the property over 39 years. See *Election to use ADS*, page 9-4.

Qualified Real Property

Property	Section 179	15-Year Recovery	Special Depreciation
Leasehold improvement property	Yes	Yes	Yes ¹
Retail improvement property	Yes	Yes	No ²
Restaurant property	Yes	Yes	No ²
Improvement property	No ³	No ³	Yes
Provision expires	Permanent	Permanent	Tax year 2020 ⁴ December 31, 2019

¹ Beginning in 2016, leasehold improvement property is eligible for special depreciation as qualified improvement property.

² Unless the property is also considered improvement property.

³ Unless the property is also considered leasehold improvement property, retail improvement property, or restaurant property.

⁴ Tax year 2021 for certain noncommercial aircraft and certain long production period property. **December 31, 2020**

Qualified leasehold improvement property. Qualified leasehold improvement property includes improvements made to an interior portion of nonresidential real property if the following requirements are met.

- The improvement is made by the lessee, lessor, or any sublessee.
- The improvement is section 1250 property. This does not include section 1245 property that is eligible for a shortened recovery period under cost segregation rules. See *Planning Tip: Cost Segregation*, page 9-14.
- The lease is not between related persons.
- The interior portion of the building must 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.

Nonqualifying leasehold improvement property. Qualified leasehold improvement property does not include enlargement of the building, an elevator or escalator, a structural component that benefits a common area, or the internal structural framework of the building.

Qualified retail improvement property. Qualified retail improvement property includes improvements made to the interior of nonresidential real property if the following requirements are met.

- The improvements must be made to space open to the general public and used in a retail trade or business of selling tangible personal property to the public.
- The improvements must be placed in service more than three years after the building was first placed in service.

Nonqualifying retail improvement property. Qualified retail improvement property does not include enlargement of the building, an elevator or escalator, a structural component that benefits a common area, or the internal structural framework of the building.

Qualified restaurant property. Qualified restaurant property is any section 1250 property that is a building or an improvement to a building placed in service during the tax year. More than 50% of the building's square footage must be devoted to preparation of meals and seating for on-premises consumption of prepared meals.