2010 DEPRECIATION OF ASSETS

(Approved through 5/31/2011)

BY

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DEPRECIATION

CURRENT FOR 2010 (THIS PAGE):

2010/2011: **1st** Year Expensing is $500,000. Dep., Amort., Depletion. Phaseout occurs when purchases exceed $2 million. No Expensing after $2.5 million.

Empowerment Zones & D.C. Zone: 2009 Extended through 2011.

Opportunity to Expense Film & Television Production Costs:
Extended through 2011

Farm Equipment & Machinery: 5 Year Recovery Period for 2009 not extended.

15-yr. Amortization for qualified leasehold restuarant & retail improvement: Instead of depreciating for 39 yearshas been extended through 2011.

2008/2009/2010: **Property placed in service,** a special first-year depreciation allowance of 50% of the basis of eligible property is allowed in addition to first-year expensing. After 9/8/2010 & before 1/1/20/12 eligible can qualify for 100% Bonus depreciation. The 50% applies after 12/31/2009 to 9/9/10.

The limit on the first-year expensing deduction for business equipment is increased to $250,000. The limit is reduced if the cost of qualifying property placed in service during 2008/2009 exceeds $800,000. For an enterprise zone may be a high of $285,000.
2010 = $500,000. Phaseout starts @ 2 Million,
The maximum depreciation deduction (including expensing) for a auto placed in service, 2008/2009, is $10,960. if the special depreciation allowance applies; otherwise, $2,960. For a light truck or van, the maximum deduction is $11,160 with the special allowance, or $3,160. without the special allowance.

Disaster Victims: No incentives for 2010 & Costs for 2009 no 2010 Extensions.

Depreciation is a loss in the value of property over the time the property is being used.
Recovery of the cost of certain property is accomplished by taking depreciation deductions
Causes of property to depreciate: Wear and tear, Age, Deterioration and Obsolescence

DEPRECIATION

TYPES OF PROPERTY

Tangible property - property that you can see or touch.

Real tangible property - land and buildings and generally anything built or constructed on land, or anything growing on or attached to the land.

Personal tangible property - tangible personal property includes cars, trucks, machinery, furniture, equipment and anything that is tangible except real property.

Note: "personal" in the sense used for depreciation discussions does not mean personal USE property.

Intangible property - generally any property that has value but you cannot see or touch. Includes:

Computer software, if acquired with assets acquired for business
Copyrights
Franchises
Patents
Trademarks
Trade names.

TO CLAIM DEPRECIATION

Must be owner of the property
Must use the property in trade or business or for producing income

DEPRECIABLE PROPERTY- BASIC REQUIREMENTS

Property must be used in business or held to produce income
Property must have a determinable useful life longer than one year
Property must be something that wears out, decays, gets used up, becomes obsolete, or loses its value from natural causes.

PARTIAL BUSINESS USE

Depreciation deduction allowed only on the business use or the use for production of income.
Records required to show business use, nonbusiness use and/or investment use

DEPRECIATION

SPECIAL ITEMS

Land preparation costs -Landscaping - To be depreciable, costs must be so closely associated with other depreciable property that you can determine a life for them along with the life of the associated property.

Repairs and replacements - If increases value of property, makes it more useful, or lengthens its life, the cost must be capitalized and depreciated.

Durable containers - Used to ship product - depreciable if all following requirements are met:

Life longer than one year
Qualify as property used in business
Title to the property does not pass to the buyer.

Professional libraries -depreciable. (Technical books, journals and information services used in business that have useful life of one year or less are expensed as ordinary expense, not depreciable)

Videocassettes - Depreciable if in business of renting videocassettes. - Special rules for depreciation.

Idle property - MUST claim deduction for depreciation if temporarily idle.

DEPRECIATION

<u>Cooperative Apartments -</u> if used in business or for production of income - can deduct your share of cooperative housing corporation's depreciation.

If bought stock as part of its first offering:

1) Figure the depreciation for all the depreciable real property owned by the corporation
2) Subtract from the amount in (1) any depreciation for space owned by the corporation that can be rented but cannot be lived in by tenant-stockholders. Result is yearly depreciation as reduced.
3) Divide number of your shares of stock by total number of shares outstanding including any shares held by the corporation
4) Multiply the yearly depreciation, as reduced, by the number you figured in #3. This is your share of depreciation.

If bought stock after its first offering, figure the basis of depreciable real property to use in #1 above

- Multiply cost per share by total number of outstanding shares
- Add to the amount figured in (1) any mortgage debt on the property on date you bought the stock
- Subtract from the amount figured in (2) any mortgage debt that is not for the depreciable real property, such as the part for the land.

Depreciation deduction can not be more than the part of adjusted basis in the stock of the corporation that is allocable to business or income producing property.

Change to business use (Cooperative apartment) - If bought as part of first offering basis in all the depreciable real property owned by the cooperative is smaller of:

Fair market value on date of change to business use
Corporations adjusted basis on that date

DEPRECIATION

INTANGIBLE PROPERTY

Patents and copyrights (self created)

Use straight line method over the useful life.
Useful life is lessor of life granted it by the government or remaining life.
Valueless in any year before useful life expires - deduct balance in full for that year.

Patents and copyrights subject to amortization -
If acquired as part of acquisition of a substantial portion of a business after August 10, 1993 - generally have to amortize cost over 15 years

Agreement not to compete

Before August 11, 1993 - if for a fixed number of years, agreement is depreciable property. You must be able to establish from facts and circumstances that you bought an agreement not to compete.

After August 10, 1993 - MUST amortize over 15 years

Designs and patterns and formats, including certain computer software - Generally must amortize over 15 years the cost of assets acquired after August 10, 1993.

Franchises - Generally After 8-10-93, must amortize their cost over 15 years.

Customer or subscription lists, location contracts, and insurance expirations.
Generally, must amortize over 15 years the cost of these items

AMORTIZATION OF GEOLOGICAL AND GEOPHYSICAL COSTS

Geological and Geophysical costs (G&G costs) paid or incurred in connection with oil and gas exploration or development in the United States must be amortized over a 24-month period beginning on the midpoint of the tax year that the expenses were paid or incurred. G&G costs are those expenditures incurred for the purpose of obtaining and accumulating data that will serve as the basis for the acquisition and retention of an interest in an oil or gas property.

DEPRECIATION

INTANGIBLE PROPERTY

Computer software - Includes all programs designed to cause a computer to perform a desired function. Computer software also includes any data base or similar item that is public domain and is incidental to the operation of qualifying software.

> Year 2000 Costs
>
> These are costs to manually convert existing software, develop new software, purchase or lease new software to replace existing software or develop or purchase software tools to assist in converting existing software to recognize dates beginning in the year 2000. Treat year 2000 costs as computer software for depreciation purposes.

Software developed before August 11, 1993 - can choose to either treat the costs as current expenses or capitalize costs and depreciate them. If depreciated, use straight line method over 5 years (or shorter life if you can clearly establish). Can not change methods without approval of IRS.

Software purchased before 8-11-93 - If cost was included in price of computer hardware and software cost not separately stated, treat entire amount as cost of hardware. If cost of software separately stated can depreciate over 5 years straight line method.

Software acquired after August 10, 1993- can depreciate over 36 months if meets all of following requirements:

- Readily available for purchase by the general public
- Not subject to an exclusive license
- Has not been substantially modified

Even if does not meet above requirements, can depreciate over 36 months if it was not acquired in connection with the acquisition of a substantial portion of a business.

Off the shelf computer software, available for purchase by the general public and is purchased after 2002 and before 2006, is qualifying property for purposes of section 179 deduction.

If acquired after August 10, 1993 - must amortize it over 15 years if it does not meet all of the previous requirements or if you acquired it in connection with the acquisition of a substantial portion of a business. Unless it is purchased as a whole unit and the cost of the hardware cannot be separated from the cost of the software, straight line 5 years or section 179.

Software leased - generally deduct in same manner that other rental payments are treated. Figure adjusted basis deduct salvage value and divided balance by useful life.

<u>DEPRECIATION</u>

<u>WHAT CAN NOT BE DEPRECIATED</u>

<u>Property placed in service and disposed of in same year</u>.

<u>Land</u> (does not wear out or become obsolete and cannot be used up)

<u>Inventory</u> - (property held primarily for sale to customers in ordinary course of business.)

<u>Equipment used to build capital improvements</u>. Add depreciation on equipment used during construction to basis of improvements.

<u>Leased property</u> - true lease no burden of exhaustion of capital improvements And <u>no incidents of ownership</u> for the property.

(If lease property to someone, generally can depreciate its cost even the lessee has agreed to preserve, replace, renew and maintain the property. However if the lease provides that the lessee is to maintain the property and return it to you or equivalent in value at the expiration of the lease in as good condition and value as when leased, you can cannot depreciate the cost of the property.)

