

**Depreciation Quickfinder[®] Handbook
(2010 Tax Year)**

Page Updates for the 2010 Tax Relief Act

Instructions: This packet contains “marked up” changes to the pages in the *Depreciation Quickfinder[®] Handbook* that were affected by the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (2010 Tax Relief Act), which was enacted after the handbook was published. To update your handbook, you can make the same changes in your handbook or print the revised page and paste over the original page.

 **Note:** The pages included in this packet are “marked up” for the items described in the *2010 Tax Relief Act—Handbook Update Guide* following this cover sheet.

Depreciation Quickfinder® Handbook 2010 Tax Year

2010 Tax Relief Act—Handbook Update Guide

How to use this guide: This guide lists the topics discussed in the 2010 *Handbook* that were affected by the 2010 Tax Relief Act, which was enacted after the *Handbook's* publication date. The changes listed here have been made for you by the Quickfinder editorial team in the Page Updates for the 2010 Tax Relief Act packet. To update your *Handbook*, you can make the same changes in your *Handbook* or print the revised page from the Page Updates for the 2010 Tax Relief Act packet and paste over the original page. For a complete summary of the 2010 Tax Relief Act (including provisions affecting 2011 and later years) go to the *Tax Act—2010 Tax Relief Act* section of the Updates section of *Quickfinder.com*.

Page	Section or Table Title	Change/Comment
Front Cover	2010 Section 179 Limits	The additional deduction and increased property limit for qualified disaster assistance property was <i>not</i> extended for disasters occurring after 2009 or for assets placed in service in designated renewal communities after 2009. The additional deduction and increased property limit are extended for assets placed in service in empowerment zones in 2010 or 2011.
Front Cover	Recovery Periods for Common Assets Placed in Service in 2010	The five-year recovery period for new farm machinery and equipment was <i>not</i> extended for assets placed in service in 2010. The 15-year (39-year for ADS) recovery period for qualified leasehold improvements, restaurant property and retail improvements is extended to 2010 and 2011.
Inside Front Cover	Exception to MACRS Declining Balance Method—Straight Line Method Required	The 15-year (39-year for ADS) recovery period for qualified leasehold improvements, restaurant property and retail improvements is extended to 2010 and 2011.
2-1	MACRS Depreciation Methods Available for Regular Tax	The five-year recovery period for new farm machinery and equipment was <i>not</i> extended for assets placed in service in 2010. The 15-year (39-year for ADS) recovery period for qualified leasehold improvements, restaurant property and retail improvements is extended to 2010 and 2011.
2-2	ADS Recovery Periods	The 15-year (39-year for ADS) recovery period for qualified leasehold improvements, restaurant property and retail improvements is extended to 2010 and 2011.
2-3	Property Classification	The 7-year recovery period for motorsports entertainment complex property was extended to 2010 and 2011. The five-year recovery period for new farm machinery and equipment was <i>not</i> extended for assets placed in service in 2010. The 15-year (39-year for ADS) recovery period for qualified leasehold improvements, restaurant property and retail improvements is extended to 2010 and 2011.
2-5	Indian Reservation Property	The shorter MACRS recovery periods for Indian reservation property are extended to 2010 and 2011.
2-8	Farm Property Recovery Periods	The five-year recovery period for new farm machinery and equipment was <i>not</i> extended for assets placed in service in 2010.
2-10	Special (Bonus) Depreciation Allowance	For qualifying property placed in service after 2009, the special depreciation allowance rate is as follows: <ul style="list-style-type: none"> • Property placed in service 1/1/10–9/8/10: 50%. • Property placed in service 9/9/10–12/31/11: 100%. • Property placed in service 1/1/12–12/31/12: 50%.
2-10	Special (Bonus) Depreciation Allowance Table	The special depreciation allowance is extended for: <ul style="list-style-type: none"> • Assets placed in service in 2011 and 2012 (2011 – 2013 for long production period property, except only costs incurred before 2013 qualify). • Assets placed in service in specified areas of the GO Zone in 2011. The special depreciation allowance was <i>not</i> extended for: <ul style="list-style-type: none"> • Qualified disaster assistance property related to disasters occurring after 2009. • Certain real property placed in service in the NY Liberty Zone after 2009.

2010 Tax Relief Act—Handbook Update Guide (Continued)

Page	Section or Table Title	Change/Comment
2-11	Qualified Assets	References to special depreciation should include both 50% and 100% special depreciation (100% if purchased 9/9/10–12/31/10).
2-11	Long Production Period Property	The special depreciation allowance is extended for long production period property and certain aircraft placed in service in 2011 – 2013, except, for long production period property, only costs incurred before 2013 qualify.
2-12	Note at top of left-hand column	The election to forego the special depreciation allowance and instead increase the limit on certain credits will be available for assets placed in service in 2011 and 2012 (2011–2013 for long-production-period property and certain aircraft) [IRC §168(k)(4)(D)]. The election will be available for property eligible for the special depreciation allowance solely due to the extension of the special depreciation allowance for certain property placed in service after 2010 (Round Two Property). However, corporations that have already made this election for an earlier year can elect to not apply the election to Round Two property. Also, for Round Two property, the limit on unused research credits cannot be increased by making this election.
2-12	Qualified Disaster Assistance Property	The expired special depreciation allowance was <i>not</i> extended to federally declared disasters occurring in 2010.
2-12	New York (NY) Liberty Zone Property	The special depreciation allowance was <i>not</i> extended for certain real property placed in service in the NY Liberty Zone after 2009.
4-2	Quick Guide To MACRS Depreciation Tables	The special depreciation allowance is extended for assets placed in service in 2011 and 2012. Note: For property placed in service 9/9/10–12/31/11 the special depreciation allowance rate is 100%. The 15-year (39-year for ADS) recovery period for qualified leasehold improvements, restaurant property and retail improvements is extended to 2010 and 2011.
4-4	Table 5	The 15-year (39-year for ADS) recovery period for qualified leasehold improvements, restaurant property and retail improvements is extended to 2010 and 2011.
4-28	Table 21	The special depreciation allowance is extended for assets placed in service in 2011 and 2012. Note: For property placed in service 9/9/10–12/31/11 the special depreciation allowance rate is 100%.
4-29	Tables 22 and 23	The special depreciation allowance is extended for assets placed in service in 2011 and 2012. Note: For property placed in service 9/9/10–12/31/11 the special depreciation allowance rate is 100%.
4-30	Tables 24 and 25	The special depreciation allowance is extended for assets placed in service in 2011 and 2012. Note: For property placed in service 9/9/10–12/31/11 the special depreciation allowance rate is 100%.
5-1	Annual Deduction Limit	For 2012, the annual deduction limit will be \$125,000 (adjusted for inflation).
5-1	Section 179 Annual Limits	For 2012, the annual deduction limit will be \$125,000 and the qualifying property phase-out threshold will be \$500,000. Both amounts will be adjusted for inflation.
5-2	Increased Section 179 Limits for Targeted Areas	The additional deduction and increased property limit for qualified disaster assistance property was <i>not</i> extended for disasters occurring after 2009 or for assets placed in service in designated renewal communities after 2009. The additional deduction and increased property limit are extended for assets placed in service in empowerment zones in 2010 or 2011.
5-5	Eligible Property	Off-the-shelf software is eligible for Section 179 expensing through 2012.
5-7	Revoking the Election	The ability to revoke a Section 179 expensing election without IRS approval is extended through 2012.
7-1	Depreciable Real Property	The 15-year (39-year for ADS) recovery period for qualified leasehold improvements, restaurant property and retail improvements is extended to 2010 and 2011.
7-2	Special (Bonus) Depreciation for Real Property	The special depreciation allowance is extended for assets placed in service in 2011 and 2012. Note: For property placed in service 9/9/10–12/31/11, the special depreciation allowance rate is 100%.

