

Client Alert.

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Reid—McConnell Job Creation Act Provides 100 Percent “Bonus Depreciation”, Dubbed the Largest Temporary Investment Incentive in U.S. History

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On December 9, 2010, Senate Majority Leader Harry Reid (D-NV) introduced the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act 2010 (the “Bill”). Based on a framework agreed to by President Obama and Congressional Republicans on December 6, 2010, the Bill amends the House’s H.R. 4853, the Middle Class Tax Relief Act of 2010. It focuses on the extension of Bush-era tax rates set to expire at the end of this year and a number of economic stimulus measures. Among its provisions, the Bill would allow businesses to currently expense as “bonus depreciation” 100 percent of the cost of certain property acquired after September 8, 2010 but before 2012 and 50 percent of the cost of certain property acquired in 2012. The White House has called this “the largest temporary investment incentive in American history.”

CURRENT LAW

Generally, when arriving at their taxable income, businesses may immediately deduct their current expenses (e.g., the cost of labor) but must capitalize and deduct over time, through depreciation or amortization deductions, their capital expenses (e.g., investments in equipment). Throughout the history of the Internal Revenue Code, Congress has enacted both permanent and temporary economic stimulus measures allowing businesses to accelerate the timing of their depreciation and amortization deductions, with the intention of reducing their current taxable income and stimulating their current investment in capital expenditures (at the potential expense, of course, of increased taxable income and reduced investment in the future).

Most recently, as part of the Economic Stimulus Act of 2008, the American Recovery and Reinvestment Act of 2009, and the Small Business Jobs Act of 2010, Congress provided 50 percent “bonus depreciation” for certain “qualified property” acquired and placed in service during 2008, 2009, and 2010. In brief, businesses have been able to immediately deduct 50 percent of their cost in such property in the year of acquisition, while deducting the remaining 50 percent under the normal depreciation and amortization rules of the Internal Revenue Code.

NEW LAW

The Bill provides 100 percent “bonus depreciation” for “qualified property” acquired after September 8, 2010 but before 2012 and 50 percent “bonus depreciation” for “qualified property” acquired during 2012. Thus, under the Bill businesses would be able to deduct the full cost of their 2011 investments in qualified property and half the cost of their 2012 investments in such property. Qualified property generally includes most equipment and software, but not most real property (e.g., buildings). More specifically, qualified property includes tangible property with a depreciation period of 20 years or less, certain water utility property, certain computer software, and certain leasehold improvement property (generally, certain interior improvements).

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To qualify for 100 percent bonus depreciation:

- The original use of the property must commence with the taxpayer;
- The property must be acquired after September 8, 2010 and before January 1, 2012, but not pursuant to a binding contract in effect prior to September 8, 2010, or the property must be acquired pursuant to a binding contract entered into after September 8, 2010 but before January 1, 2012; and
- The property must be placed in service before January 1, 2012 (or January 1, 2013, in the case of certain property with long recovery periods, transportation property, or certain aircraft).

Similarly, to qualify for the additional 50 percent bonus depreciation:

- The original use of the property must commence with the taxpayer;
- The property must be acquired after December 31, 2011 and before January 1, 2013, but not pursuant to a binding contract in effect prior to January 1, 2012, or the property must be acquired pursuant to a binding contract entered into after December 31, 2011, but before January 1, 2013; and
- The property must be placed in service before January 1, 2013 (or January 1, 2014, in the case of certain property with long recovery periods, transportation property, or certain aircraft).

Property subject to Section 168(g) (e.g., property used outside the U.S. and tax-exempt use or financed property) is excluded from bonus depreciation. In addition, special rules address certain transportation property, aircraft, passenger automobiles, self-constructed property, and other matters. Importantly, the deduction for bonus depreciation would be available for purposes of the alternative minimum tax.

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