<u>Incidents of ownership include</u>

- The legal title
- Legal obligation to pay for it
- The responsibility to pay its maintenance and operating expenses
- Duty to pay any taxes
- Risk of loss if the property is destroyed, condemned, or diminishes in value through obsolescence or exhaustion.

<u>Goodwill -</u> can not be depreciated but, after August 10, 1993, amortizable over 15 years.

<u>Trademarks and trade names</u>- generally amortizable, not depreciable, over 15 years.

DEPRECIATION

WHEN DEPRECIATION BEGINS AND ENDS

Begins - When placed in service for use in trade or business or for production of income.

Ends - When fully recovered cost or other basis or when retire it from service.

Placed in service - when ready and available for a specific use (even if not using it)

Retired from service - sale, exchange, abandoned or destroyed

BASIS ADJUSTMENT

Must reduce basis in the asset by the amount of depreciation ***allowed or allowable***

If did not deduct correct amount of depreciation for the property on two or more consecutively filed tax returns, you have adopted a method of accounting for that property. If you have adopted a method of accounting, you cannot change the method by filing amended returns. Must get consent from Commissioner of Internal Revenue to change method of accounting.

In some cases may be able to obtain automatic consent if deducted LESS than the allowable amount for the property.

WATCH FOR ACCOUNTING METHOD CHANGE IF:

Changes from non-Depreciable or non-Amortizable items to Depreciable or Amortizable or vice versa, and a correction to require depreciation or amortization in lieu of a deduction for the cost of depreciable or amortizable assets that had been consistently treated as an expense in the year of purchase, or vice versa, are changes in Accounting Methods.

IRS did grant its consent to certain changes of depreciation methods under its automatic change procedures, including changes from impermissible depreciation methods to permissible depreciation methods, and changes from permissible depreciation methods to other permissible depreciation methods. Rev.Proc.2004-3 I.R.B.311

<u>DEPRECIATION</u>

<u>N O T E:</u> The following is effective in taxpayer's second tax year ending on or after 12/31/03

> Change in accounting method required: Taxpayers are granted automatic consent to change to a method of accounting to comply with the capitalization requirements for sef created intangibles for the first tax year ending on or after December 31, 2003. Automatic consent is not granted for prior years in which unauthorized changes were made without first amending the prior returns. See Rev. Proc. 2004-23, 2004-1 C.B.785..

Taxpayers are also granted automatic consent to change a method of accounting to comply with the capitalization requirements for self-created intangibles for the second tax year ending on or after December 31, 2003. See Rev. Proc. 2005-9, 2005-2 I.R.B. 303, modified by Rev. Proc. 2005-17, 2005-13 I.R.B. 797.

<u>DEPRECIATION</u>

<u>FORM 4562</u>

<u>Purpose of form 4562</u>

Part I
- Electing section 179 deduction
- Figuring maximum section 179 deduction for current year
- Figuring any section 179 deduction carryover to next year

Part II
- Reporting Special Depreciation Allowance (not listed property).

Part III
- **Reporting MACRS deductions for property placed in service before this year** and
- Reporting MACRS depreciation deductions for property (other than listed property) placed in service during current year

Part IV
- Summarizing other parts

Part V
- Reporting depreciation on autos and other listed property
- Reporting information on use of autos and other transportation vehicles
- Employer provided vehicles checklist, cell tele, certain computers, etc..

Part VI
- Reporting amortization deductions

<u>Must attach form 4562 to return if claiming any of the following:</u>

- A section 179 deduction for the current year or carryover from prior year
- A depreciation deduction for property placed in service during current year
- A depreciation deduction on any vehicle or other listed property, regardless of when it was placed in service
- A deduction for any vehicle if deduction is reported on a form other than Schedule C or C-EZ.
- A deduction for amortization of costs if the amortization began in current year
- Any depreciation on a corporate income tax return (other than 1120S)

<u>Employees</u> claiming actual expenses (including depreciation) or standard mileage rate must use either form 2106 or 2106-EZ instead of Part V of form 4562.

<u>DEPRECIATION</u>

<u>SECTION 179 DEDUCTION</u>

Section 179 of the Internal Revenue Code allows an election to deduct all or part of the cost of certain <u>qualifying</u> property in the <u>year placed in service.</u> The election is in lieu of depreciation deductions recovery over specified recovery period.

<u>QUALIFYING PROPERTY</u>

Depreciable property

Acquired by purchase for use in business

Acquired by trade - boot only qualified for section 179

Tangible personal property

Other tangible property (except buildings and structural components) used as:

a) an integral part of manufacturing, production or extraction or of furnishing transportation, communications, electricity, gas, water, or sewage disposal service.

b) a research facility used in connection with any of the activities in (a) above.

c) A facility used in connection with any of the activities in (a) for the bulk storage of fungible commodities

Single purpose agricultural (livestock) or horticultural structures

Storage facilities (except buildings and their structural components) used in connection with distributing petroleum or any primary product of petroleum.

DEPRECIATION

SPECIFIC QUALIFYING ASSETS - SECTION 179

- **Leased property** - Generally can not take section 179 expense on cost of property leased to someone else. (Not applicable to corporations) Can claim section 179 deduction based on cost of:

  - Property leased to other than is manufactured by you

  - Property leased to others if both following apply:
    a) Term of lease is less than half the property's class life
    b) For the first 12 months after property is transferred to lessee, the total of the business deductions that you are allowed on the property (except rent and reimbursed amounts are more than 15% of the rental income from the property.

- **Tangible personal property** - property that is not real property
  Land and land improvements such as buildings and other permanent structures and their components are **real property**. Swimming pools, paved parking lots, wharves, docks, bridges, and fences are examples of land improvements. They are not tangible personal property.

- **Business property**-All business property, other than structural components That is contained in or attached to a building is tangible personal property. Certain local laws prohibit some tangible property from being tangible property for purposes of section 179.
  Property such as refrigerators, grocery store counters, transportation and office equipment, printing presses, testing equipment and signs are tangible personal property.

- **Gasoline storage tanks and pumps** at retail service stations are tangible personal property

- **Livestock** is qualifying property. (Livestock includes horses, cattle, hogs, sheep, goats, and mink and other furbearing animals)

DEPRECIATION

SPECIFIC QUALIFYING ASSETS - SECTION 179

- **Single Purpose Agricultural (Livestock) or Horticultural Structures**

  For determination of single purpose structure - poultry is livestock

  Agricultural structure - Any building or enclosure specifically designed, constructed and used for **both** of the following reasons:

  - ♦ House, raise, and feed a particular type of livestock and its produce
  - ♦ House the equipment including any replacements needed to house, raise, or feed livestock.

  Includes property used to breed chickens or hogs, produce milk from dairy cattle, produce feeder cattle or pigs, broiler chickens or eggs.

  Facility must include, as an integral part of the structure or enclosure, equipment necessary to house, raise, and feed the livestock.

  Horticultural structure - Either of the following**:**

  - ♦ Greenhouse specifically designed, constructed and used for commercial production of plants
  - ♦ Structure specifically designed, constructed, and used for commercial production of mushrooms.

  Use of structure - Must be used ONLY for the purpose which qualifies it.

  - ♦ ***Using part of greenhouse to sell plants will disqualify the greenhouse for section 179***
  - ♦ If structure includes work space will not qualify as single purpose **unless work space is used only for:**
    - Stocking, caring for, or collecting livestock or plants or their produce.
    - Maintaining the enclosure or structure
    - Maintaining or replacing equipment or stock enclosed or housed in the structure

- **Partial Business Use**

  Can elect section 179 only if used more than 50% for trade or business in the tax year placed in service.

DEPRECIATION

NON QUALIFYING ASSETS -(FOR SECTION 179)

- Property held only for production of income
  Includes investment property, rental property (if renting property is not taxpayer's trade or business) and property that produces royalties. If use property in active conduct of trade or business You do not hold it **only** for production of income

- Real property, including buildings and structural components

- Property acquired from certain groups or persons

  a) acquired by one member of a controlled group from a member of the same group

  b) Property's basis is either:
     - determined in whole or part by its adjusted basis in the hands of the person from whom it was acquired or
     - determined under stepped up basis rules for property acquired from a decedent.

  c) Property is acquired from a related person
     (See related persons next page)

- Air conditioning or heating units

- Certain property used predominantly outside the U.S.