2010 Tax Relief Act—Handbook Update Guide (Continued)

Page	Section or Table Title	Change/Comment
7-6	Builders of Energy-Efficient New Homes Credit	The credit is extended for 2010 and 2011.
7-7	Energy-Efficiency Improvements	No changes to efficiency standards were made for property placed in service in 2010.
7-7	Qualified leasehold improvements eligible for special (bonus) depreciation.	The special depreciation allowance is extended for assets placed in service in 2011 and 2012. Note: For property placed in service 9/9/10–12/31/11, the special depreciation allowance rate is 100%.
7-8	Qualified Leasehold Improvements	The 15-year (39-year for ADS) recovery period for qualified leasehold improvements is extended to 2010 and 2011.
7-8	Qualified Restaurant Property	The 15-year (39-year for ADS) recovery period for qualified restaurant property is extended to 2010 and 2011.
7-9	Qualified Retail Improvement Property	The 15-year (39-year for ADS) recovery period for qualified retail improvement property is extended to 2010 and 2011.
7-20	Guide to Assets Used in Casino/Hotel Industry	The 15-year (39-year for ADS) recovery period for qualified leasehold improvements, restaurant property and retail improvements is extended to 2010 and 2011.
7-24	Guide to Assets Used in the Restaurant Industry	The 15-year (39-year for ADS) recovery period for qualified leasehold improvements, restaurant property and retail improvements is extended to 2010 and 2011.
7-28	Guide to Assets Used in a Retail Business	The 15-year (39-year for ADS) recovery period for qualified leasehold improvements, restaurant property and retail improvements is extended to 2010 and 2011.
7-33	Guide to Assets Used in the Biotech/Pharmaceutical Industry	The 15-year (39-year for ADS) recovery period for qualified leasehold improvements, restaurant property and retail improvements is extended to 2010 and 2011.
7-39	Guide to Assets Used in the Auto Dealership Industry	The 15-year (39-year for ADS) recovery period for qualified leasehold improvements, restaurant property and retail improvements is extended to 2010 and 2011.
8-4	What Deductions Are Recaptured?	The special depreciation allowance is extended for assets placed in service in 2011 and 2012. Note: For property placed in service 9/9/10–12/31/11, the special depreciation allowance rate is 100%.
9-7	Depreciating Vehicles Acquired in a Trade	References to special depreciation should include both 50% and 100% special depreciation (100% if placed in service 9/9/10–12/31/11).
10-4	Special (Bonus) Depreciation Summary	The special depreciation allowance is extended for: <ul style="list-style-type: none"> • Qualifying assets placed in service in 2011 and 2012. Note: For property placed in service 9/9/10–12/31/11, the special depreciation allowance rate is 100%. These deadlines are extended for an additional year for certain long-production property and aircraft. • Assets placed in service in specified areas of the GO Zone in 2011.
11-8, 11-9	Claiming the Incremental Research Credit	The credit was extended for amounts paid or incurred in 2010 and 2011.
12-4	Table of Class Lives and Recovery Periods	The five-year recovery period for new farm machinery and equipment was <i>not</i> extended for assets placed in service in 2010.
13-3	Selected Disaster Relief Provisions	The expired special relief provisions were <i>not</i> extended to federally declared disasters occurring after 2009. The additional first-year (bonus) depreciation was extended for assets placed in service in specified areas of the GO Zone.
13-5	Designated Renewal Community	The designation of renewal communities was <i>not</i> extended beyond 2009. [IRC §1400E(b)(1)]
13-5	Empowerment Zone	The designation of empowerment zones was extended through 2011. [IRC §1391(d)(1)(A)(i)]

Depreciation

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Depreciation, Amortization, Sales and Exchanges 2010 Tax Year

2010 Vehicle Quick Facts	
Cars—GVW (unloaded) up to 6,000 lbs.	
Depreciation limits apply when basis exceeds (with bonus) ¹	\$ 18,433
Depreciation limits apply when basis exceeds (without bonus) ¹	15,300
Depreciation limit—Acquisition year (with bonus) ²	11,060
Depreciation limit—Acquisition year (without bonus) ²	3,060
Second-year limit	4,900
Third-year limit	2,950
All years thereafter	1,775
Truck or Van (Including SUVs and Minivans on a Truck Chassis) GVW (loaded) up to 6,000 lbs.	
Depreciation limits apply when basis exceeds (with bonus) ¹	\$ 18,600
Depreciation limits apply when basis exceeds (without bonus) ¹	15,800
Depreciation limit—Acquisition year (with bonus) ²	11,160
Depreciation limit—Acquisition year (without bonus) ²	3,160
Second-year limit	5,100
Third-year limit	3,050
All years thereafter	1,875
Car, Truck or Van (Including SUVs and Minivans) GVW over 6,000 but not over 14,000 lbs.	
Depreciation limit	N/A
Maximum Section 179 deduction	\$ 25,000 ³
Standard Mileage Rates	
Business	50¢
Depreciation component	23¢
Charitable	14¢
Medical and moving	16.5¢
¹ Assuming half-year convention applies.	
² Applies to the sum of MACRS depreciation, special (bonus) depreciation and Section 179 expense claimed.	
³ Some exceptions, including pickups with a bed at least six feet long.	

2010 Section 179 Limits	
Maximum deduction	\$ 500,000
Qualifying property limit before phase-out	2,000,000
Additional deduction for federally declared disaster areas, empowerment zones and designated renewal communities ²	— ^{1,3}
Additional property limit for federally declared disaster areas, empowerment zones and designated renewal communities ²	35,000 ^{1,3}
Maximum deduction for qualified real property ⁴	250,000
Maximum deduction (per vehicle) for car, truck or van (including SUVs and Minivans) with GVW over 6,000 but not over 14,000 lbs.	25,000
¹ If less, the amount of qualifying Section 179 property placed in service in the specified location.	
² Defined at Tab 13.	
³ These provisions expired in 2009. However, pending legislation may extend them through 2010.	
⁴ Includes qualified leasehold improvement property, qualified restaurant property and qualified retail improvement property.	

Recovery Periods for Common Assets Placed in Service in 2010		
	Recovery Period (Years)	
	MACRS/AMT	ADS
Assets Used in All Business Activities		
Office furniture and equipment	7	10
Computers and peripheral equipment	5	5
Typewriters, calculators, copiers	5	6
Airplanes (noncommercial) and helicopters	5	6
Automobiles	5	5
Light general purpose trucks (less than 13,000 lbs.)	5	5
Heavy general purpose trucks (13,000 lbs. or more)	5	6
Tractor units (for over-the-road use)	3	4
Trailers	5	6
Assets Used in Agricultural Activities		
Agricultural machinery and equipment	7 ¹	10
Breeding or dairy cattle	5	7
Breeding or work horses, 12 years old or less	7	10
Farm buildings, other than single purpose	20	25
Single-purpose agricultural or horticultural structures	10	15
Assets Used in Oil and Gas Industry		
Assets used in drilling oil and gas wells	5	6
Assets used in exploring and producing oil and gas	7	14
Specialized Assets		
Assets unique to wholesale and retail trade, and personal and professional services	5	9
Section 1245 assets used in marketing petroleum and petroleum products	5	9
High technology medical equipment	5	5
Real Property		
Qualified leasehold improvement property	15	39 ¹
Qualified restaurant property	15	39 ¹
Qualified retail improvement property	15	39 ¹
Land improvements (sidewalks, roads, drainage facilities, bridges, fences, landscaping, radio towers)	15	20
Retail motor fuel outlets	15	20
Billboards	15	20
Residential rental real property	27.5	40
Nonresidential real property	39	40
Other		
Assets used in construction activities by general building contractors, real estate subdividers and developers	5	6
Appliances, carpet and furniture used in a residential rental property	5	9
¹ Favorable recovery periods for these assets expired in 2009. However, pending legislation may extend them through 2010.		

Only 50% of the Section 179 property is considered for the phase-out threshold.



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The *Depreciation Quickfinder® Handbook* is to be used as a first-source, quick reference to basic tax principles applied to property used in a trade or business or for the production of income. Its focus is to present often-needed reference information in a concise, easy-to-use format. The summaries, highlights, tax tips and other information included herein are intended to be of concern for the average taxpayer only. Information included is general in nature and we acknowledge the existence of many exceptions. The information this publication contains has been carefully compiled from sources believed to be reliable, but its accuracy is not guaranteed. The publisher is not engaged in rendering legal, accounting or other advice and will not be held liable for any actions or suit based on this handbook. For further information that applies to a specific tax situation, see IRS publications, rulings, regulations, court cases and Code sections applicable to that situation. This handbook is not intended to be used as your only reference source.

Exceptions to MACRS Declining Balance Method— Straight-Line Method Required

Asset	Recovery Period
Real estate—commercial	39 years
Real estate—residential rental	27.5 years
Listed property used 50% or less in trade or business	ADS recovery period
Trees or vines bearing fruit or nuts	10 years
Property used predominantly in farming if taxpayer elects out of uniform capitalization rules for plants with long preproductive life	ADS recovery period
Qualified leasehold improvement property	15 39 years [†]
Qualified restaurant property	15 39 years [†]
Qualified retail improvement property	15 39 years [†]
Property used predominantly outside of the U.S.	ADS recovery period
Property used in a tax-exempt activity or financed by tax-exempt bonds	ADS recovery period
Property imported from a country subject to trade restrictions	ADS recovery period
Water utility property	25 years

[†]—Favorable recovery periods for these assets expired in 2009. However, pending legislation may extend them through 2010.

3-Year, 5-Year, 7-Year, 10-Year and 15-Year MACRS Property Half-Year Convention

Year	Depreciation Rate for Recovery Period				
	3-year	5-year	7-year	10-year	15-year
1	33.33%	20.00%	14.29%	10.00%	5.00%
2	44.45	32.00	24.49	18.00	9.50
3	14.81	19.20	17.49	14.40	8.55
4	7.41	11.52	12.49	11.52	7.70
5		11.52	8.93	9.22	6.93
6		5.76	8.92	7.37	6.23
7			8.93	6.55	5.90
8			4.46	6.55	5.90
9				6.56	5.91
10				6.55	5.90
11				3.28	5.91
12					5.90
13					5.91
14					5.90
15					5.91
16					2.95

Depreciation Recapture Rules

Asset Description	Section 1245	Section 1250
MACRS (post-1986)		
Personal property [including special (bonus) depreciation and Section 179 property]	100% ordinary	—
Real property held one year or less	—	100% ordinary
Real property held more than one year	—	Taxed at 25% maximum rate, to the extent of depreciation claimed*
ACRS (1981 – 1986)		
Personal property (including Section 179 property)	100% ordinary	—
Nonresidential real property held more than one year—accelerated depreciation claimed	100% ordinary	—
Nonresidential real property held more than one year—SL depreciation used	—	Taxed at 25% maximum rate, to the extent of depreciation claimed*
Residential real property held more than one year	—	Ordinary to extent of depreciation claimed over SL*
Pre-ACRS (pre-1981)		
Personal property	100% ordinary	—
Residential real property	—	Ordinary to extent post-1975 depreciation exceeds SL*
Nonresidential real property	—	Ordinary to extent post-1969 depreciation exceeds SL*
Low-income Housing		
Held less than one year	—	100% ordinary
Held over one year	—	Ordinary to the extent post-1975 depreciation exceeds SL, reduced by 1% for each full month held over 100*
Section 197 Intangibles		
Amortizable intangibles placed in service after 8/10/93	100% ordinary	—

* For noncorporate taxpayers, gain to the extent of depreciation claimed (other than recaptured Section 1250 ordinary income) is unrecaptured Section 1250 gain, taxed at 25% maximum rate.

