

B. Temporary Increase in Limitations on Expensing of Certain Depreciable Business Assets

Present Law

A taxpayer that satisfies limitations on annual investment may elect under section 179 to deduct (or “expense”) the cost of qualifying property, rather than to recover such costs through depreciation deductions.⁵ For taxable years beginning in 2008, the maximum amount that a taxpayer may expense is \$128,000 of the cost of qualifying property placed in service for the taxable year. The \$128,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds \$510,000.⁶ In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. Off-the-shelf computer software placed in service in taxable years beginning before 2011 is treated as qualifying property.

The amount eligible to be expensed for a taxable year may not exceed the taxable income for a taxable year that is derived from the active conduct of a trade or business (determined without regard to this provision). Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to similar limitations). No general business credit under section 38 is allowed with respect to any amount for which a deduction is allowed under section 179. An expensing election is made under rules prescribed by the Secretary.⁷ For taxable years beginning in 2011 and thereafter, other rules apply.⁸

⁵ Additional section 179 incentives are provided with respect to qualified property meeting applicable requirements that is used by a business in an empowerment zone (sec. 1397A), a renewal community (sec. 1400J), or the Gulf Opportunity Zone (sec. 1400N(e)).

⁶ Amounts applicable for 2008 are set forth in Rev. Proc. 2007-66, 2007-45 I.R.B. 970. Present law provides that the maximum amount a taxpayer may expense, for taxable years beginning in 2007 through 2010, is \$125,000 of the cost of qualifying property placed in service for the taxable year. The \$125,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds \$500,000. The \$125,000 and \$500,000 amounts are indexed for inflation in taxable years beginning after 2007 and before 2011.

⁷ Sec. 179(c)(1).

⁸ Under the rules in effect for taxable years beginning in 2011 and thereafter, a taxpayer with a sufficiently small amount of annual investment may elect to deduct up to \$25,000 of the cost of qualifying property placed in service for the taxable year. The \$25,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds \$200,000. The \$25,000 and \$200,000 amounts are not indexed. In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business (not including off-the-shelf computer software). An expensing election may be revoked only with consent of the Commissioner (sec. 179(c)(2)).

Explanation of Provision

The provision increases the \$128,000 and \$510,000 amounts under section 179 for taxable years beginning in 2008 to \$250,000 and \$800,000, respectively. The \$250,000 and \$800,000 amounts are not indexed for inflation.

Effective Date

The provision is effective for taxable years beginning after December 31, 2007.

C. Special Depreciation Allowance for Certain Property

Present Law

A taxpayer is allowed to recover through annual depreciation deductions the cost of certain property used in a trade or business or for the production of income. The amount of the depreciation deduction allowed with respect to tangible property for a taxable year is determined under the modified accelerated cost recovery system (“MACRS”). Under MACRS, different types of property generally are assigned applicable recovery periods and depreciation methods. The recovery periods applicable to most tangible personal property range from three to 25 years. The depreciation methods generally applicable to tangible personal property are the 200-percent and 150-percent declining balance methods, switching to the straight-line method for the taxable year in which the taxpayer’s depreciation deduction would be maximized.

Section 280F limits the annual depreciation deductions with respect to certain passenger automobiles to specified dollar amounts, indexed for inflation.

Section 167(f)(1) provides that capitalized computer software costs, other than computer software to which section 197 applies, are recovered ratably over 36 months.

A taxpayer that satisfies limitations on annual investment may elect under section 179 to deduct (or “expense”) the cost of qualifying property, rather than to recover such costs through depreciation deductions.⁹ For taxable years beginning in 2008, the maximum amount that a taxpayer may expense is \$128,000 of the cost of qualifying property placed in service for the taxable year. The \$128,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds \$510,000.¹⁰ In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. Off-the-shelf computer software placed in service in taxable years beginning before 2011 is treated as qualifying property. For taxable years beginning in 2011 and thereafter, other rules apply.¹¹

⁹ Additional section 179 incentives are provided with respect to qualified property meeting applicable requirements that is used by a business in an empowerment zone (sec. 1397A), a renewal community (sec. 1400J), or the Gulf Opportunity Zone (sec. 1400N(e)).

¹⁰ Amounts applicable for 2008 are set forth in Rev. Proc. 2007-66, 2007-45 I.R.B. 970. Present law provides that the maximum amount a taxpayer may expense, for taxable years beginning in 2007 through 2010, is \$125,000 of the cost of qualifying property placed in service for the taxable year. The \$125,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds \$500,000. The \$125,000 and \$500,000 amounts are indexed for inflation in taxable years beginning after 2007 and before 2011.

¹¹ Under the rules in effect for taxable years beginning in 2011 and thereafter, a taxpayer with a sufficiently small amount of annual investment may elect to deduct up to \$25,000 of the cost of qualifying property placed in service for the taxable year. The \$25,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds \$200,000. The \$25,000 and \$200,000 amounts are not indexed. In general, qualifying property

Explanation of Provision

The provision allows an additional first-year depreciation deduction equal to 50 percent of the adjusted basis of qualified property.¹² The additional first-year depreciation deduction is allowed for both regular tax and alternative minimum tax purposes for the taxable year in which the property is placed in service.¹³ The basis of the property and the depreciation allowances in the year the property is placed in service and later years are appropriately adjusted to reflect the additional first-year depreciation deduction. In addition, there are no adjustments to the allowable amount of depreciation for purposes of computing a taxpayer's alternative minimum taxable income with respect to property to which the provision applies. The amount of the additional first-year depreciation deduction is not affected by a short taxable year. The taxpayer may elect out of additional first-year depreciation for any class of property for any taxable year.

