

IRS Clarifies When 100 Percent Bonus Depreciation Applies

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The IRS recently issued guidance clarifying when taxpayers are eligible for 100 percent bonus depreciation. In addition, the guidance provides procedures for electing 100 percent bonus depreciation and 50 percent bonus depreciation for certain property.

The Internal Revenue Service (IRS) recently issued guidance explaining when property is eligible for 100 percent bonus depreciation and providing various elections for taxpayers eligible for bonus depreciation.

In December 2010, the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (Tax Relief Act) extended the additional first-year depreciation (bonus depreciation) rules through 2012. The bonus depreciation rules, which provide for a 50-percent depreciation deduction in the year qualified property is placed in service, were set to expire at the end of 2010. In addition to extending the availability of bonus depreciation in general, the Tax Relief Act provided for a new 100 percent depreciation deduction for qualified property that is acquired and placed into service by the taxpayer between September 8, 2010, and January 1, 2012. Qualified property placed into service after December 31, 2011, and prior to December 31, 2012, would be eligible for the 50-percent bonus depreciation. Recently, the IRS issued Revenue Procedure 2011-26 (the Guidance) to clarify when 100 percent bonus depreciation is available and to provide election procedures for taxpayers deciding to elect 50-percent bonus depreciation for certain property. The Guidance is discussed further below.

For further discussion on the bonus depreciation rules and their extension last year, see [Bonus Depreciation Reinstated for Property Placed in Service or Acquired in 2010](#) and [Congress Passes Bill Extending Section 1603 Grant and Other Energy-Related Incentives](#).

Background

The bonus depreciation rules generally apply to property with a recovery period of 20 years or less and to certain longer production period property. Special acquisition date rules apply to self-constructed property, which includes property constructed for the

taxpayer by another person pursuant to a binding written contract entered into prior to the property's construction, manufacture or production.

Under the bonus depreciation statute enacted by the Tax Relief Act—as well as the explanation of the bonus depreciation rules provided by the Joint Committee of Taxation's "General Explanation of Tax Legislation Enacted in the 111th Congress" (JCS-2-11, March 2011)—it was somewhat unclear when property, particularly self-constructed property and components of self-constructed property, would be eligible for 100 percent bonus depreciation. The U.S. Department of Treasury regulations under former bonus depreciation rules provided that, if the manufacture, construction or production of a larger self-constructed project begins before December 31, 2007, the larger self-constructed property and any acquired or self-constructed components related to the larger self-constructed property did *not* qualify for 50-percent bonus depreciation. Prior to the issuance of the Guidance, it was unclear how this rule extended to self-constructed property placed in service after September 8, 2010. Was the taxpayer required merely to have begun construction on its property after December 31, 2007, and to place that property in service between September 8, 2010, and the end of 2011? Or was the taxpayer required to have both begun construction on the property and to place the property in service after September 8, 2010? Also, how do these rules apply to components of the larger self-constructed property?

In addition, for non-self-constructed property (*e.g.*, property that the taxpayer purchases assembled and places into service), it was unclear whether the taxpayer could have entered into a binding contract to purchase such property prior to September 8, 2010, and be eligible for 100-percent bonus depreciation. The 100-percent bonus depreciation rule required that the property be "acquired" after September 8, 2010, but the application of the rules requiring that no binding contract be in place prior to a certain date was not certain.

The Guidance

The Guidance makes it clear that if a taxpayer enters into a written binding contract after September 8, 2010 and before January 1, 2012 to acquire (including to manufacture, construct or produce) qualified property, the property will be treated as having met the acquisition date requirements. Thus, the Guidance provides a general rule that binding written contracts to acquire or construct property must be entered into

after September 8, 2010, to be eligible for 100-percent bonus depreciation. Furthermore, construction on self-constructed property must begin after September 8, 2010.

However, the Guidance creates an exception to the rule that construction on qualified property must begin after September 8, 2010, for components of self-constructed property that are acquired after September 8, 2010, and before January 1, 2012. This exception provides that, even if construction on the larger self-constructed project began prior to September 8, 2010, if components of that property were not acquired or construction on such components did not begin until after September 8, 2010, the taxpayer may elect to apply 100-percent bonus depreciation to those components.

In addition to the election for components, the Guidance also provides an election that permits taxpayers to elect 50-percent bonus depreciation in lieu of the required 100-percent bonus depreciation or an election out of bonus depreciation completely. The election is limited to property placed in service in a taxpayer's taxable year that includes September 9, 2010, and will apply to all property that is in the same class of property. The IRS explained that this election is intended to assist taxpayers who may have difficulty determining the exact date during a month on which the taxpayer acquired or placed in service property (thus eliminating the need to determine if property went into service after September 8, 2010, for 100-percent bonus depreciation purposes).

The Guidance also provides procedures for those taxpayers who did not elect 50-percent bonus depreciation for some or all qualified property placed in service after December 31, 2009, on a return for a tax year beginning in 2009 and ending in 2010 or for a tax year of less than 12 months beginning and ending in 2010, but now wish to make the 50-percent bonus depreciation election.

Procedures to elect 100-percent bonus depreciation for components and 50-percent bonus depreciation are described in more detail in the Guidance.

Finally, the Guidance clarifies that the 100-percent bonus depreciation deduction must be determined *after* reduction of the eligible property's basis by the amount of any credits claimed for the property that require an adjustment to basis (e.g., the investment tax credit provided under Internal Revenue Code Section 48) or by any cash grant

payments received pursuant to Section 1603 of the American Recovery and Reinvestment Tax Act of 2009.

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