Section 280F Depreciation Limits Vehicles Placed in Service Before 2010*

Placed In Service	Cars	Trucks and Vans
2009		
First year (50% special depreciation)	\$ 10,960	\$ 11,060
First year (no special depreciation)	2,960	3,060
Second year	4,800	4,900
Third year	2,850	2,950
Fourth year and thereafter	1,775	1,775
2008		
First year (50% special depreciation)	\$ 10,960	\$ 11,160
First year (no special depreciation)	2,960	3,160
Second year	4,800	5,100
Third year	2,850	3,050
Fourth year and thereafter	1,775	1,875
2007		
First year	\$ 3,060	\$ 3,260
Second year	4,900	5,200
Third year	2,850	3,050
Fourth year and thereafter	1,775	1,875
2006		
First year	\$ 2,960	\$ 3,260
Second year	4,800	5,200
Third year	2,850	3,150
Fourth year and thereafter	1,775	1,875

* Amounts must be pro-rated if less than 100% business use.

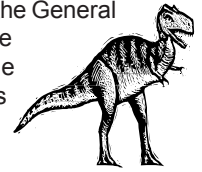
MACRS



Tab 2 Topics

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New York (NY) Liberty Zone Property	Page 2-12
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MACRS consists of two depreciation systems, the General Depreciation System (GDS) and the Alternative Depreciation System (ADS). The GDS is the method used for regular tax, unless the ADS is used. The ADS can be elected for any asset. However, its use is mandatory in certain situations. See *Alternative Depreciation System (ADS)* on Page 2-2.



Note: For alternative minimum tax (AMT), depreciation is computed under different rules, often resulting in an adjustment to AMT income. See *Alternative Minimum Tax (AMT) Depreciation* on Page 2-6.

Assets are classified under MACRS. The classification generally determines the depreciation method, convention and recovery period. See *Property Classification* on Page 2-3.

DEPRECIATION METHODS

Unless the alternative depreciation system (ADS) is required or elected, the general depreciation system (GDS) applies.

General Depreciation System (GDS)

Three depreciation methods are available under the general depreciation system. For most property, other than nonresidential real property and residential rental property, the default (no election made) is the 200% declining balance method over the GDS recovery period.

Alternatively, taxpayers can elect either the:

- 1) 150% declining balance method over the GDS recovery period or
- 2) Straight-line method over the GDS recovery period.



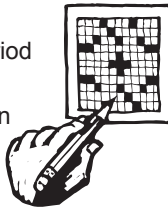
See *MACRS Depreciation Methods Available for Regular Tax* below for details on the methods for specific assets.

MACRS GENERAL RULES

The Modified Accelerated Cost Recovery System (MACRS) is used to depreciate most business, rental and investment property placed in service after 1986.

Under MACRS, compute depreciation by: [IRC §168(a)]

- 1) Applying an allowable depreciation method,
- 2) Assigning the asset the proper recovery period and
- 3) Using the appropriate convention (assumption about when property is placed in and taken out of service).



MACRS Depreciation Methods Available for Regular Tax

Property	General Depreciation System (GDS)			Alternative Depreciation System (ADS) ²
	No Election Made	Elective 150% Declining Balance Method ¹	Elective SL MACRS	
Three-year, five-year, seven-year and 10-year property classes (except farm property). ³	200% declining balance over GDS recovery period.	150% declining balance over GDS recovery period.	Straight-line over GDS recovery period.	Straight-line over ADS recovery period.
<ul style="list-style-type: none"> • Farm property (except real property).³ • 15-year and 20-year property. 	150% declining balance over GDS recovery period.	N/A	Straight-line over GDS recovery period.	Straight-line over ADS recovery period.
<ul style="list-style-type: none"> • Nonresidential real property. • Residential rental property. • Qualified leasehold improvement property.⁴ • Qualified restaurant property.⁴ • Qualified retail improvement property.⁴ • Trees or vines bearing fruit or nuts. • 25-year (water utility) property. 	Straight-line over GDS recovery period.	N/A	N/A	Straight-line over ADS recovery period.

¹ For property placed in service before 1999, elective 150% declining balance method used the ADS recovery periods.

² See *ADS Recovery Periods* on Page 2-2.

³ New farm equipment placed in service in 2009 was 5-year property. Five-year treatment excluded grain bins, cotton ginning assets, fences or other land improvements [IRC §168(e)(3)]. For 2010, farm equipment has a recovery period of 7 years. **Although the 5-year recovery period expired for assets placed in service after 2009, at the time this publication went to press, legislation was pending that would extend it through 2010. Tax professionals should be alert to legislative activity in this area.**

⁴ Qualified leasehold improvement property, qualified restaurant property and qualified retail improvement property have a 15-year recovery period if placed in service in 2009. **Although the 15-year recovery period expired for assets placed in service after 2009, at the time this publication went to press, legislation was pending that would extend these provisions through 2010. Tax professionals should be alert to legislative activity in this area. Even if the 15-year recovery period is extended, these types of assets will still be depreciated straight-line rather than 150% declining balance.**

before 2012.

Elective Depreciation Methods

The election to use a depreciation method other than the default method is made the year the property is placed in service. Once an election is made to use a method for an item in a property class, the same method applies to all property in that class placed in service in the year of the election.

Exception: The election to use a different depreciation method is made on a property-by-property basis for nonresidential real and residential rental property.

Electing a Depreciation Method	
Method	How to Elect
150% method	Enter "150 DB" under column (f) in Part III of Form 4562.
SL	Enter "SL" under column (f) in Part III of Form 4562.
ADS	Complete line 20 in Part III of Form 4562.

Advantage of Straight-Line Depreciation

MACRS straight-line depreciation is useful to taxpayers desiring smaller depreciation deductions than what regular MACRS provides. For example, taxpayers may elect straight-line if they desire to increase current income in order to use a net operating loss carryover or create passive income to offset passive losses.

ALTERNATIVE DEPRECIATION SYSTEM (ADS)

Under the alternative depreciation system, assets are depreciated straight-line over their ADS recovery period.

When ADS Is Required

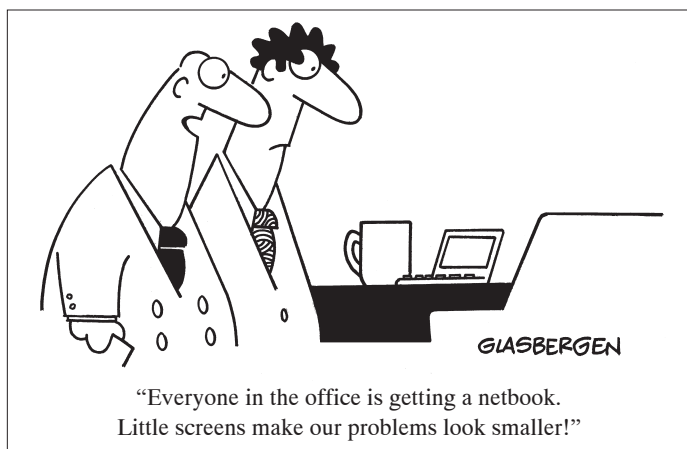
The ADS method can be elected for any asset, but is mandatory in the following situations: [IRC §168(g)(1) and 280F(b)(1)]

- 1) Listed property with 50% or less qualified business use.
- 2) Tangible property used predominantly outside the United States during the year.
- 3) Tax-exempt use property.
- 4) Property financed by tax-exempt bonds.
- 5) Property used predominantly in a farming business if it is placed in service in a year an election not to apply the uniform capitalization rules to certain farming costs is in effect (see *Farm Property* on Page 2-7).
- 6) Property imported from a foreign country for which an Executive Order is in effect because the country maintains trade restrictions or engages in other discriminatory acts.



ADS Recovery Periods

The recovery periods for most property generally are longer under ADS than they are under GDS.



ADS Recovery Periods ¹	
Property	Recovery Period
Rent-to-own property	4 years
Automobiles and light duty trucks	5 years
Computers and peripheral equipment	5 years
High technology telephone station equipment installed on customer premises	5 years
High technology medical equipment	5 years
New York Liberty Zone leasehold improvement property	9 years
Personal property with no class life	12 years
Natural gas gathering lines	14 years ²
Single purpose agricultural and horticultural structures	15 years
Any tree or vine bearing fruit or nuts	20 years
Electric transmission property used in the transmission at 69 or more kilovolts of electricity	30 years ²
Natural gas distribution lines	35 years ²
Qualified leasehold improvement property, qualified restaurant property or qualified retail improvement property	39 years ³
Nonresidential real property	40 years
Residential rental property	40 years
Section 1245 real property not listed in Revenue Procedure 87-56	40 years
Railroad grading and tunnel bore	50 years

¹ This list is not all-inclusive. The ADS recovery periods for property not listed above can be found in the tables in Revenue Procedure 87-56 (reproduced at Tab 12).

² Applicable to property placed in service after April 11, 2005, the original use of which began after that date (but not applicable if under a binding contract or if construction began on a self-constructed asset before April 12, 2005).