- Property used predominantly to furnish lodging or in connection with the furnishing or lodging (see discussion later)

- Property used by certain tax - exempt organizations

- Property used by governmental units

- Property used by foreign persons or entities

- Certain property leased to others (if a non corporate lessor)

<u>DEPRECIATION</u>

<u>RELATED PERSONS -</u> For determining property not qualified for section 179 deduction

- Individual, his spouse, child, parent, or other ancestor or lineal descendant
- Corporation and any individual who owns directly or indirectly more than 50% of the value of the corporations outstanding stock
- Two corporations that are members of same controlled group
- Fiduciary of a trust and a corporation if more than 50% of the value of the outstanding stock of corporation owned directly or indirectly by or for the trust or the grantor of the trust
- Grantor and fiduciary, and the fiduciary and beneficiary, of any trust
- Certain educational and charitable organizations and any person (including a member of the person's family) who directly or indirectly controls the organization
- Partnership and a person who owns directly or indirectly an interest of more than 50% of the <u>capital **or** profits</u> of the partnership
- Two partnerships if same persons directly or indirectly own more than 50% of the capital or profits of each
- Two S corporations if same persons owns more than 50% in value of the outstanding stock of each corporation
- An S corporation and a corporation that is not an S corporation if the same person owns more than 50% in value of outstanding stock of each
- A corporation and a partnership if same person owns more than 50% in value of the outstanding stock of the corporation and more than 50% of the capital interest, or profits interest, in the partnership

DEPRECIATION

PROPERTY USED FOR LODGING

Exception - the following property used predominantly in connection with the furnishing of lodging ***can*** qualify as section 179 property.

- Non-lodging commercial facilities which are available to those who are not using the lodging facilities on the same basis as they are available to those using the lodging facilities.

- ***Property used by a hotel or motel in connection with a trade or business of furnishing lodging where the predominant portion of the accommodations are used by transients.***

- Property which is a certified historic structure to the extent of that portion of the basis which is attributable to qualified rehabilitation expenditures.

- An energy property - either of the following:

  Equipment that uses solar energy to generate electricity, to heat or cool (or provide hot water for use in) a structure, or to provide solar process heat.

  Equipment used to produce, distribute or use energy derived from a geothermal deposit, up to (but not including) the electrical transmission stage.

  If taxpayer did not construct, reconstruct, or erect the equipment, the original use of the property must begin with taxpayer. Property must meet standards prescribed by regulations in effect at the time.

  Energy property does NOT include any property that is public utility property.

DEPRECIATION

SECTION 179 ELECTION

Not automatic
Must elect to take the deduction

Election made by taking deduction on form 4562

On original tax return filed for the tax year property placed in service
immaterial whether or not filed timely
Or on an amended return filed by due date (including extensions) for the tax year the property was placed in service.

Can **not** make an election for section 179 on amended return after due date including extensions.

REVOKING THE ELECTION

Can only be revoked with IRS consent, prior to tax year 2003
IRS will grant consent only in extraordinary circumstances.
Requests for consent subject to user fee:
$500 if gross income less than $150,000
$3,500 if gross income is $150,000 or more.
Filed with Commissioner of Internal Revenue in Washington DC 20224
Request must be signed by taxpayer or representative.

RECORDKEEPING REQUIREMENTS FOR SECTION 179

Must keep records that show specific identification of each piece of qualifying section 179 property. Records must show:

- How property was acquired
- Who acquired from
- When it was placed in service

Can not change the selection of section 179 property

DEPRECIATION

FIGURE THE SECTION 179 DEDUCTION

Must figure section 179 deduction before figuring depreciation deduction.

Must subtract amount elected to deduct under section 179 from the business/ investment cost of the qualifying property. Result is called ***unadjusted basis*** for computing depreciation deductions.

May divide the deduction among the items in any way as long as the deduction is not more than the limits.

SECTION 179 LIMITS

Cost of property - deduction can not be more than the business cost of the qualifying property

Maximum dollar limit (Amounts reduced by the costs in excess of investment limits.)

- For 1999 cannot be more than $19,000
- For 2000 cannot be more than $20,000
- For 2001 - 2002 not more than $24,000
- For 2003 - not more than $100,000
- For 2004 - not more than $102,000
- For 2005 - not more than $105,000
- For 2006 - not more than $108,000
- For 2007 - not more than $125,000.(Investment limit $500,000.)
- For 2008 - not more than $250,000.(Investment limit $800,000.)

Except: Qualified Enterprise Zone and Renewal Communities are limited to $285,000 for 2008.

Gulf Opportunity Zone(GO Zone) Property limit may increase.

Enterprise zones - Maximum dollar limit for property that is qualified "Zone Property" is calculated by adding the current maximum Section 179 deduction and $35,000 for businesses located in an empowerment zone. Amounts for the New York Liberty Zone ended 12/31/06. The Gulf Opportunity Zone amount is higher than most Section 179 property.

Joint returns - taxpayer and spouse treated as one taxpayer in determining an reduction to maximum dollar limit, regardless of which party acquired the property or placed it in service.

Married filing separate returns - each treated as one taxpayer for maximum dollar limit and the $500,000 investment limit. Unless elected otherwise 50% of the maximum dollar limit (after applying investment limit) will be allocated to each party.

Reduce maximum dollar limit for each dollar in excess of **investment limit**.

DEPRECIATION

SECTION 179 LIMITS

Investment limits

For each dollar of business cost over:

1. 2003 - $400,000, for Sec. 179 property
2. 2004 - $410,000. for Sec. 179 property
3. 2005 - $420,000. for Sec. 179 property
4. 2006 - $430,000. for Sec. 179 property
5. 2007 - $500,000. for Sec. 179 property
6. 2008 - $800,000. for Sec. 179 property
7. 2009 - $800,000 Sec. 179 Property

placed in service in same year - reduce maximum dollar limit by one dollar (But not below zero). For New York Liberty Zone and Gulf Opportunity property only 50% of the cost of qualified property is taken into consideration. Gulf Opportunity Property the limit is increased by $600,000 to $1,100,000.

No carryover on the disallowed amount.

Taxable income limit

Total cost deductible each year is limited to taxable income from the active conduct of ***any*** trade or business if you meaningfully participate in the management or operations of the trade or business

Total net income (or loss) from all trades/business actively conducted during the year.

- Includes section 1231 gains (or losses) (See next page)
- Includes interest from working capital of trade or business

Include in total taxable income

- Wages
- Salaries
- Tips
- Other pay earned as employee.

Do **not** take into account any un-reimbursed employee business expenses

Figure taxable income without regard to:

- Section 179 deduction
- Self employment tax deduction
- Net operating loss carry back or carryforward.

Any cost that is not deductible in one tax year under section 179 because of this limit can be carried to the next tax year.

DEPRECIATION

SECTION 1231 GAINS AND LOSSES

1) The sale or exchange of real property or depreciable personal property used in trade or business if held for more than 1 year

2) The sale or exchange of cattle or horses held for draft, breeding, dairy, or sporting purposes if held for 2 years or more

3) The sale or exchange of livestock (other than cattle, horses, and poultry) held for draft, breeding, dairy or sporting purposes if held for 1 year or more.

4) The sale, exchange, or involuntary conversion of unharvested crops on land used in farming if sold, exchanged, or had to involuntarily convert the crop and land at the same time and to the same person and held the land for more than 1 year

5) The cutting of timber for sale or for use in trade or business if meet both of following requirements:
    - Elect to treat the cutting as a sale or exchange
    - Either owned the timber for more than 1 year or held
      a contract right to cut the timber for more than 1 year.

6) The disposal of timber held for more than 1 year under a cutting contract if you treat the disposal as a sale or exchange and retain economic interest in the timber.

7) The disposal of coal (including lignite) or iron ore (mined in the US) owned for more than 1 year under a contract in which you retain an economic interest in the timber.

DEPRECIATION

CARRYOVER OF DISALLOWED DEDUCTION

Can select the properties for which costs will be carried forward

If no selection, total carryover allocated equally among the properties elected

Must deduct costs being carried from earliest tax year first.

Basis adjustment - Upon disposition of property adjusted basis of property is increased before sale or other disposition by amount of disallowed Section 179 deduction.

PARTNERSHIPS AND PARTNERS

Section 179 limits apply to both the partnership and to each partner.

Partnership determines section 179 deduction subject to limits and then allocates the deduction among its partners.

Partner:

Add amount allocated from partnership to other nonpartnership business section 179 costs.
Apply maximum dollar limit to total.

Investment limit - business cost of section 179 property placed In service by the partnership is ***not*** attributed to any partner.

For purposes of section 179, if tax year of taxpayer and partnership differ, the amount of the partnership's taxable income attributable to taxpayer for a tax year is determined by the partnership tax year that ends with or within taxpayer's tax year.

Basis of partnership interest must be reduced even if that partner can not deduct all of the total because of limitations.

S CORPORATIONS

Rules that apply to partnership and partners also apply to S corporation and its shareholders.

