New Regulations on Bonus Depreciation

Neil E. Harl
Iowa State University

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New Regulations on Bonus Depreciation

— by Neil E. Harl*

Although enactment of the 50 percent bonus depreciation provision in 2003 was overshadowed by the dramatic increase in expense method depreciation,² the bonus depreciation provisions nonetheless represent a significant change in the framework for claiming depreciation.³ Temporary regulations, issued in September, 2003, have added important new dimensions to the bonus depreciation rules.⁴

Bonus depreciation generally

The 50 percent bonus depreciation provision, enacted in 2003, increased the bonus depreciation allowance from 30 percent to 50 percent of the income tax basis of eligible property after expense method depreciation has been claimed.⁵ The increased allowance applies to property, the original use of which commences with the taxpayer, after May 5, 2003, if the property was acquired by the taxpayer after May 5, 2003 and before January 1, 2005, if there was no binding contract for the acquisition of the property in effect before May 6, 2003. If there was a binding contract in effect before May 6, 2003, but not before September 11, 2001, the property remained eligible for the 30 percent bonus depreciation allowance previously available.⁶ The property, to be eligible, must be placed in service under the 2003 provision before January 1, 2005, except for property with longer production periods.⁷

For both the 30 percent and 50 percent bonus depreciation allowances, the property had to be new (the original use must commence with the taxpayer).⁸

What is meant by “income tax basis”

The 30 percent and 50 percent bonus depreciation allowances are applied against the “adjusted basis of the qualified property.”⁹ The question is what is meant by that language, particularly in light of a 2000 IRS Notice that the income tax basis of property in a like-kind exchange does not include the basis carried over from the item traded in.¹⁰

The temporary regulations, published on September 8, 2003, define “unadjusted depreciable basis” as the basis of property for purposes of I.R.C. § 1011, without regard to I.R.C. § 1016(a)(2), (3).¹¹ The temporary regulations go on to state that this basis reflects the reduction in basis for use other than in the taxpayer’s trade or business (or for the production of income), for expense method depreciation and for other required bonus adjustments.¹² Thus, the income tax basis is the entire adjusted tax basis of the property given up in a like-kind exchange, such as with a machinery trade, plus the boot paid on the transaction.

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* Charles F. Curtiss Distinguished Professor in Agriculture and Professor of Economics, Iowa State University; member of the Iowa Bar.
The prior regulations specify that no depreciation is allowable for property placed in service and disposed of during the same taxable year.\textsuperscript{13} The new temporary regulations contain a similar provision.\textsuperscript{14} That provision bars a bonus depreciation claim on a trade that occurs if the taxpayer acquires and disposes of an asset in the same taxable year. However, the new temporary regulations allow a 50 percent bonus depreciation allowance for property acquired and placed in service after May 5, 2003, that had been acquired in a 2002 trade where the property qualified for the 30 percent depreciation allowance.\textsuperscript{15}

Example: Farmer M purchased a new combine in 2002 for $200,000, claiming a 30 percent bonus depreciation allowance of $60,000 and regular depreciation of $15,000 (assuming a seven-year life, 150 percent declining balance and a half-year convention). That reduced the combine’s income tax basis to $125,000 as of January 1, 2003. On June 1, 2003, Farmer M traded the combine for a new combine, paying boot of $50,000. The adjusted income tax basis of the new combine is $175,000 (the $125,000 basis on January 1, 2003, plus boot of $50,000). For the June 1, 2003, purchase, Farmer M can claim a 50 percent bonus depreciation allowance of $87,500 (50 percent of $175,000) plus regular depreciation for the year.

Harmonization of regulations with Notice 2000-4

An obvious problem framed by the new temporary regulations is whether it is possible to harmonize the basis calculation rules with Notice 2000-4.\textsuperscript{16} The 2000 Notice specifies that the income tax basis of property relinquished in a like-kind exchange, such as a machinery trade, is to remain on the depreciation schedule as a separate item. Only the boot paid is treated as newly purchased MACRS property.\textsuperscript{17} At a minimum, it seems inconsistent to allow a 50 percent bonus depreciation allowance on the carryover basis plus the boot paid and then to require that the carryover basis amount remain as a separate line on the depreciation schedule. It would seem more appropriate to strike a modest blow for simplicity and give the unpopular Notice 2000-4\textsuperscript{18} a decent burial.

FOOTNOTES

2 Id., Sec. 202(a), amending I.R.C. § 179.
5 I.R.C. § 168(k)(4).
7 Id.
12 Id.
16 2000-1 C.B. 313.
17 Id.
18 Id.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

BANKRUPTCY

GENERAL

EXEMPTIONS.

TOOLS OF THE TRADE. Prior to filing for Chapter 7, the debtors operated a cattle farm and cattle hauling business. The cattle and trucks were sold in the bankruptcy case and the debtors obtained off-farm employment. The debtors claimed exemptions for various farm implements and equipment as tools of the trade. The debtors provided evidence of a lease of nearby farm land and expressed an intent to restart cattle raising through cattle share or leasing contracts, although no such contracts had yet been obtained. The proposed cattle operation would incur additional expenses which were not included on the bankruptcy schedules. Most of the proposed cattle operation would be financed by family loans and the off-farm income. The court noted that much of the equipment was in poor condition and would require repair before use. The FSA held a security interest in the equipment and the debtors sought to avoid that security interest as impairing the exemptions. The court held that the debtors did not provide sufficient evidence of a reasonable ability to resume farming in that too many expenses were not accounted for and the sources of revenue were too speculative. In re Henke, 294 B.R. 105 (Bankr. D. N.D. 2003).

WAGES. The debtor was a dairy farmer who filed for Chapter 7. The debtor claimed exemptions under federal nonbankruptcy and state exemption law. The debtor received two payments...