³ Applicable to property placed in service before January 1, 2010. ~~If placed in service after this date, the ADS recovery period is, at the time this publication went to press, 40 years. However, legislation was pending that would extend the 39-year ADS recovery period through 2010. Tax professionals should be alert to legislative activity in this area.~~ 2012.

Tax-exempt use property subject to a lease. The ADS recovery period cannot be less than 125 percent of the lease term for any property leased under a leasing arrangement to a tax-exempt organization, governmental unit or foreign person or entity (other than a partnership).

ASSIGNING THE RECOVERY PERIOD

The recovery period is the number of years over which an asset's basis is recovered under MACRS. Different recovery periods are often assigned under GDS and ADS.

GDS Recovery Periods

The GDS applies unless the taxpayer elects, or is required, to use the alternative depreciation system. Certain property is classified under Section 168. That classification determines the GDS recovery period. See *Property Classification* on Page 2-3.

Revenue Procedure 87-56 Recovery Periods

Revenue Procedure 87-56 (reproduced at Tab 12) lists the recovery periods for assets not contained in *Property Classification* on Page 2-3. It also lists the recovery periods for assets used in specific activities.

Revenue Procedure 87-56 provides three lives for the assets listed:

- **Class life.** This is the class life that was applicable for the property as of January 1, 1986, under former Section 167(m) and the Class Life Asset Depreciation Range (CLADR) System, which was used before 1981. The class life is used to determine the recovery period for assets not specifically listed in Section 168 or in Revenue Procedure 87-56. However, for the assets listed in the Revenue Procedure, the recovery periods are specified, so class life is not needed for determining the recovery period.
- **GDS Recovery Period.**
- **ADS Recovery Period.**

Property Classification

Classification	Examples	GDS Depreciation Method ¹	GDS Recovery Period	Convention
3-year property	<ul style="list-style-type: none"> Tractor units for over-the-road use. Any race horse, regardless of age when placed in service.² Any horse (other than a race horse) over 12 years old when placed in service. Qualified rent-to-own property.³ 	200% ⁴ Declining balance	3 years	Half-year or mid-quarter
5-year property	<ul style="list-style-type: none"> Automobiles, taxis, buses and trucks. Computers and peripheral equipment. Office machinery (such as typewriters, calculators and copiers). Property used in research and experimentation. Breeding cattle and dairy cattle. Appliances, carpets, furniture, etc., used in a residential rental real estate activity. Certain geothermal, solar and wind energy property. 	200% ⁴ Declining balance	5 years	Half-year or mid-quarter
7-year property	<ul style="list-style-type: none"> Office furniture and fixtures (such as desks, files and safes). Agricultural machinery and equipment.⁵ Property that does not have a class life and has not been designated by law as being in any other class. Certain motorsports entertainment complex property placed in service after October 22, 2004, and before January 1, 2010. [IRC §168(e)(3)(C)(ii) and (i)(15)(D)]⁶ Any natural gas gathering line placed in service after April 11, 2005. Assets used to convert corn to ethanol. (IRS Notice 2009-64) 	200% ⁴ Declining balance	7 years	Half-year or mid-quarter
10-year property	<ul style="list-style-type: none"> Vessels, barges, tugs and similar water transportation equipment. Single purpose agricultural or horticultural structure (see Tab 7). Any tree or vine bearing fruits or nuts.⁷ Qualified smart electric meters and qualified smart electric grid systems placed in service after October 3, 2008.⁸ 	200% ⁴ Declining balance	10 years	Half-year or mid-quarter
15-year property	<ul style="list-style-type: none"> Certain improvements made directly to land or added to it (such as shrubbery, fences, roads and bridges). Retail motor fuels outlet (see Tab 7), such as a convenience store. Any municipal wastewater treatment plant. Qualified leasehold improvement property (see Tab 7).^{7,9} Qualified restaurant property (see Tab 7).^{7,9} Qualified retail improvement property (see Tab 7).^{7,9} Initial clearing and grading land improvements for gas utility property placed in service after October 22, 2004. Electric transmission property (that is, Section 1245 property) used in the transmission at 69 or more kilovolts of electricity placed in service after April 11, 2005. Any natural gas distribution line placed in service after April 11, 2005. 	150% Declining balance	15 years	Half-year or mid-quarter
20-year property	<ul style="list-style-type: none"> Farm buildings (other than single purpose agricultural or horticultural structures). Municipal sewers not classified as 25-year property. Initial clearing and grading land improvements for electric utility transmission and distribution plants placed in service after October 22, 2004. 	150% Declining balance	20 years	Half-year or mid-quarter
25-year property ¹⁰	<ul style="list-style-type: none"> Property that is an integral part of the gathering, treatment or commercial distribution of water, and that, without regard to this provision, would be 20-year property. Municipal sewers placed in service after June 12, 1996, other than property placed in service under a binding contract in effect at all times since June 9, 1996. 	Straight-line	25 years	Half-year or mid-quarter
Residential rental property	<ul style="list-style-type: none"> Any building or structure, such as a rental home (including a mobile home), if 80% or more of its gross rental income for the tax year is from dwelling units (see Tab 7). 	Straight-line	27.5 years	Mid-month
Nonresidential real property ¹¹	<ul style="list-style-type: none"> Section 1250 property, such as an office building, store or warehouse that is neither residential rental property nor property with a class life of less than 27.5 years (see Tab 7). 	Straight-line	39 years	Mid-month

¹ Elective methods may be available. See *MACRS Depreciation Methods Available for Regular Tax* on Page 2-1.

² Effective for race horses placed in service after December 31, 2008 and before January 1, 2014. Outside of that date range, only race horses more than two years old when placed in service are 3-year property. [IRC §168(e)(3)(A)]

³ Five years for qualified rent-to-own property placed in service before August 6, 1997.

⁴ If used in farming, must use 150% instead of 200% declining balance.

⁵ New farm equipment placed in service in 2009 was 5-year property. Five-year treatment excluded grain bins, cotton ginning assets, fences or other land improvements [IRC §168(e)(3)(B)(vii)]. For 2010, farm equipment has a recovery period of 7 years. ~~Although the 5-year recovery period expired for assets placed in service after 2009, at the time this publication went to press, legislation was pending that would extend it through 2010. Tax professionals should be alert to legislative activity in this area.~~

⁶ ~~For 2010, certain motorsports entertainment complex property will have either a 15-year or 39-year recovery period, depending on the type of property it is. However, at the time this publication went to press, legislation was pending that would extend the 7-year recovery period through 2010. Tax professionals should be alert to legislative activity in this area.~~

⁷ Must use straight-line method.

⁸ Must use 150% declining balance method. [IRC §168(b)(2)(C)]

⁹ Qualified leasehold improvement property, qualified restaurant property and qualified retail improvement property have a 15-year recovery period if placed in service ~~in 2009. Although the 15-year recovery period expired for assets placed in service after 2009, at the time this publication went to press, legislation was pending that would extend these provisions through 2010. Tax professionals should be alert to legislative activity in this area.~~

¹⁰ 20 years for property placed in service before June 13, 1996, or under a binding contract in effect before June 10, 1996.

¹¹ 31.5 years for property placed in service before May 13, 1993.

before 2012.

Indian Reservation Property

Caution: Although the accelerated recovery periods for Indian reservation property expired for property placed in service after 2009, at the time this publication went to press, legislation was pending that would extend them through 2010. Tax professionals should be alert to legislative activity in this area.



The recovery periods for qualified property placed in service on an Indian reservation after 1993 and before 2010 are shorter than normal for some property classes. To be eligible for the shorter recovery periods, the property must be used predominantly in the active conduct of a trade or business or a rental real estate activity within an Indian reservation. [IRC §168(j)]

2012.

Recovery Periods for Qualified Indian Reservation Property

Property Class	Recovery Period
Three-year property	Two years
Five-year property	Three years
Seven-year property	Four years
10-year property	Six years
15-year property	Nine years
20-year property	12 years
Nonresidential real property	22 years

Caution: Although the accelerated recovery periods for Indian reservation property expired for property placed in service after 2009, at the time this publication went to press, legislation was pending that would extend them through 2010. Tax professionals should be alert to legislative activity in this area. If the legislation is passed, this table is still applicable. If it does not pass, use the recovery periods in the Property Classification table on Page 2-3.

CONVENTIONS

Half-Year Convention

Under the half-year convention, all property placed in service or disposed of during a tax year is treated as placed in service or disposed of on the midpoint of that tax year [IRC §168(d)(4)]. Thus, half of a full year's depreciation is taken both in the year the property is placed in service and in the year of disposition.

The half-year convention applies to all property except:

- 1) Residential rental and nonresidential real property and
- 2) Property subject to the mid-quarter convention (discussed below).



Mid-Quarter Convention

If more than 40% of the basis of property is placed in service in the last three months of the year, the mid-quarter convention applies [IRC §168(d)(3)]. Then, all property placed in service or disposed of during any quarter of a tax year is treated as placed in service, or disposed of, at the midpoint of that quarter.

Excluded items. To determine if the mid-quarter convention applies, the following items are not counted:

- 1) Property depreciated under a method other than MACRS,
- 2) Residential rental property,
- 3) Nonresidential real property,
- 4) Property placed in service and disposed of in the same tax year and
- 5) Property expensed under Section 179.

Effect of mid-quarter convention. If the mid-quarter convention applies, property placed in service in the first half of the year receives more than a half-year's worth of depreciation in the year placed in service while property placed in service in the last half of the year receives less than a half-year's worth of depreciation (for example, property placed in service in the fourth quarter receives only 12.5% of a full year's worth of depreciation).