DEPRECIATION

PASSENGER AUTOMOBILES

For passenger autos placed in service in 2009, the **total of section 179 and depreciation deductions cannot be more than $10,960., (truck/van $11,160.) for 2009.**

SECTION 179 RECAPTURE - *BUSINESS USE DROPS*

If claim the deduction and, in a later year, do not use it predominantly for business, may have to recapture part of the section 179 deduction.

This can occur in any tax year during the *recovery period* of the property.

Section 179 is treated as depreciation for purposes of recapture rules. Treat any gain realized from sale or other disposition as ordinary income up to the section 179 and depreciation deductions claimed.

COMPUTING RECAPTURE

Subtract depreciation that would have been allowable on the section 179 amount for prior tax years and the tax year of recapture from the section 179 deduction claimed. Include the recapture amount in income on the form where the original deduction was taken (may be SE income) (Part V of form 4797)

SECTION 179 RECAPTURE ON *DISPOSITIONS* OF THE PROPERTY

Include section 179 with other depreciation in computing recapture on form 4797 part III. Include the recapture amount as ordinary income (not Self Employment Income)

DEPRECIATION

SPECIAL DEPRECIATION ALLOWANCE - 30% BONUS DEPRECIATION

★ New property acquired between September 10, 2001 and September 10, 2004 and placed into service between September, 11, 2001 and before 1-1-2005 or in the case of certain property with longer production periods, before 1-1-2006.

★ Applied after Section 179 and before MACRS computation

★ Mandatory for property that qualifies unless taxpayer elects out.

This is an additional deduction based on the qualified property's depreciable basis.

AMT - Alternative Minimum Tax and Depreciation

This special depreciation allowance is deductible for both regular tax and AMT with no AMT adjustment required for any depreciation figured on the remaining basis of the property.

- However, this exception in the AMT rules does not apply if you have elected not to claim the special depreciation allowance.

Qualified Property

- MACRS property with 20 or less years recovery
- Water utility property
- Computer software that is not 197 intangible
- Qualified leasehold improvement property

Nonqualified Property

- Property in use by anyone prior to 9/11/01
- Property which must use ADS depreciation
- Qualified New York Liberty Zone leasehold improvement property

Acquisition Date

- Property must be acquired after 9/10/01 and prior to 9/11/04, or
- Property must be acquired through a written binding agreement which was entered into after 9/10/01 and before 9/11/04, or
- Manufacture, construction or production of the property must have began after 9/10/01 and before 9/11/04.

DEPRECIATION

SPECIAL DEPRECIATION ALLOWANCE - 30% BONUS DEPRECIATION - Continued

Electing Out

- Elect out by attaching a statement to a generally timely filed tax return for the year in which the property was placed into service
- Election is for entire class of property
- Election can be made when filing an amended return, if filed within 6 months of the due date of the original return
- Election can be revoked with IRS consent.

Automobiles and the Special Depreciation Allowance

For autos eligible for the special depreciation allowance, you can add $4,600 to the first year's depreciation, effectively ($7,660).

50% SPECIAL DEPRECIATION ALLOWANCE

Qualified property:

1. acquired after May 5, 2003 and before January 1, 2005

2. property you manufacture, construct or produce can meet this test if you began the manufacture, construction or production after May 5, 2003.

3. property must be placed in service after May 5, 2003 and before 1-1-2005 or in the case of certain property with longer production periods, before 1-1-2006.

4. must be NEW - you must be the originating user.

You can elect to claim the 30% special allowance instead - see above

Election Out

- Elect out by attaching a statement to a generally timely filed tax return for the year in which the property was placed into service
- Election is for entire class of property
- Election can be made when filing an amended return, if filed within 6 months of the due date of the original return
- Election can be revoked with IRS consent.

DEPRECIATION
MODIFIED ACCELERATED COST RECOVERY SYSTEM (MACRS)

MACRS - Two systems that determine how to depreciate property.

- General Depreciation System (GDS)
- Alternative Depreciation System (ADS)

ADS generally requires longer recovery periods and uses only straight line method

Both ADS and GDS have pre-established class lives for most property.

Both systems provide for three preset conventions to determine number of months for which depreciation may be claimed in year property placed in service and in year of disposition.

CONVENTIONS

- For all nonresidential real and residential rental property - mid month convention
- For all other property:
  - Generally the half year convention
  - Mid quarter convention - if basis of property placed in service during the last three months of the tax year (excluding non-residential real, residential rental property and property placed in service and disposed of in same year) is more than 40% of the total bases of all property placed in service for entire year.

- IRS suspended mid-quarter convention for property placed into service in 2001. Thus taxpayers could use half year even if over 40% of all depreciable assets placed into service during 2001 were purchased in the 4th quarter of the year.

MACRS METHODS

- The 200% declining balance method over a GDS recovery period
- The 150% declining balance method over a GDS recovery period
- The 150% declining balance method over an ADS recovery period (if elected)
- The straight line method over a GDS recovery period
- The straight line method over an ADS recovery period.

You can elect to use ADS for property that qualified for GDS

DEPRECIATION
MACRS

WHAT CAN BE DEPRECIATED UNDER MACRS

In general - most tangible depreciable property placed in service after 1986.

Mandatory- Must use MACRS to depreciate all real property acquired before 1987 that changed from personal use to business or income producing use after 1986.

WHAT CANNOT BE DEPRECIATED UNDER MACRS

- Intangible property
- Motion picture film or video tape
- Sound recordings
- Certain real and personal property placed in service before 1987

  Do not treat real or personal property as owned before placed in service.

EXCLUDED FROM MACRS

Any property that can properly be depreciated under a method of depreciation not based on a term of years.

PERSONAL PROPERTY ACQUIRED AFTER 1986

Cannot use MACRS if any of following apply:

- Taxpayer or someone related to taxpayer owned or uses property in 1986.
- Acquired property from a person who owned it in 1986 and as part of the transaction the user of the property did not change
- Leased the property to a person (or someone related to this persons) who owned or used the property in 1986.
- Acquired the property in a transaction in which:

  User of the property did not change

  And Property was not MACRS property in hands of the person from whom acquired because of above rules.

Excluded property rules do not apply to any property if allowable deduction for the property for first tax year placed in service under ACRS is greater than the deduction under MACRS using half year convention.

DEPRECIATION
MACRS

REAL PROPERTY EXCLUDED FROM MACRS

Cannot use MACRS if real property acquired after 1986 and any of following apply:

- Taxpayer or someone related to taxpayer owned the property in 1986
- Taxpayer leases the property back to the person (or someone related to the person) who owned the property in 1986
- Taxpayer acquired the property in a transaction in which some of the gain or loss was not recognized. MACRS applies only to that part of basis in property that represents cash paid or unlike property given up. (Boot).

(This rule does not apply to nonresidential real property or residential real property)

DEPRECIATION
MACRS

RELATED PERSONS - FOR DETERMINATION OF USER OF PROPERTY CHANGE

(Note: These rules are different than the related party rules for determining what property does not qualify for section 179 deduction)

Individual and member of his or her immediate family, including a spouse, child, parent, brother sister, half brother, half sister or any ancestor or lineal descendant.

Corporation and individuals who owns more than 10% of value of outstanding stock

Two corporations that are members of same controlled group

Fiduciary of a trust and a corporation if more than 10% of value of outstanding stock is owned directly or indirectly by or for the trust or grantor of the trust.

Grantor and fiduciary of any trust and the fiduciary and beneficiary of any trust.

Fiduciaries of two different trusts and the fiduciaries and beneficiaries of two different trusts, if the same person is the grantor of both trusts.

Certain educational and charitable organizations and any person (or persons family member) who directly or indirectly controls the organization

Partnership and a person who owns directly or indirectly an interest of more than 10% of capital or profits of the partnership.

Two partnerships, if same persons directly or indirectly own more than 10% of capital/profits of each.

The related person and a person whoa re engaged in trades or businesses under common control.

Two S corporations if same persons own more than 10% of value of outstanding stock in each

An S corporation and a corporation that is not an S corporation if same persons own more than 10% in value of outstanding stock of each corporation

A corporation and a partnership if the same persons own both of the following

More than 10% in value of outstanding stock of corporation
More than 10% of the capital interest or profits interest in the partnership.

DEPRECIATION

BASIS OF PROPERTY FOR DEPRECIATION

COST AS BASIS - INCLUDES

- Money paid
- Debt assumed
- Basis of trade in
- Services Given
- Settlement fees (title abstract,survey transfer, legal, recording fees)
- Obligations of seller paid by buyer
- Option payments
- Legal fees
- Appraisal costs
- Cost of acquiring outstanding leases
- Cost of obtaining zone changes
- Freight
- Installation
- Testing
- Sales tax

CONSTRUCTION COST BASIS - INCLUDES

- Cost of building materials
- Architects fee
- Building permits
- Sub contractor fees
- Equipment rental to complete construction
- Operating and maintenance of equipment used in construction
- Supplies consumed in construction
- Employees wages
- May have to use uniform capitalization rules

DEPRECIATION

BASIS OF PROPERTY CHANGED FROM PERSONAL USE

Lesser of:

- Fair market value on date changed to business use

- Original cost

    Increased by improvements or additions

    Decreased by any tax deductions claimed for casualty losses and other charges to basis claimed on earlier years income tax returns.

