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ADDITIONAL DEPRECIATION ALLOWANCE AND LOSS CARRYBACKS

On March 9, 2002, the President signed into law the Job Creation and Worker Assistance Act of 2002. The legislation contains one tax provision of particular significance for agriculture and another of significance to the tax treatment of non-farm businesses in addition to other sections extending unemployment benefits and extending expiring or expired provisions. The legislation is particularly notable because of the fact that the two major tax provisions are retroactive to 2001.

Additional depreciation allowance

The legislation, which was enacted as the long-debated and delayed economic stimulus package, authorized additional depreciation for eligible property up to 30 percent of the adjusted income tax basis of qualifying property for both regular income tax and alternative minimum tax purposes.

Eligible property. The legislation defines eligible to include several categories of assets—

- Property with a recovery period of 20 years or less. That definition necessarily includes all three-year property (which includes breeding hogs and some horses); five-year property (which includes business automobiles, light trucks and breeding and dairy animals); seven-year property (which includes farm machinery and equipment, grain bins, farm fences and other property not specifically classified in another depreciation group); ten-year property (which includes single purpose agricultural and horticultural structures and trees and vines producing fruits and nuts); 15-year property (which includes non-farm fences, tile lines and other land improvements); and 20-year property (which includes farm buildings). The 2002 law does not extend the additional depreciation allowance to residential rental property (which is depreciable over 27 1/2 years and could include tenant houses or houses occupied by employees) and nonresidential real property which is depreciable over 39-years.
- Computer software.
- Water utility property.
- Qualified leasehold property.

That category of property eligible for the additional depreciation allowance is defined in terms of investment to the interior of a building which is nonresidential real property if the investment is—(1) made pursuant to a lease or by the lessor; (2) the portion of the building involved is occupied exclusively by the lessee; (3) the improvement is placed in service more than three years after the building was placed in service;
and (4) the investment does not include enlargement of the building, elevators, escalators or any structural component benefitting a common area or the internal structure of the building.24

New property. The 2002 law specifies that the property must be new property (the original use must commence with the taxpayer after September 10, 2001).25 That means used machinery and equipment, “used” breeding or dairy animals26 and buildings, fences, tile lines and other improvements on the purchase of a farm are not eligible.

Passenger automobiles. The 2002 legislation states that passenger automobiles27 subject to the depreciation limits per year28 are eligible for an increase of $460029 which is for the first taxable year in the recovery period.30

Order of deduction. The statute states that the adjusted income tax basis for eligible property for which the additional depreciation is claimed is “reduced by the amount of such deduction before computing the amount otherwise allowable as a depreciation deduction under this chapter for such taxable year and any subsequent taxable year.”31 That would suggest that the additional depreciation deduction is claimed first, then expense method depreciation is claimed next (for property eligible for that depreciation allowance—which is a narrower definition than that applicable to the new additional depreciation allowance) and then regular depreciation is claimed.32

However, the Joint Committee on Taxation in its “Blue Book”33 states that the new 30 percent depreciation allowance is claimed after expense method depreciation is claimed (which is limited to $24,000 in 2001 and 2002 and $25,000 thereafter and was not increased in the latest legislation).34

Effective date. The legislation states that the property must be acquired by the taxpayer after September 10, 2001, and before September 11, 2004 (but only if no written binding contract for the acquisition was in effect before September 11, 2001), or acquired by written contract after September 10, 2001 and before September 11, 2004 and placed in service before January 1, 2005 (except for certain property with longer production periods).35

If a taxpayer makes an election with respect to any class of property, the new provision does not apply to all property in that class (which would otherwise be the case).36

Reporting for 2001. The IRS has issued revised Form 4562, Depreciation and Amortization, and Form 2106, Employee Business Expenses, for reporting the additional first-year depreciation.37 The IRS has advised that taxpayers who have already filed their 2001 returns can file amended returns using Form 1040-X or 1120-X, together with the new revised forms, to obtain the tax benefits available under the Act.

Loss carryback

The 2002 legislation also extends the two-year net operating loss carryback38 to five years for net operating losses occurring in any taxable year ending during 2001 or 2002.40 Keep in mind that “farming losses,” beginning in 1998, have been eligible for a five-year carryback.41

The 2002 legislation includes an election to disregard the five-year carryback42 just as the 1998 enactment allows taxpayers to elect not to have the five-year carryback provision apply to “farming losses.”43

The IRS is revising the instructions for various 2001 forms that relate to NOLs and will post the revisions to its website, www.irs.gov. For information regarding the development of other materials relating to the Act, interested parties can access the home page link to “New Law May Cut Your 2001 Tax.”

FOOTNOTES
2. Id., § 101.
3. Id., § 102.
4. Id., §§ 201-209.
5. Id., §§ 601-617.
6. Id., §§ 101(b), 102(c)(2).
32. I.R.C. § 179.
35. I.R.C. § 179(b).
38. IR-2002-37.
42. I.R.C. § 172(j).
43. I.R.C. § 172(b)(3), 172(i)(3).
44. IR-2002-37.