Mid-Quarter Percentages

Quarter Placed in Service	% of Full Year Depreciation in Year Placed in Service	% of Full Year Depreciation in Disposition Year
First	87.5%	12.5%
Second	62.5%	37.5%
Third	37.5%	62.5%
Fourth	12.5%	87.5%

Note: The IRS has issued tables providing the MACRS depreciation percentages when the mid-quarter convention applies to an asset. See Tab 4.

Using the Section 179 deduction to avoid the mid-quarter convention. The Section 179 election can be used to avoid the mid-quarter convention by expensing property placed in service in the last quarter of the tax year. On the other hand, claiming a Section 179 deduction for assets placed in service during the first three quarters increases fourth-quarter additions relative to the total and may result in the application of the mid-quarter convention.

Example: Norm is a calendar-year sole proprietor. He placed the following assets in service during 2010:

Date	Description	Cost
January	Polishing machine	\$477,000
December	Grinding machine	78,000
Total		\$555,000

Norm claims a Section 179 deduction of \$78,000 for the grinding machine and \$422,000 for the polishing machine for a total of \$500,000 in 2010.

For the 40% test (to determine if the mid-quarter convention applies) Norm counts only the \$55,000 (\$477,000 – \$422,000 expensed under IRC §179) remaining basis in the polishing machine placed in service in January. The amounts expensed under Section 179 are not considered. Thus, the mid-quarter convention does not apply to Norm in 2010 since 100% of the basis of property considered for the test was placed in service in the first quarter of 2010. The \$55,000 remaining basis in the polishing machine is depreciated using the half-year convention.



Variation: Now assume that Norm claims a \$477,000 Section 179 deduction for the polishing machine and a \$23,000 Section 179 expense for the grinding machine. For the 40% test, he has placed the \$55,000 (\$78,000 – \$23,000) remaining basis of the grinding machine in service in December. Since that is 100% of the basis counted for the 40% test, 100% of Norm's assets were placed in service in the last three months of the year and the mid-quarter convention applies to the grinding machine's remaining basis in 2010.

Convention in Year of Disposition

If property subject to the half-year convention is sold, the half-year convention also applies in the year of the sale. Thus, half a year's depreciation is claimed in the year of disposition.

If the mid-quarter convention applied to property in the year placed in service, the property is treated as disposed of at the midpoint of the quarter in which the disposition occurred. See *Mid-Quarter Percentages* above for the percentage of a full year's depreciation allowed in the year of disposition.

Plants With a Preproductive Period of More Than Two Years

Plants producing the following crops or yields have a nationwide weighted average preproductive period of more than two years: (Notice 2000-45)

- Almonds
- Apples
- Apricots
- Avocados
- Blackberries
- Blueberries
- Cherries
- Chestnuts
- Coffee beans
- Currants
- Dates
- Figs
- Grapefruit
- Grapes
- Guavas
- Kiwifruit
- Kumquats
- Lemons
- Limes
- Macadamia nuts
- Mangoes
- Nectarines
- Olives
- Oranges
- Papayas
- Peaches
- Pears
- Pecans
- Persimmons
- Pistachio nuts
- Plums
- Pomegranates
- Prunes
- Raspberries
- Tangelos
- Tangerines
- Tangors
- Walnuts

Recovery Periods for Farm Property

Recovery periods for assets used in a farming business are listed below.

Farm Property Recovery Periods

IRS Pub. 225 and Rev. Proc. 87-56

Assets	Recovery Period in Years	
	GDS	ADS
Agricultural structures (single purpose).....	10	15
Airplanes (including helicopters) ¹	5	6
Automobiles.....	5	5
Calculators and copiers.....	5	6
Cattle (dairy or breeding).....	5	7
Communication equipment ²	7	10
Computer and peripheral equipment.....	5	5
Cotton ginning assets.....	7	12
Drainage facilities.....	15	20
Farm buildings ³	20	25
Farm machinery and equipment ⁴	5 or 7	10
Fences (agricultural).....	7	10
Goats and sheep (breeding).....	5	5
Grain bin.....	7	10
Hogs (breeding).....	3	3
Horses (age when placed in service)		
• Breeding and working (12 years or less).....	7	10
• Breeding and working (more than 12 years)....	3	10
• Racing horses ⁵	3	12
Horticultural structures (single purpose).....	10	15
House trailers for farm laborers—mobile (has wheels and a history of movement).....	7	10
House trailers for farm laborers—not mobile (wheels have been removed and permanent utilities and pipes are attached to it).....	20	25
Logging machinery and equipment ⁶	5	6
Nonresidential real property.....	39 ⁷	40
Office furnitures, fixtures and equipment (not calculators, copiers or typewriters).....	7	10
Paved lots.....	15	20
Residential rental property.....	27.5	40
Tractor units (over-the-road).....	3	4
Trees or vines bearing fruit or nuts.....	10	20
Truck (heavy duty, unloaded weight 13,000 lbs. or more).....	5	6
Truck (actual weight less than 13,000 lbs.).....	5	5
Vineyard trellising.....	7	10
Water wells (for raising poultry and livestock).....	15	20

Table continued in the next column

Farm Property Recovery Periods (Continued)

- ¹ Not including airplanes used in commercial or contract carrying of passengers.
- ² Not including communication equipment listed in other classes.
- ³ Not including single purpose agricultural or horticultural structures.
- ⁴ New farm equipment placed in service in 2009 was 5-year (rather than 7-year) property. Five-year treatment excluded grain bins, cotton ginning assets, fences or other land improvements. For 2010, farm equipment has a recovery period of 7 years. **Although the 5-year recovery period expired for assets placed in service after 2009, at the time this publication went to press, legislation was pending that would extend it through 2010. Tax professionals should be alert to legislative activity in this area.**
- ⁵ For race horses placed in service after December 31, 2008 and before January 1, 2014. Outside of that date range, race horses more than two years old when placed in service are 3-year property, and horses two years old or younger are 7-year property.
- ⁶ Used by logging and sawmill operators for cutting timber.
- ⁷ For property placed in service after May 12, 1993; for property placed in service before May 13, 1993, the recovery period is 31.5 years.

Example: Green Farm, Inc. is actively involved in agricultural activities. In 2010, Green Farm purchases a 10-acre piece of land that includes a farm house, hog barns, a general purpose machine shed and a grain bin. Green Farm also purchases the hog livestock on site. In considering how to depreciate the personal and real property purchased, all the assets purchased are considered farm assets, subject to the 150% declining balance method, and assigned the following recovery periods:

- The farm house (Asset Class 01.3) is used to house the farm manager and is depreciated over 20 years.
- The machine shed (Asset Class 01.3) is a general purpose farm building subject to 20-year life.
- The hog barns (Asset Class 01.4) qualify as single purpose agricultural buildings depreciated over 10 years.
- The machinery and equipment (Asset Class 01.1) inside the hog barns are seven-year property **(unless pending legislation is passed that would allow a five-year recovery period for 2010).**
- The grain bin (Asset Class 01.1) is seven-year property.
- The breeding hogs (Asset Class 01.23) qualify as three-year property.

SHORT TAX YEARS

The MACRS depreciation tables (see Tab 4) assume that the tax year in which property is placed in service and all subsequent tax years in the recovery period are full 12-month years. When property is placed in service or subject to depreciation deductions during a short tax year, or if property is disposed of before the end of the recovery period, special calculations apply. (Rev. Proc. 89-15)

When the Tax Year Begins

The tax year does not begin until the individual or entity engages in a trade or business. For employee business expense purposes, the tax year can include any period during which the person is engaged in a trade or business as an employee, including periods before assets are placed in service.

Example: On July 1, 2010, ABC Corp. expanded its sales department and required employees to furnish their own auto as a condition of employment. Bill has been an employee of ABC for three years; Curt and David are new hires. Curt previously worked for five years for a similar business; David recently graduated from college, and this is his first job. All three placed an auto in service on July 1 as a result of ABC's requirement.

Bill and Curt do not have a short tax year for the auto placed in service on July 1 because they are considered to have been engaged in a trade or business for the entire year. Conversely, David has a short tax year beginning with his employment on July 1.

Computing Depreciation After a Short Year

For the tax years after the first short year, depreciation may be computed using either the simplified method or the allocation method (Rev. Proc. 89-15). The method chosen must be consistently used until the tax year that a switch to the MACRS straight-line (SL) method is required because it produces a larger depreciation deduction. Usually, both methods produce the same depreciation allowance.

Simplified method. Calculate depreciation for a later 12-month year in the recovery period by multiplying the adjusted basis of the property at the beginning of the year by the applicable depreciation rate.

Allocation method. Calculate depreciation for each later tax year by allocating to that year the depreciation attributable to the parts of the recovery years that fall within that year. For each recovery year included, multiply the depreciation attributable to that recovery year by a fraction. The fraction's numerator is the number of months (including parts of a month) that are included in both the tax year and the recovery year. The denominator is 12. The allowable depreciation for the tax year is the sum of the depreciation figured for each recovery year.