The above, ‘lesser of’, does not apply if another code or Regulation ‘prescribes’.

In depth discussion of BASIS is covered in another course.

DEPRECIATION
BASIS - SPECIFIC ITEMS

Trade - New property basis is FMV unless property received in non taxable exchange
Trade-in - If sale for cash and immediately repurchase similar property to replace it (Repurchased from same dealer) it is **not** considered a trade in and exchange. Such a sale and purchase are two separate transactions
Restricted Property - Basis is FMV when you can transfer it or when it is no longer subject to substantial risk or forfeiture.
Property received for services - Basis is FMV of property when received (and FMV is included in ordinary income when property is received)
Bargain purchases - Must include the difference between the purchase price and the FMV in income. Basis is then FMV (cost plus amount included in income)
Unadjusted basis for ACRS and MACRS - computed per one of above methods but reduced by section 179 amount.
Transfer of property between spouses - (or former spouse incident to divorce) -Basis of property to transferee is same as adjusted basis to transferor at date of the transfer. No gain or loss recognized on transfer.
Inherited Property - Basis is FMV at date of death OR FMV at alternative valuation date if used for estate purposes.
Gift property:
If FMV less than donors basis - basis for depreciation (and gain) is donors basis
- basis for loss is FMV
If FMV is greater than donor's basis -basis is donors basis plus gift tax
- attributable to the increase
Involuntary conversions - New property received (must be similar or related in service) Basis is same as old property less any loss recognized plus additional costs of acquisition
Intangible assets - generally basis is cost
Basis for surviving tenants - add to basis survivor already had for his own interest, the FMV of the interest he acquires as a surviving tenant. Basis of own interest adjusted for depreciation etc.
Community property - if at least half of the entire community interest is includible in deceased spouse's gross estate (whether or not an estate tax return is required) the entire property (both deceased and surviving spouse's interest) is treated for basis purposes as property acquired from decedent (stepped up to FMV). If less than half of community interest included in decedents gross estate, only the deceased spouse's interest is treated as acquired from a decedent.
Cost of tearing down a building - Purchase of land and building where building is to be demolished - all basis allocated to land, none to building. Increase cost of land basis by costs to remove building. Decrease cost of land basis by proceeds from building removed.

Basis for depreciation must be allocated between land and buildings. Settlement fees must be allocated between land and buildings.

<u>DEPRECIATION-MACRS</u>
<u>CLASS LIFE AND RECOVERY PERIODS</u>

<u>GENERAL DEPRECIATION SYSTEM</u>

<u>GDS</u> uses different declining balance rates and straight line method depending on the property class, the way the property is used, and election made:

- 200% declining balance over a GDS recovery period used for **<u>nonfarm</u>** property in 3, 5, 7 and 10 year property classes.

- 150% declining balance over GDS recovery period used for **<u>all property used in farming businesses</u>** * (except real property) and for all other property in 15 and 20 year property classes

> Instead of using the 150% DB rate over GDS recovery period for property used in farming business, can **<u>elect</u>** to use any of:
> - 150% DB rate over **<u>ADS</u>** recovery period
> - Straight Line over GDS recovery period
> - Straight line over ADS recovery period
>
> If elect to apply uniform capitalization rules to any plant produced in farming, must use ADS.

- Straight line method over a GDS recovery period used for nonresidential real property and residential rental property and **<u>can elect</u>** to use for property in the 3,5,7,10,15 and 20 year classes.

- 150% declining balance rate over ADS recovery period used, <u>if elected</u> for property in 3,5,7, and 10 year property classes.

> **Effective for property placed in service after 1998 - if choose to depreciate using 150% DB rate, use same recovery periods would have used if chosen 200% DB**

> **Election to use 150% dB method for one item in a property class applies to all property in that class placed in service in the tax year of election. Once election made, cannot change it**

***Farming business:** business involving cultivating land or raising or harvesting any agricultural or horticultural commodity. Includes operating nursery or sod farm, raising or harvesting crops, raising or harvesting trees bearing fruit, nuts or other crops, raising ornamental trees, raising, shearing, feeding , caring for , training and managing animals. <u>Farming does not include processing commodities or products if not a normal part of growing raising or harvesting these products.</u>

Fruit or nut trees and vines - Use GDS straight line method over recovery period of 10 years.

DEPRECIATION-MACRS
CLASS LIFE AND RECOVERY PERIODS

GENERAL DEPRECIATION SYSTEM

- **3 year property class -**includes tractor units for over the road use and any race horse over 2 years old when placed in service. Also includes any other horse over 12 years old when placed in service And qualified rent - to -own property.

- **5 year property** - includes automobiles, taxis, buses, trucks, computers and peripheral equipment, office machinery, and any property used in research and experimentation, breeding and dairy cattle. Also includes appliances, carpeting, furniture, etc used in rental real estate activity.

- **7 year property** - includes office furniture and fixtures. **Any property that does not have a class life and has not been designated by law as being in any other class is 7 year property.**

- **10 year property** - vessels, barges, tugs, similar water transportation equipment, any single purpose agricultural or horticultural structure, and any tree or vine bearing fruits or nuts.

- **15 year property -** land improvements (such as parking lot), sidewalk, road, fence, patio or driveway, landscaping and gas stations.
- Qualified-restaurant property effective 10-22-2004 & placed in service prior to January 1, 2006.
- Qualified-leasehold improvement property effective 10-22-2004 & placed in service prior to January 1, 2006.

- **20 year property** - farm buildings (other than single purpose structures)

  Residential rental property-Includes mobile home

  If 80% or more of gross rental income for tax year is from dwelling units. (House, apartment used to provide living accommodations in a building or structure. Does not include a unit in a hotel, motel, inn or other establishment where more than half of the units are used on transient basis. If owner occupies any part of building for personal use, gross rental income includes fair rental value of the part owner occupied. Recovery period is 27.5 years.

  Nonresidential real property - includes section 1250 property that is not either:
  - Residential rental property
  - Property with a class life of less than 27.5 years.

  Recovery period is:

  39 years for property placed in service after May12, 1993

  31.5 years for property placed in service before May 13, 1993.

OFFICE IN HOME - Depreciate as **nonresidential real property** over 39 years.

DEPRECIATION-MACRS
CLASS LIFE AND RECOVERY PERIODS

RENT TO OWN PROPERTY -

Qualified rent-to-own property is property held by a rent-to-own dealer for purposes of being subject to rent-to-own contract. Includes tangible personal property generally used in the home for personal use.

Computers, televisions, video cassette recorders, stereos, camcorders, appliances, furniture, washing machines and dryers, refrigerators, other similar consumer durable property. Consumer durable property does **not** include real property, aircraft, boats, motor vehicles or trailers.

Class life 3 years after Aug 5,1997 (5 years if placed in service before Aug 6, 1997)

Rent to own dealer - person who, in ordinary course of business, regularly enters into rent-to-own contracts if a substantial portion of contracts end with customer returning the property before the dealer receives all of the payments required to transfer ownership to customer. Contracts must be for use of consumer property - tangible personal property of a type generally used within the home for personal use.

Rent to own contract - any lease meeting the following rules that is for the use of a consumer property between a rent-to-own dealer and a customer who is an individual. Contract must meet all of the following rules.

- Be titled "Rent to Own Agreement" or "Lease agreement with Ownership option" or use other similar language
- Provide a beginning date and a maximum period of time not to exceed 156 weeks or 36 months (including renewals or options to extend
- Provide for regular periodic weekly or monthly payments that can be either level or decreasing. If decreasing, then no payment can be less than 40 percent of the largest payment
- Provide for total payments to generally exceed normal retail price of the property plus interest
- Provide for total payments that do not exceed $10,000 for each item
- Provide that the customer has no legal obligation to make all payments and that at the end of each weekly or monthly payment period, customer can either continue to use the property by making the next payment or return the property in good working order and be free of any further obligation and not entitled to return of any prior payments
- Provide that legal title to the property remains with rent to own dealer until customer makes either all required payments or the early purchase payments required under the contract to acquire legal title
- Provide that the customer has no right to sell, sublease, mortgage, pawn, pledge, or otherwise dispose of the property until all contract payments have been made.

DEPRECIATION-MACRS
CLASS LIFE AND RECOVERY PERIODS

Water Utility Property

Placed in service after 6-12-1996 - straight line 25 year recovery period
Definition: Property that is an integral part of the gathering, treatment or commercial distribution of water and that, without regard to this provision, would have been 20 year recovery period.