The interaction of the additional first-year depreciation allowance with the otherwise applicable depreciation allowance may be illustrated as follows. Assume that in 2008, a taxpayer purchases new depreciable property and places it in service.¹⁴ The property's cost is \$1,000, and it is five-year property subject to the half-year convention. The amount of additional first-year depreciation allowed under the provision is \$500. The remaining \$500 of the cost of the property is deductible under the rules applicable to five-year property. Thus, 20 percent, or \$100, is also allowed as a depreciation deduction in 2008. The total depreciation deduction with respect to the property for 2008 is \$600. The remaining \$400 cost of the property is recovered under otherwise applicable rules for computing depreciation.

In order for property to qualify for the additional first-year depreciation deduction it must meet all of the following requirements. First, the property must be (1) property to which MACRS applies with an applicable recovery period of 20 years or less, (2) water utility property (as defined in section 168(e)(5)), (3) computer software other than computer software covered by section 197, or (4) qualified leasehold improvement property (as defined in section 168(k)(3)).¹⁵ Second, the original use¹⁶ of the property must commence with the taxpayer after December 31,

is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business (not including off-the-shelf computer software). An expensing election may be revoked only with consent of the Commissioner (sec. 179(c)(2)).

¹² The additional first-year depreciation deduction is subject to the general rules regarding whether an item is deductible under section 162 or instead is subject to capitalization under section 263 or section 263A.

¹³ However, the additional first-year depreciation deduction is not allowed for purposes of computing earnings and profits.

¹⁴ Assume that the cost of the property is not eligible for expensing under section 179.

¹⁵ A special rule precludes the additional first-year depreciation deduction for any property that is required to be depreciated under the alternative depreciation system of MACRS.

¹⁶ The term "original use" means the first use to which the property is put, whether or not such use corresponds to the use of such property by the taxpayer.

2007.¹⁷ Third, the taxpayer must purchase the property within the applicable time period. Finally, the property must be placed in service after December 31, 2007, and before January 1, 2009. An extension of the placed in service date of one year (i.e., to January 1, 2010) is provided for certain property with a recovery period of 10 years or longer and certain transportation property.¹⁸ Transportation property is defined as tangible personal property used in the trade or business of transporting persons or property. Special rules, including an extension of the placed-in-service date of one year (i.e., to January 1, 2010), also apply to certain aircraft.

The applicable time period for acquired property is (1) after December 31, 2007, and before January 1, 2009, but only if no binding written contract for the acquisition is in effect before January 1, 2008, or (2) pursuant to a binding written contract which was entered into after December 31, 2007, and before January 1, 2009.¹⁹ With respect to property that is manufactured, constructed, or produced by the taxpayer for use by the taxpayer, the taxpayer must begin the manufacture, construction, or production of the property after December 31, 2007, and before January 1, 2009. Property that is manufactured, constructed, or produced for the taxpayer by another person under a contract that is entered into prior to the manufacture, construction, or production of the property is considered to be manufactured, constructed, or produced by the taxpayer. For property eligible for the extended placed in service date, a special rule limits the amount of costs eligible for the additional first year depreciation. With respect to such property, only the portion of the basis that is properly attributable to the costs incurred before January 1, 2009 (“progress expenditures”) is eligible for the additional first-year depreciation.²⁰

If in the normal course of its business a taxpayer sells fractional interests in property to unrelated third parties, then the original use of such property begins with the first user of each fractional interest (i.e., each fractional owner is considered the original user of its proportionate share of the property).

¹⁷ A special rule applies in the case of certain leased property. In the case of any property that is originally placed in service by a person and that is sold to the taxpayer and leased back to such person by the taxpayer within three months after the date that the property was placed in service, the property would be treated as originally placed in service by the taxpayer not earlier than the date that the property is used under the leaseback.

If property is originally placed in service by a lessor (including by operation of section 168(k)(2)(D)(i)), such property is sold within three months after the date that the property was placed in service, and the user of such property does not change, then the property is treated as originally placed in service by the taxpayer not earlier than the date of such sale.

¹⁸ In order for property to qualify for the extended placed in service date, the property is required to have an estimated production period exceeding one year and a cost exceeding \$1 million.

¹⁹ Property does not fail to qualify for the additional first-year depreciation merely because a binding written contract to acquire a component of the property is in effect prior to January 1, 2008.

²⁰ For purposes of determining the amount of eligible progress expenditures, it is intended that rules similar to sec. 46(d)(3) as in effect prior to the Tax Reform Act of 1986 shall apply.

Property does not qualify for the additional first-year depreciation deduction when the user of such property (or a related party) would not have been eligible for the additional first-year depreciation deduction if the user (or a related party) were treated as the owner. For example, if a taxpayer sells to a related party property that was under construction prior to January 1, 2008, the property does not qualify for the additional first-year depreciation deduction. Similarly, if a taxpayer sells to a related party property that was subject to a binding written contract prior to January 1, 2008, the property does not qualify for the additional first-year depreciation deduction. As a further example, if a taxpayer (the lessee) sells property in a sale-leaseback arrangement, and the property otherwise would not have qualified for the additional first-year depreciation deduction if it were owned by the taxpayer-lessee, then the lessor is not entitled to the additional first-year depreciation deduction.

The limitation on the amount of depreciation deductions allowed with respect to certain passenger automobiles (sec. 280F) is increased in the first year by \$8,000 for automobiles that qualify (and do not elect out of the increased first year deduction). The \$8,000 increase is not indexed for inflation.

Effective Date

The provision is effective for property placed in service after December 31, 2007.