Example #1: Mary Jones forms a proprietorship that has a short tax year beginning March 15 and ending December 31. She is treated as having a 10-month tax year and, under the half-year convention, calculates a \$167 ($\$1,000 \times 40\% \times 5 \div 12$) depreciation allowance for year 1 on a \$1,000 asset with a five-year life. If Mary uses the simplified method for computing depreciation in the following years, her depreciation in years 2 and 3 will be as follows:

Year	Depreciation Allowance
2.....	$(\$1,000 - \$167) \times 40\% = \$333$
3.....	$(\$1,000 - \$167 - \$333) \times 40\% = \200

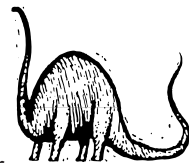
Example #2: Assume the same facts as in Example #1, except that the allocation method is used to compute the depreciation in years after the short year. For the second year, a two-part calculation is required. Seven months of depreciation is calculated using the method applicable to the first short-year calculation, and five months of depreciation is computed using the adjusted basis of \$600 (\$1,000 original cost less \$400 depreciation allowance claimed in the first 12 months). The following table shows the calculations for the first three years under this method.

Year	Depreciation Allowance
1.....	$[40\% \times \$1,000 \times (5 \div 12)] = \167
2.....	$[40\% \times \$1,000 \times (7 \div 12)] + [40\% \times \$600 \times (5 \div 12)] = \333
3.....	$[40\% \times \$600 \times (7 \div 12)] + [40\% \times \$360 \times (5 \div 12)] = \200

Straight-Line Method

To avoid complex calculations in figuring depreciation for years after a short tax year, the taxpayer may elect to depreciate all assets placed in service during the short year under the SL method.

Under SL, depreciation after the short tax year is determined by dividing the number one by the years remaining in the recovery period at the beginning of a year, then multiplying the result by the unrecovered adjusted basis. When figuring the number of years remaining, consider the convention used in the year property is placed in service. If the number of years remaining is less than one, the depreciation rate for that tax year is 1.0 (100%).



SPECIAL (BONUS) DEPRECIATION ALLOWANCE

(or 100%)

A 50% special (bonus) depreciation allowance can be claimed in the year qualifying property is placed in service, even if it is a short year. Short year depreciation computations are then applied to the remaining adjusted basis.

(or 100%)

To be eligible for the 50% special (bonus) depreciation allowance, an asset must pass three tests:

- 1) It must be qualified property.
- 2) Its original use must begin with the taxpayer after 2007.
- 3) It must be acquired and placed in service before 2014 (before 2012 for long production period property and noncommercial aircraft).



Note: The 100% allowance applies to property placed in service 9/9/10 – 12/31/11.

Computing the Deduction

Determine the special (bonus) depreciation allowance without any pro-ration based on when the property was placed in service. Property placed in service on the last day of the tax year is eligible for the full special (bonus) depreciation amount. The special (bonus) depreciation allowance is an additional deduction computed after any Section 179 deduction (if applicable) and before regular MACRS depreciation is calculated.

(or 100%)

Special (Bonus) Depreciation Allowance

Asset Placed in Service	Applicable Rules	Authority
After December 31, 2007 and before 2014.	<ul style="list-style-type: none"> • 50% additional depreciation automatically applies. • Can elect out. 	IRC §168(k)(1)(A), as amended
Long Production Period Property after December 31, 2007 and before 2012. ¹	<ul style="list-style-type: none"> • 50% additional depreciation automatically applies. • Can elect out. 	IRC §168(k)(2)(B), as amended
After 2007 for disasters declared after 2007 and occurring before 2010. ²	<ul style="list-style-type: none"> • 50% additional depreciation automatically applies. • Can elect out. 	IRC §168(n)
In specified portions of the GO Zone after August 27, 2005 and before 2014. ^{3,4}	<ul style="list-style-type: none"> • 50% additional depreciation automatically applies. • Can elect out. 	IRC §1400N(d)(6)
In the NY Liberty Zone after September 10, 2001 and before 2007 (2010 for certain real property). ⁵	<ul style="list-style-type: none"> • 30% additional depreciation automatically applies. • Can elect out. 	IRC §1400L(b)

¹ Property must have been under a written contract before January 1, 2014. Special depreciation is only available to the extent of adjusted basis attributable to manufacture, construction or production before January 1, 2014.

² Property must be qualified disaster assistance property placed in service in a federally declared disaster area. Although the special depreciation provision for qualified disaster assistance property expired for disasters occurring after 2009, at the time this publication went to press, legislation was pending that would extend it through 2010. Tax professionals should be alert to legislative activity in this area.

³ Available only for real property or personal property and software used in such real property.

⁴ See *Specified portion of GO Zone* in the Tab 13 Glossary for a list of affected counties and parishes.

⁵ Although the special (bonus) depreciation for certain real property in the NY Liberty Zone expired for assets placed in service after 2009, at the time this publication went to press, legislation was pending that would extend it through 2010. Tax professionals should be alert to legislative activity in this area.

Qualified Assets

To qualify for the **50%** special (bonus) depreciation allowance, an asset must be one of the following: [IRC §168(k)(2)]

- 1) MACRS asset with a recovery period of 20 years or less,
- 2) Depreciable computer software other than software amortizable under Section 197 (for example, off-the-shelf software),
- 3) Water utility property defined in Section 168(e)(5) or
- 4) Qualified leasehold improvement property (see *Qualified Leasehold Improvement Property* below).



Qualified property does not include:

- 1) Property placed in service and disposed of in the same tax year.
- 2) Property converted from business use to personal use in the same tax year it is acquired.
- 3) Property that must be depreciated using the Alternative Depreciation System (ADS). This includes listed property used 50% or less in a qualified business use.
- 4) Qualified NY Liberty Zone leasehold improvement property.
- 5) Property for which taxpayer elected not to claim any additional first-year depreciation allowance.

Qualified Leasehold Improvement Property

A leasehold improvement qualifies for additional first-year depreciation if it meets four tests: [IRC §168(k)(3)]

- 1) The improvement is to an interior portion of a building.
- 2) The building is nonresidential real property.
- 3) The improvement was made pursuant to a lease by the lessee, sub-lessee or the lessor (landlord) to property to be occupied exclusively by the lessee or sub-lessee.
- 4) The improvement is placed in service more than three years after the date the building was first placed in service.

The following improvements are not qualified leasehold improvement property:

- 1) The enlargement of the building,
- 2) An elevator or escalator,
- 3) Any structural component benefiting a common area and
- 4) The internal structural framework of the building.



Caution: Leases between related parties do not qualify. Related parties include an individual and his or her spouse, children, grandchildren, parents, grandparents and siblings. It also includes an individual and certain entities (for example, corporations) if the individual owns (directly or indirectly) 80% or more of the entity's value.

Original Use

To qualify for the special (bonus) depreciation allowance, the asset must generally be new, rather than pre-owned (that is, original use must commence with the taxpayer) [IRC §168(k)(2); Reg. §1.168(k)-1(b)(3)]. However:

- New property acquired after December 31, 2007 for personal use and subsequently converted to business use meets the original use requirement.
- Capital expenditures to recondition or rebuild acquired or owned property satisfy the original use requirement.

- Assets that are reconditioned or rebuilt before the taxpayer buys them generally don't meet the original use test, but property containing used parts is not treated as reconditioned or rebuilt if the cost of the used parts is 20% or less of the property's total cost.
- Assets placed in service after December 31, 2007 by a person and then sold to the taxpayer for leaseback to that person within three months after being placed in service will be treated as a new asset placed in service by the taxpayer on a date not earlier than the date it is used first by the lessee under the leaseback arrangement.

Example: During 2010, Bobcat Company buys a used machine for \$20,000 and spends \$5,000 to recondition it. The \$20,000 purchase price is ineligible for the special (bonus) depreciation allowance. The \$5,000 additional cost to recondition the machine is eligible for the special (bonus) depreciation allowance, assuming all other requirements are also met.

Long Production Period Property

The special (bonus) depreciation allowance is available for long production period property and noncommercial aircraft placed in service before ~~2012~~, [IRC §168(k)(2)] **2014**

Law Change Alert: Although long production period property now qualifies for special depreciation through December 31, ~~2011~~, **2013**, the deduction is only available to the extent of adjusted basis attributable to manufacture, construction or production before January 1, ~~2011~~, [IRC §168(k)(2)(B)(ii)] **2013**

Long production period property. The property must be (1) certain transportation property or (2) certain self-produced MACRS property with a recovery period of 10 years or longer or MACRS property with a recovery period of 10 years or longer that is acquired for resale. The asset must have an estimated production period of more than one year and a cost of more than \$1 million.

Noncommercial aircraft. The aircraft must (1) be originally used by the taxpayer, (2) not be transportation property other than for agricultural or firefighting purposes, (3) at the time of contract for purchase, have a nonrefundable deposit of 10% of the cost (or \$100,000, if less) and (4) have an estimated production period exceeding four months and cost more than \$200,000.

Electing Out of the Special (Bonus) Depreciation Allowance

A taxpayer can elect not to claim special depreciation for any class of property for any tax year [IRC §168(k)(2)(D); Reg. §1.168(k)-1(e)]. The election to not claim this depreciation must be made for all additions within an entire class placed in service for the tax year.


The election out of this depreciation is made by attaching a statement similar to that below to the tax return for the year it is to be effective. Generally, it must be made by the due date, including extensions, of the tax return for the tax year in which the qualified property is placed in service.


Election Out of 50% Bonus Depreciation

Taxpayer elects under Internal Revenue Code Section 168(k)(2)(D)(iii) to not claim the additional 50% first-year bonus depreciation deduction (the special depreciation allowance) for the following classes of property placed in service during the tax year ended [year-end]: [list property classes for which election is made].


Foregoing Special (Bonus) Depreciation Allowance to Claim Additional Credits

Corporations may forego the special (bonus) depreciation allowance and instead elect to claim additional research or minimum tax credits [IRC §168(k)(4)]. This provision applies to years ending, and property placed in service, after March 31, 2008 and before 2010 (2011 for certain long-lived assets).