And Any municipal sewer

Gas station convenience stores (retail motor fuels outlet)

Whether or not it sells food or other convenience items

Placed in service after August 19, 1996 - 15 year recovery property.

Definition - real property if it is used to a substantial extent in the retail marketing of petroleum or petroleum products and it meets **any one** of the following three tests:

- It is not larger than 1,400 square feet
- 50% or more of the gross revenues are generated from petroleum sales
- 50% or more of the floor space in property is devoted to petroleum Marketing sales.

Does not include any facility related to petroleum and natural gas trunk pipelines.

Personal home changed to rental use (after 1986)

Depreciate it as residential rental property over 27.5 years under GDS

Additions or improvements

Treated as separate property items for depreciation purposes.
Recovery period begins on later of following two dates:
Date placed the addition or improvement in service
Date placed the property to which addition or improvement was made in service
The class and recovery period of the addition or improvement is the one that would apply to the underlying property if placed in service at the same time as the improvement.

DEPRECIATION-MACRS
CLASS LIFE AND RECOVERY PERIODS

SHORTER RECOVERY PERIOD PROPERTY USED ON INDIAN RESERVATION

Qualified property - 3,5,7,10,15,20 year property and **non residential** property

Must use predominantly in active conduct of trade or business **on an Indian reservation**

Must **not** be:

a) Property used or located outside an Indian reservation on a regular basis
b) Property acquired directly or indirectly from a related person
c) Property placed in service for purposes of conducting or housing class I, II, or III gaming.

Does **not** include property that must be depreciated under ADS.

Qualified Infrastructure Property

Item #1 above does not apply to qualified infrastructure property located outside the reservation that is used to connect with qualified infrastructure property within the reservation. To be qualified infrastructure property it must:

- Meet rules stated above under Qualified property (except that it can be outside the reservation)
- Benefit the tribal infrastructure
- Be available to general public
- Be placed in service in connection with active conduct of a trade or business within the reservation

Infrastructure property includes, but is not limited to:

Roads, power lines, water systems, railroad spurs and communication facilities.

Related person

For this purpose the relationship 10% is applied and includes brothers and sisters.

Shorter recovery periods for Indian reservation property are:

Property Class	Recovery Period
3 year	2 years
5 year	3 years
7 year	4 years
10 year	6 years
15 year	9 years
20 year	12 years
Non residential real property	22 years

DEPRECIATION-MACRS
CLASS LIFE AND RECOVERY PERIODS

ALTERNATIVE DEPRECIATION SYSTEM (A D S)

You must use ADS for certain property. You may elect to use ADS for property that qualifies for GDS. If use ADS, recovery of cost using straight line method. Recovery periods are generally longer under ADS.

ADS recovery periods for many items of property can be found in tables in IRS Pubs
If ADS period not listed in tables:

- Personal property that is not listed and that has a class life - recovery period is the class life
- Personal property without a class life - recovery period 12 years
- For all section 1245 property not listed in tables-recovery period 40 years

Property	**Recovery Period**
Nonresidential real and residential rental property	40 years
Automobiles and light duty trucks	5 years
Computers and peripheral equipment	5 years
High technology telephone station equipment installed on customer premises.	5 years
High technology medical equipment	5 years
Single purpose agricultural and horticultural structures	15 years
Any tree or vine bearing fruit or nuts	20 years
Personal property with no class life	12 years

<u>DEPRECIATION</u>-<u>MACRS</u>
<u>CONVENTIONS</u>

<u>HALF YEAR CONVENTION</u>

Generally used for property other than nonresidential real and residential rental property.

Treat all property placed in service or disposed of during a tax year as placed in service or disposed of at the <u>midpoint</u> of the year.

No matter when in the year begin or end the use of the property, treat it as if began or ended in the middle of the year.

<u>MID MONTH CONVENTION</u>

Used for Nonresidential and Residential rental property.

Treat all property placed in service or disposed of during a month as placed in service or disposed of at the midpoint of the <u>month.</u>

<u>MID QUARTER CONVENTION</u>

<u>Used for property</u> (other than nonresidential real property and residential rental property)
<u>When:</u> Total depreciable bases of MACRS property placed in service during the last three months of that year are more than 40% of total depreciable bases of all MACRS property placed in service during the entire year.

Exception: If the 3rd or 4th quarter of taxpayer includes September 11, 2001: you can elect to apply the half-year convention to all property, except nonresidential real property and residential rental property. To make the election write: "Election Pursuant to Notice 2001-70" accross the top of the Form 4562 for 2001.

<u>When applicable:</u>
Must use this convention for <u>all MACRS</u> property placed in service <u>during the year</u>**.**

<u>To determine total bases of property do</u> <u>not</u> **<u>include basis of any of:</u>**

- Non residential property
- Residential rental property
- Property placed in service and disposed of in same year

DEPRECIATION-MACRS
CONVENTIONS

Depreciable basis is basis multiplied by percentage of business use and then reduced by:

- Amount of amortization taken
- Section 179 claimed on the property
- Any deduction claimed for clean-fuel vehicles of clean-fuel vehicle refueling property.

Treat all property placed in service or disposed of during tax year as placed in service at midpoint of the quarter. No matter when, during a quarter, the property is placed in service or disposed of, treat it as being placed in service in the middle of the quarter.

DEPRECIATION-MACRS

USING PERCENTAGE TABLES

Must apply the rates in percentage tables to property's unadjusted basis

Cannot use percentage tables for a short year

When use percentage tables must continue to use them for the entire recovery period unless there are adjustments to basis of property for reasons other than
- a) Depreciation allowed or allowable
- b) An addition or improvement to that property that is depreciated as a separate item of property

Can not continue to use tables if there is an adjustment to basis of property other than for a reason listed above.

UNADJUSTED BASIS

Reduce original cost basis by:
- Amortization taken
- Section 179 taken
- Deduction claimed for clean-fuel vehicle or clean fuel vehicle refueling property
- Amount of any qualified electric vehicle credit.

Trade property - unadjusted basis is cash paid plus adjusted basis of trade in minus the above

Deductions for clean-fuel vehicles or clean fuel vehicle refueling property and any electric vehicle credit are subject to recapture. If recapture part or all of the deduction or credit may increase basis of the property by the amount of the recapture. Recover additional basis over rest of recovery period beginning with year of recapture.

CASUALTY LOSS BASIS ADJUSTMENT

If reduce basis because of casualty - **can not** continue to use tables. For year of the adjustment and future years, figure depreciation using property's adjusted basis at the end of the year of adjustment.

DEPRECIATION-MACRS

COMPUTING DEPRECIATION WITHOUT TABLES

Must apply appropriate convention for first and last year.

Declining Balance Method

Divide specified declining balance percentage (150% or 200% changed to a decimal) by recovery period.

> 3 year property depreciated using 200% declining balance rate
> Divide 2.00 (200%) by 3 to get 0.6667 or 66.67%.

Multiply adjusted basis by declining balance rate above
Apply appropriate convention for first and last year

For all other years:

> Reduce adjusted basis by amount of depreciation claimed in earlier years.
> Multiply by same DB rate used in earlier years.

Switch to Straight line in year when it provides a greater deduction.

Straight Line Method

Must determine a new depreciation rate for each tax year.
Must apply appropriate conventions.

Divide number 1 by years remaining in recovery period at beginning of tax year.
Must take into account the convention used in year placed in service.
Multiply result by adjusted basis

<u>DEPRECIATION-MACRS</u>

<u>DISPOSITIONS</u>

Permanent withdrawal or property used in trade or business or in production of income.

By sale, exchange, retirement, abandonment, involuntary conversion or destruction.

Early disposition: (before end of recovery period)

If depreciated under MACRS, allowed deduction for year of disposition.
Use applicable convention (convention used when property placed in service)

<u>RECAPTURE OF DEPRECIATION</u>

With the exception of gain on disposition of residential rental and nonresidential real property, all gain on disposition of property depreciated under MACRS is recaptured (Included in income) as ordinary income up to the amount of previously allowed depreciation deducted for the property.

Depreciation, for this purpose, includes any section 179 deduction claimed on the property, and any deduction claimed for clean-fuel vehicles and clean fuel vehicle refueling property.

There is **<u>no recapture for residential rental and nonresidential real property.</u>**

<u>CHANGE OF USE OF MACRS PROPERTY</u>

On or after June 17, 2004 the effect on the amount of depreciation allowed in the year of change and subsequent years depends on whether the change is:

1. A conversion of personal use property to a business or income producing use.

<u>OR</u>

2. A conversion of MACRS property to personal use,

<u>OR</u>

3. A change in use of MACRS property that results in a different recovery period, depreciation method or both. Regulation 1.168(i)-4(a)

For changes before June 17, 2004, the IRS will allow any reasonable method of depreciation in the year of change and subsequent taxable years that is consistently applied to any property for which the use changes in the hands of the same taxpayer. Regulation 1.168(i)-4(g)(1).