 **Note:** The election to forego special depreciation will also be available for assets placed in service in 2011 and 2012. However, taxpayers will not be able to increase the limit on unused research credits.


 **Note:** Although special (bonus) depreciation provisions were extended through 2010 (2011 for certain long-lived assets), this provision was not extended for an additional year.

A corporation making the election foregoes the special (bonus) depreciation deductions and instead increases the limit on the use of research credits or minimum tax credits. The increases in the allowable credits are treated as refundable. The depreciation for qualified property is calculated for both regular tax and AMT purposes using the straight-line method in place of the method that would otherwise be used.

 **Observation:** The IRS has provided a worksheet for calculating the refundable credit amounts on its website at www.irs.ustreas.gov/pub/irs-utl/amtresearchworksheet.pdf. See Revenue Procedures 2008-65, 2009-16 and 2009-33 for guidance on making the election.

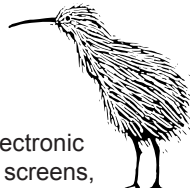
Qualified Recycling and Cellulosic Biofuel Plant Property

A 50% special (bonus) depreciation allowance applies to certain reuse and recycling property placed in service after August 31, 2008 [IRC §168(m)] and cellulosic biofuel plant property placed in service after October 3, 2008 and before 2013. [IRC §168(l)]

 **Note:** These provisions are separate from the 50% special (bonus) depreciation allowance under Section 168(k). Property qualifying under Section 168(k) is not eligible for the special depreciation allowed under Sections 168(l) and 168(m).


Qualified reuse and recycling property is any machinery and equipment (including software to operate the equipment but not buildings or real estate) which is used exclusively to collect, distribute or recycle qualified reuse and recyclable materials such as:

- Scrap plastic, glass, textiles, rubber or packaging.
- Recovered fiber.
- Scrap ferrous and nonferrous metals or electronic scrap (such as cathode ray tubes, flat panel screens, similar video display devices and central processing units).



Qualified cellulosic biofuel plant property is property used to make cellulosic biofuel (any liquid fuel), including ethanol from cellulose, in the manner prescribed in Section 168(l).

QUALIFIED DISASTER ASSISTANCE PROPERTY

 **Caution:** Although the special depreciation provision for qualified disaster assistance property expired for disasters occurring after 2009, at the time this publication went to press, legislation was pending that would extend it through 2010. Tax professionals should be alert to legislative activity in this area.

An additional 50% special (bonus) depreciation allowance is available for qualified disaster assistance property placed in service after 2007 in federally declared disaster areas for disasters declared after 2007 and occurring before 2010. [IRC §168(n)]

Qualified disaster assistance property is property used in an active trade or business that is:

- 1) MACRS property with a recovery period of 20 years or less,
- 2) Computer software,
- 3) Water utility property,
- 4) Qualified leasehold improvement property,
- 5) Nonresidential real property or
- 6) Residential rental property.


Qualified disaster assistance property must also meet the following requirements:

- 1) Substantially all of the property's use must be in a federally declared disaster area.
- 2) The property must replace or rehabilitate property that was damaged or destroyed.
- 3) Its first use in the disaster area must begin with the taxpayer.
- 4) It must be acquired by the taxpayer by purchase on or after the disaster date, but only if no written binding contract for the acquisition was in effect before that date.
- 5) It must be placed in service by the taxpayer on or before the last day of the third calendar year following the disaster date (fourth calendar year in the case of nonresidential real property and residential rental property).



NEW YORK (NY) LIBERTY ZONE PROPERTY

The provisions for the special (bonus) depreciation allowance and increased Section 179 deductions for NY Liberty Zone property applied to property placed in service after September 10, 2001 and before 2007 (2010 for certain real property). (IRC §1400L)

 **Caution:** Although the special (bonus) depreciation for certain real property in the NY Liberty Zone expired for assets placed in service after 2009, at the time this publication went to press, legislation was pending that would extend it through 2010. Tax professionals should be alert to legislative activity in this area.

GENERAL ASSET ACCOUNTS

A taxpayer can elect to group depreciable assets into one or more general asset accounts (GAAs) if the assets have the following attributes in common. [IRC §168(i)(4); Reg. §1.168(i)-1]

- Asset class,
- Depreciation method,
- Recovery period,
- Convention (for example, half-year convention) and
- Tax year in which they were placed in service.

The following rules also apply for establishing a GAA:

- Properties without an asset class but with the same depreciation method, recovery period and convention can be grouped into the same GAA.
- Property subject to the mid-quarter convention can only be grouped into a GAA with property placed in service in the same quarter.
- Property subject to the mid-month convention can only be grouped into a GAA with property placed in service in the same month.
- Passenger automobiles subject to the limits on passenger automobile depreciation must be grouped into a separate GAA.

Calculating Depreciation for a GAA

Each GAA is treated as a single asset and depreciated using the applicable depreciation method, recovery period and convention for the assets in the GAA. For each GAA, the depreciation allowance must be maintained in a separate depreciation reserve account.

Example: Make & Sell, a calendar-year corporation, set up a GAA for 10 machines. The machines cost a total of \$100,000 and were placed in service in June 2010. One of the machines cost \$82,000 and the rest cost a total of \$18,000. This GAA is depreciated under the 200% declining balance method with a five-year recovery period and a half-year convention. Make & Sell did not claim the Section 179 deduction or special (bonus) depreciation on the machines. The depreciation allowance for 2010 is \$20,000 [(\$100,000 × 40%) ÷ 2]. As of January 1, 2011, the accumulated depreciation on the GAA is \$20,000.

Quick Guide to MACRS Depreciation Tables

Property Class	Regular Tax			Alternative Minimum Tax ¹
	General Depreciation System		Alternative Depreciation System ¹ (if elected or required, also use for AMT)	
	No election made	SL Election (if elected, also use for AMT)		
Property Placed in Service after 1998²				
3-year, 5-year, 7-year and 10-year (Nonfarm) ³	200% DB GDS recovery period <i>Tables 1 – 4</i>	SL GDS recovery period <i>Tables 15 – 19</i>	SL ADS recovery period <i>Tables 15 – 19</i>	150% DB GDS recovery period <i>Tables 1 – 4</i>
3-year, 5-year, 7-year and 10-year (Farm Property) ^{4, 5}	150% DB GDS recovery period <i>Tables 1 – 4</i>	SL GDS recovery period <i>Tables 15 – 19</i>	SL ADS recovery period <i>Tables 15 – 19</i>	150% DB GDS recovery period <i>Tables 1 – 4</i>
15-year ⁶	150% DB 15 years <i>Table 5</i>	SL 15 years <i>Table 5</i>	SL ADS recovery period <i>Tables 15 – 19</i>	If Section 1250 property, SL 15 years If Section 1245 property, 150% DB 15 years <i>Table 5</i>
20-year	150% DB 20 years <i>Table 6</i>	SL 20 years <i>Table 6</i>	SL ADS recovery period <i>Tables 15 – 19</i>	If Section 1250 property, SL 20 years If Section 1245 property, 150% DB 20 years <i>Table 6</i>
Residential Rental Real Property	SL 27.5 years <i>Table 7</i>	N/A	SL 40 years <i>Table 20</i>	SL 27.5 years <i>Table 7</i>
Nonresidential Real Property ^{3, 6}	SL 39 years <i>Table 9</i>	N/A	SL 40 years <i>Table 20</i>	SL 39 years <i>Table 9</i>
Property Placed in Service 1987 – 1998				
3-year, 5-year, 7-year and 10-year (Nonfarm)	200% DB GDS recovery period <i>Tables 1 – 4</i>	SL GDS recovery period ⁷ <i>Tables 15 – 19</i>	SL ADS recovery period <i>Tables 15 – 19</i>	150% DB ADS recovery period <i>Tables 10 – 14</i>
3-year, 5-year, 7-year and 10-year (Farm Property placed in service after 1988) ⁴	150% DB GDS recovery period <i>Tables 1 – 4</i>	SL GDS recovery period ⁷ <i>Tables 15 – 19</i>	SL ADS recovery period <i>Tables 15 – 19</i>	150% DB ADS recovery period <i>Tables 10 – 14</i>
15-year	150% DB 15 years <i>Table 5</i>	SL 15 years ⁷ <i>Table 5</i>	SL ADS recovery period <i>Tables 15 – 19</i>	SL ADS recovery period <i>Tables 15 – 19</i>
20-year	150% DB 20 years <i>Table 6</i>	SL 20 years ⁷ <i>Table 6</i>	SL ADS recovery period <i>Tables 15 – 19</i>	SL ADS recovery period <i>Tables 15 – 19</i>
Residential Rental Real Property	SL 27.5 years <i>Table 7</i>	N/A	SL 40 years <i>Table 20</i>	SL 40 years <i>Table 20</i>
Nonresidential Real Property (placed in service after 1986 and before May 13, 1993)	SL 31.5 years <i>Table 8</i>	N/A	SL 40 years <i>Table 20</i>	SL 40 years <i>Table 20</i>
Nonresidential Real Property (placed in service after May 12, 1993 and before 1999)	SL 39 years <i>Table 9</i>	N/A	SL 40 years <i>Table 20</i>	SL 40 years <i>Table 20</i>

¹ Can be elected for any asset, if not already required. [IRC §168(b)(2)(D) and (g)(1)(E)]

² Additional special (bonus) depreciation is available for 2008 – ~~2010~~ [IRC §168(k)]. See *Tables 21–25*.