DEPRECIATION

GENERAL ASSET ACCOUNTS

To make it easier to figure MACRS depreciation - can group separate properties into one or more general asset account and depreciate as a single item of property.

Special rules for automobiles - apply deduction limits

Property not eligible for general asset account

Property used both in trade or business (or for production of income) and in a personal activity in the tax year in which it was first placed in service.

Property generating foreign source income - special treatment required.

Each general asset account must include only property placed in service in the same year and that has following in common.

- Asset class
- Recovery period
- Depreciation method
- Convention

No asset class - if same depreciation method, recovery period and convention, placed in service in same year, can be grouped into same general asset account

Mid Quarter convention - Property subject to mid quarter convention can only be grouped into general asset account with property that is placed in service in the **same quarter** of the taxable year.

Mid month convention - Property subject to mid month convention can only be grouped into a general asset account with property placed in service in the **same month** of the taxable year.

Passenger auto - Subject to limits on passenger auto depreciation must be grouped in a separate general asset account

<u>DEPRECIATION</u>

<u>DISPOSITIONS OF PROPERTY FROM GENERAL ASSET ACCOUNT</u>

Unadjusted depreciable basis and depreciation reserve of the general asset account are not affected by disposition of property from the general asset account.

Must remove from general asset account any property changed to personal use.

For purposes of determining gain or loss, when disposed of property in a general asset account, treat the property as having an adjusted basis of **<u>zero</u>** immediately before disposition. **<u>No loss can result from disposition.</u>**

Must recognize as ordinary income, up to a limit, any amount realized when disposed of property in a general asset account.

Limit is result of:

- The sum of unadjusted depreciable basis of the general asset account **<u>plus</u>**
- Any expensed costs for property in the account that are subject to recapture as depreciation **<u>minus</u>**
- Any amount previously recognized as ordinary income upon the disposition of other property from the account.

If dispose of all of the property, or the last item of property in a general asset account, may recover the adjusted depreciable basis of the general asset account.

Election to include property in general asset account is made by each owner - at partnership or S corporation level and not by each partner or shareholder.

Make the election by typing or printing at top of form 4562 “GENERAL ASSET ACCOUNT ELECTION MADE UNDER SECTION 168(i)(4)”

DEPRECIATION

LISTED PROPERTY - Any of the following:

- Any passenger auto(See Exempt below)
- Any other property used for transportation * (See Exempt below)
- Any property of a type generally used for entertainment, recreation, or amusement (including photographic, phono graphic, communication, and video-recording equipment)
- Any computer and related peripheral equipment **unless it is used only at a regular business establishment and owned or leased by a person operating the establishment.**
- Any cellular telephone (or similar telecommunication equipment)

* Other property used for transportation includes trucks, busses, boats, airplanes motorcycles, and any other vehicles for transporting persons or goods.

Exempt Vehicles that are NOT listed property

- Clearly marked police and fire vehicles
- Unmarked vehicles used by law enforcement officers if use is officially authorized.
- Ambulances used as such and hearses used as such
- Any vehicle with loaded gross vehicle weight of over 14,000 pounds that is designed to carry cargo
- Bucket trucks (cherry pickers), cement mixers, dump trucks (including garbage trucks), flatbed trucks and refrigerated trucks
- Combines, cranes, derricks and forklifts
- Passenger buses with capacity of at least 20 passengers that are used as passenger buses, Qualified moving vans seating over 9 passengers. And those without rear seating.
- Qualified specialized utility repair trucks
- School buses if substantially all the use of the buses is in transporting students and employees of schools
- Tractors and other special purpose farm vehicles.

DEPRECIATION

LISTED PROPERTY

Qualified Moving Vans

Any truck or van used by a professional moving company for moving household or business goods if following requirements are met:

- No personal use allowed other than for travel to and from a move site or for minor personal use, such as stop for lunch on way from one move site to another
- Personal use for travel to and from a move site happens no more than five times a month on average
- Personal use is limited to situations in which it is more convenient to the employer, because of location of the employees residence in relation to the location of the move site, for the van not to be returned to employer's business location

Qualified specialized utility repair truck

Not a van or pickup truck **and all three** of following apply

- Truck specifically designed for and used to carry heavy tools, testing equipment or parts
- Shelves, racks, or other permanent interior construction has been installed to carry and store the tools, equipment or parts and would make it unlikely that the truck would be used, other than minimally, for personal purposes.
- The employer requires the employee to drive the truck home in order to be able to respond in emergency situations for purposes of restoring or maintaining electricity, gas, Telephone, water, sewer, or steam utility service.

Qualified Trucks and Vans Placed in Service after 2002

Defined as passenger automobiles built on a truck chassis including minivans and sport utility vehicles built on a truck chassis. First year limitations:

- $3,360 if placed in service in 2003 and either not qualified for the special depreciation allowance or taxpayer elects out

- $7,960 if placed in service between 1/1/03 and 5/5/03 and is eligible for the 30% special depreciation.

- $11,010 if placed in service after 5/5/03 and is eligible for the 50% special depreciation and taxpayer has not elected out. The limitation still applies if the taxpayer elects to claim the 30% special depreciation allowance.

DEPRECIATION

LISTED PROPERTY

MAXIMUM DEPRECIATION DEDUCTION FOR TRUCKS AND VANS

Placed in service	1st Year	2nd Year	3rd Year	4th and Later years
2003	11,010	5,400	3,250	1,875
2004	10,910	5,300	3,150 `	1,875
2005	3,260	5,200	3,150	1,875
2006	3,260	5,200	3,150	1,875
2007	3,260	5,200	3,050	1,875
2008	11,160	5,400	3,050	1,875
2008	For above 11,160: if no special depreciation allowance taken, vehicle is not qualified property and the maximum deduction is $3,160.			
2009	11,060.($3,060.)if not qualified for special allowance.			
		4,900	2,950	1,775
2010	3,160	5,100	3,050	1,875
	11,160 Bonus: If business use exceeds 50%			

SPORT UTILITY VEHICLES and other vehicles with similar limits(see IRS Pub. 946).

Rated at more than 6,000 pounds but not more than 14,000 pounds gross vehicle weight, taxpayers can elect to expense only up to $25,000..

Computer and Related Peripheral Equipment

Programmable electronically activated device that is capable of accepting information, applying prescribed processes to the information and supplying the results with or without human intervention. A central processing unit with extensive storage, logic, arithmetic, and control capabilities.

Related peripheral equipment is any auxiliary machine which is designed to be controlled by the central processing unit of a computer.

Neither computers or related peripheral equipment:

Equipment which is an integral part of property which is not a computer

Typewriters, calculators, adding and accounting machines, copiers, duplicating equipment, and similar equipment

Equipment of a kind used primarily for user’s amusement or entertainment such as video games.

Improvements to listed property

Must be capitalized and treated as a new item of depreciable property.

<u>DEPRECIATION</u>

<u>LISTED PROPERTY</u>

<u>Predominant Use Test</u>

If listed property not used predominantly (more than 50%) in a qualified business use - can not take section 179 deduction for the property and **<u>Must</u>** depreciate the property using ADS (straight line method) over the ADS recovery period.

Can not use percentage of <u>investment</u> use of listed property as part of the percentage of qualified business use to meet predominant use test.

However, you <u>do</u> use the combined total of business and investment use to figure depreciation deduction.

Property does not stop being predominantly used in a qualified business use because of a transfer at death.

Must apply predominant use test for an item of listed property ***EACH YEAR*** *of the* ***A D S RECOVERY PERIOD.***

<u>Required</u> use of straight line method for item that does not meet predominant use test is **not the same** as **<u>electing</u>** straight line method. Not required to use straight line method for all other property in the same class as the item of listed property.

<u>Year after first recovery year fail to meet predominant use test</u>

May be required to recapture part of the section 179 and depreciation deductions claimed.

Excess depreciation - The amount allowable for the property including section 179 deduction claimed for tax years before the first tax year not used predominantly in a qualified business ***<u>minus</u>*** the amount of depreciation that <u>would have been allowed</u> for those years if had not used the property predominantly in a qualified business use for the year placed in service. (Refigure depreciation using ADS method.)

DEPRECIATION

LISTED PROPERTY

Qualified Business Use

Any use in trade or business, except - Does **NOT** include:

1) Use of property held merely to produce income (investment use)
2) Leasing of property to any 5% owner or related person (to the extent that the property is used by a 5% owner or person related to the owner or lessee of the property)
3) The use of property as pay for services of a 5% owner or related person
4) The use of property as pay for services of any person (other than a 5% owner or related person) unless the value of the use is included in that person's gross income and income tax is withheld when required.

5% owner- In capital or profits interest in the business.

Leasing or compensatory use of aircraft

If at least 25% of total use of any aircraft during the tax year is for qualified business use, treat the leasing or compensatory use of the aircraft by a 5% owner or related person as a qualified business use.

Commuting

Use of vehicle for commuting is not business use, regardless of whether work is performed during the trip.

Display material that advertises the owner or user's trade or business Does not convert an otherwise personal use into business use.

Use of passenger auto by another person

Do not treat that use as business use unless one of following applies:

5) Use is directly connected with business
6) Have properly reported the value of the use as income to the other person and withheld tax on income when required
7) Paid a fair market rent - treat any payment received for use of the auto as a rent payment.

LISTED PROPERTY

Qualified Business Use (continued)

Used for employer's convenience

Use is for employer's convenience if it is for a substantial business reason of the employer.

Use required as a condition of employment

Use of property must be required for employee to perform duties properly. Employer need not explicitly require the employee to use the property. Mere statement by employer that the use of the property is a condition of employment is not sufficient.

Proof of business use

Can not take any depreciation or section 179 deduction for the use of listed property (including passenger auto) regardless of date placed in service, unless can prove business/investment use with adequate records or sufficient evidence.

Deductions after recovery period

Can not claim depreciation deduction based on listed property (other than passenger auto) in years after the recovery period.

Leased property

Limits on cost recovery generally do not apply to any listed property leased or held for leasing by anyone regularly engaged in the business of leasing listed property.

Lessee of listed property (other than passenger auto) leased after 1986 must include an inclusion amount in gross income for the first tax year the property is not used predominantly in a qualified business use.

DEPRECIATION

LISTED PROPERTY- PASSENGER AUTOMOBILE

Passenger auto:

Any four wheeled vehicle made primarily for use on public streets, roads, and highways and rated at 6,000 pounds or less of unloaded gross vehicle weight (6,000 pounds or less of gross vehicle weight for trucks and vans).

Includes any part, component, or other item physically attached to the automobile or usually included in the purchase price of an automobile. Does not include retrofit parts and components to modify an automobile to run on clean fuel.

Maximum deductions determined by date placed in service.

Year Place In Service	Pre 5/6/03	Post 5/5/03	2nd year	3rd year	4th-Later year
20110 (1St Yr Bonus=$11,060			$4,900	$2,950	$1,775
No Bonus is $3,060 over 50% Buss-use.)					
2008 & 2009		$10,960**	$4,800	$2,850	$1,175
2007		$ 3,060	$4,900	$2,850	$1,775
2006		$ 2,960	$4,800	$2,850	$1,775
2005		$ 2,960	$4,700	$2,850	$1,625
2004		$10,610*	$4,800	$2,850	$1,675
2003	$7,660*	$10,710*	$4,900	$2,950	$1,775
2002	$7,660*		$4,900	$2,950	$1,775
2001	$7,600*		$4,900	$2,950	$1,775
2000	$3,060		$4,900	$2,950	$1,775

* $7,660 if 50%, $3060 if special 30% bonus depreciation is not claimed

$2,960 if auto does not qualify for the Special Allowance **OR you elect not to claim any allowance.

Not considered passenger , - not considered passenger automobiles for this purpose

Ambulance, hearse, or combination ambulance-hearse used directly in trade of business

A vehicle used directly in the trade or business of transporting persons or property for pay or hire

For autos placed in service in 2003, depreciation, **including section 179** deduction can not be more than $10,710 for 2003, ($7,660 if 50%/$3,060 if special 30% bonus depreciation is not claimed)

Must reduce the limits further if business/investment use is less than 100%

DEPRECIATION

LISTED PROPERTY- PASSENGER AUTOMOBILE

Exceptions for electric vehicles

Maximum deductions for electric vehicles

Year placed In service	Pre 5/6/03	Post 5/5/03	2nd year	3rd year	4th & Later
2007/2008/2009 Use Passenger Autos OR Truck & Vans tables, as case may be.					
2006		$8,980	$14,400	$8,650	$5,225
2005		$8,880	$14,200	$8,450	$5,125
2004		$8,880	$14,200	$8,450	$5,125
2003	$22,880*	$32,030*	$14,600	$8,750	$5,225
2002	$22,980*		$14,700	$8,750	$5,325
2001	$23,080*		$14,800	$8,850	$5,325
2000	$ 9,280		$14,800	$8,850	$5,325

*$22,880 if 50%, $9,080 if special 30% bonus depreciation is not claimed

Fully depreciated auto

May continue to claim other operating expenses for business use
Must continue to keep records

LISTED PROPERTY - TRUCKS & VANS

Maximum deductions for trucks & vans

Year placed In service	Pre 5/6/03	Post 5/5/03	2nd year	3rd year	4th & Later
2009		$11,060($3,060)	$4.900	$2,950	$1,775
2008		$11,160($3,160)	$5,100	$3,050	$1,875
2007		$3,260	$5,200	$3,050	$1,875
2006		$3,260	$5,200	$3,150	$1,875
2005		$3,260	$5,200	$3,150	$1,875

DEPRECIATION

ADEQUATE RECORDS

Maintain an account book, diary, log, statement of expense, trip sheet or similar record or other documentary evidence that, together with the receipt, is sufficient to establish each element of an expenditure or use.

Records must be in an orderly manner.

Time
Place
Business purpose

SAMPLING

May maintain adequate record for portions of a tax year and use that record to support business and investment use for the entire year if it can be shown by other evidence that the periods for which maintained adequate record are representative of use throughout the year.

HOW LONG TO KEEP RECORDS

For listed property - as long as any excess depreciation can be recaptured
Recapture can occur in any tax year of the recovery period.

DEPRECIATION

EXAMPLE OF TABLE OF CLASS LIVES AND RECOVERY PERIODS
(these tables can be obtained from IRS or in publication 946)

Asset Class	Description of assets included	Class life (In years)	Recovery periods (in years) GDS (MACRS)	ADS
00.11	Office furniture, fixtures and Equipment: Includes furniture and fixtures that are not a structural component of a building. Includes such assets as desks, files, safes, and communications equipment. Does not include communications Equipment that is included in other classes.	10	7	10
00.12	Information systems Computers and peripheral equipment	6	5	5
00.13	Data Handling Equipment Except computers Includes ONLY typewriters, calculators, adding and Accounting machines, copiers, and duplicating equipment.	6	5	6
00.21	Airplanes (except those used in commercial or contract carrying of passengers or freight) and all helicopters.	6	5	6
00.22	Automobiles and taxis	3	5	5
00.23	Buses	9	5	9
00.241	Light general purpose trucks (Actual weight less than 13,000 pounds)	4	5	5
00.242	Heavy General Purpose Trucks Includes heavy general purpose trucks, concrete ready mix trucks and ore trucks (actual unloaded weight 13,000 pounds or more.	6	5	6

DEPRECIATION

REFLECTED/LOOK BACK RULES

(Code section 1245(a)(2) REGS 1.1245-2(a)(4)(i)

All write-offs "reflected" in the adjusted basis are counted for recapture rules. (Gain is ordinary gain to extent of depreciation taken for 1245 property.

To prevent escape from recapture through non taxable transfers, the "reflection rule" provides in effect for the **survival of the depreciation account in carryover basis situations**. One depreciable property takes the basis of another property such as in trade in or involuntary conversions.

TRADE INS

Although basis for depreciation of new property is adjusted basis plus boot (additional cash paid), the COST of the property for SALE purposes includes the original cost of the first property PLUS the additional boot paid.

Accumulated depreciation for SALE purposes includes depreciation taken on both first and second properties.

Trade in items should be recorded on depreciation schedules showing the total cost (original cost plus all boot items) with an adjustment for prior depreciation on the trade in and then the remaining basis for the new item for depreciation basis.

GIFT OF SECTION 1245 PROPERTY

Gift property carries over the donor's depreciation deductions.
You can NOT "give away" the property to escape recapture.

CHARITABLE CONTRIBUTIONS OF SECTION 1245 PROPERTY

Contribution deduction must be reduced by the ordinary income portion that would have been taxable if sold for FMV

REFLECTED/LOOK BACK RULES

DEATH TRANSFERS OF SECTION 1245 PROPERTY

Passage of property at death is exempt from section 1245 recapture.
Taxpayer (or estate) does **not** have to realize recapture income
Heirs do **not** carry over any of the potential 1245 recapture.

The "skeletons in our closet" can not be traded away or given away. We have to keep records of depreciation taken. Gifting it to someone is NOT a good idea for a relationship – since you are giving the donee the recapture potential!!