³ Qualified NY Liberty Zone leasehold improvements are depreciated SL over five years for regular tax and AMT. [IRC §1400L(c)]

⁴ ADS method is required for farm assets when an election to not apply the uniform capitalization rules is in effect. [IRC §263A(e)(2)]

⁵ Trees and vines bearing fruit or nuts depreciated SL over 10 years for regular tax and AMT. [IRC §168(e)(3)(D)]

⁶ Qualified leasehold improvement property and qualified restaurant property placed in service after 10/22/04 and before ~~2010~~, and qualified retail improvement property placed in service during ~~2009~~, are depreciated using SL over 15 years for regular tax and AMT [IRC §168(b)(3) and (e)(3)(E)]. **At the time this publication went to press, legislation was pending that would extend these provisions through 2010. Tax professionals should be alert to further legislative developments.**

⁷ Use the ADS recovery period for AMT [IRC §56(a)(1)]. See *Tables 15 – 19*.

2009 – 2011

Table 4
10-Year MACRS

For property placed in service after 1986

200% Declining Balance

• Regular tax depreciation for personal property with 10-year recovery period (includes boats not used for transportation and assets used in certain activities).

150% Declining Balance

• Regular tax depreciation for 10-year assets used in a farming business (including single-purpose farm structures).
• AMT depreciation for personal property with 10-year recovery period placed in service after 1998.
• Can be elected for regular tax.

Year	Half-Year Convention	Mid-Quarter Convention—Quarter in Which Acquired				Year	Half-Year Convention	Mid-Quarter Convention—Quarter in Which Acquired			
		1	2	3	4			1	2	3	4
1.....	10.00 %	17.50%	12.50%	7.50%	2.50%	1.....	7.50%	13.13%	9.38%	5.63%	1.88%
2.....	18.00	16.50	17.50	18.50	19.50	2.....	13.88	13.03	13.59	14.16	14.72
3.....	14.40	13.20	14.00	14.80	15.60	3.....	11.79	11.08	11.55	12.03	12.51
4.....	11.52	10.56	11.20	11.84	12.48	4.....	10.02	9.41	9.82	10.23	10.63
5.....	9.22	8.45	8.96	9.47	9.98	5.....	8.74	8.71	8.73	8.75	9.04
6.....	7.37	6.76	7.17	7.58	7.99	6.....	8.74	8.71	8.73	8.75	8.72
7.....	6.55	6.55	6.55	6.55	6.55	7.....	8.74	8.71	8.73	8.75	8.72
8.....	6.55	6.55	6.55	6.55	6.55	8.....	8.74	8.71	8.73	8.74	8.72
9.....	6.56	6.56	6.56	6.56	6.56	9.....	8.74	8.71	8.73	8.75	8.72
10.....	6.55	6.55	6.55	6.55	6.55	10.....	8.74	8.71	8.73	8.74	8.71
11.....	3.28	0.82	2.46	4.10	5.74	11.....	4.37	1.09	3.28	5.47	7.63

These percentages incorporate the switch from declining-balance (DB) to straight-line (SL) method when SL yields a larger deduction.

Note: For early disposition, multiply the depreciation obtained from these tables by ½ if half-year convention applied. For a disposition of property under the mid-quarter convention, see *Convention in Year of Disposition* on Page 2-5.

Table 5
15-Year MACRS

For property placed in service after 1986

150% Declining Balance

• Regular tax depreciation for property with a 15-year recovery period, including land improvements (both Section 1245 and 1250 property) and assets used in certain activities.

Straight-Line

• Regular tax depreciation for qualified leasehold improvement property and qualified restaurant property placed in service after 10/22/04 and before 2010, and qualified retail improvement property placed in service during 2009. ~~Although the 15-year recovery period for these types of property expired for assets placed in service after 2009, at the time this publication went to press, legislation was pending that would extend these provisions through 2010. Tax professionals should be alert to further legislative developments.~~ **2009 – 2011.**
• AMT depreciation for 15-year property placed in service after 1998 that is Section 1250 property.
• ADS depreciation for assets with 15-year ADS life.
• Can be elected for regular tax and AMT.

Year	Half-Year Convention	Mid-Quarter Convention—Quarter in Which Acquired				Year	Half-Year Convention	Mid-Quarter Convention—Quarter in Which Acquired			
		1	2	3	4			1	2	3	4
1.....	5.00 %	8.75%	6.25%	3.75%	1.25%	1.....	3.33%	5.83%	4.17%	2.50%	0.83%
2.....	9.50	9.13	9.38	9.63	9.88	2.....	6.67	6.67	6.67	6.67	6.67
3.....	8.55	8.21	8.44	8.66	8.89	3.....	6.67	6.67	6.67	6.67	6.67
4.....	7.70	7.39	7.59	7.80	8.00	4.....	6.67	6.67	6.67	6.67	6.67
5.....	6.93	6.65	6.83	7.02	7.20	5.....	6.67	6.67	6.67	6.67	6.67
6.....	6.23	5.99	6.15	6.31	6.48	6.....	6.67	6.67	6.67	6.67	6.67
7.....	5.90	5.90	5.91	5.90	5.90	7.....	6.67	6.67	6.66	6.66	6.67
8.....	5.90	5.91	5.90	5.90	5.90	8.....	6.66	6.66	6.67	6.67	6.66
9.....	5.91	5.90	5.91	5.91	5.90	9.....	6.67	6.67	6.66	6.66	6.67
10.....	5.90	5.91	5.90	5.90	5.91	10.....	6.66	6.66	6.67	6.67	6.66
11.....	5.91	5.90	5.91	5.91	5.90	11.....	6.67	6.67	6.66	6.66	6.67
12.....	5.90	5.91	5.90	5.90	5.91	12.....	6.66	6.66	6.67	6.67	6.66
13.....	5.91	5.90	5.91	5.91	5.90	13.....	6.67	6.67	6.66	6.66	6.67
14.....	5.90	5.91	5.90	5.90	5.91	14.....	6.66	6.66	6.67	6.67	6.66
15.....	5.91	5.90	5.91	5.91	5.90	15.....	6.67	6.67	6.66	6.66	6.67
16.....	2.95	0.74	2.21	3.69	5.17	16.....	3.33	0.83	2.50	4.17	5.83

These percentages incorporate the switch from declining-balance (DB) to straight-line (SL) method when SL yields a larger deduction.

Note: For early disposition, multiply the depreciation obtained from these tables by ½ if half-year convention applied. For a disposition of property under the mid-quarter convention, see *Convention in Year of Disposition* on Page 2-5.

Table 20
Straight-Line—40-Year
Mid-Month Convention

For property placed in service after 1986

- Alternative Depreciation System for residential rental or nonresidential real property.
- AMT depreciation for residential rental or nonresidential real property placed in service before 1999.
- Can be elected for regular tax and AMT.


Year	Month property placed in service											
	1	2	3	4	5	6	7	8	9	10	11	12
1	2.396%	2.188%	1.979%	1.771%	1.563%	1.354%	1.146%	0.938%	0.729%	0.521%	0.313%	0.104%
2-40	2.500	2.500	2.500	2.500	2.500	2.500	2.500	2.500	2.500	2.500	2.500	2.500
41	0.104	0.312	0.521	0.729	0.937	1.146	1.354	1.562	1.771	1.979	2.187	2.396

 **Note:** For early disposition, pro-rate the depreciation from this table for the number of months in service (using mid-month convention).

Table 21
MACRS with Special (Bonus) Depreciation—All Lives
Half-Year Convention

For property placed in service in 2008 - ~~2010~~ ²⁰¹²

Year	200% declining balance				150% declining balance	
	3-year	5-year	7-year	10-year	15-year	20-year
1	66.665%	60.000%	57.145%	55.000%	52.500%	51.8750%
2	22.225	16.000	12.245	9.000	4.750	3.6095
3	7.405	9.600	8.745	7.200	4.275	3.3385
4	3.705	5.760	6.245	5.760	3.850	3.0885
5		5.760	4.465	4.610	3.465	2.8565
6		2.880	4.460	3.685	3.115	2.6425
7			4.465	3.275	2.950	2.4440
8			2.230	3.275	2.950	2.2610
9				3.280	2.955	2.2310
10				3.275	2.950	2.2305
11				1.640	2.955	2.2310
12					2.950	2.2305
13					2.955	2.2310
14					2.950	2.2305
15					2.955	2.2310
16					1.475	2.2305
17						2.2310
18						2.2305
19						2.2310
20						2.2305
21						1.1155


 **Note:** For early disposition, multiply the depreciation obtained from these tables by ½ if half-year convention applied. For a disposition of property under the mid-quarter convention, see *Convention in Year of Disposition* on Page 2-5.



50% **Table 22**
MACRS with Special (Bonus) Depreciation—All Lives
Mid-Quarter Convention—Property Placed in Service in First Quarter

For property placed in service in 2008 – ~~2010~~ **2012**


Year	200% declining balance				150% declining balance	
	3-year	5-year	7-year	10-year	15-year	20-year
1	79.165%	67.500%	62.500%	58.750%	54.375%	53.2815%
2	13.890	13.000	10.715	8.250	4.565	3.5000
3	6.175	7.800	7.655	6.600	4.105	3.2410
4	0.770	5.505	5.465	5.280	3.695	2.9980
5		5.505	4.375	4.225	3.325	2.7730
6		0.690	4.370	3.380	2.995	2.5650
7			4.375	3.275	2.950	2.3730
8			0.545	3.275	2.955	2.2295
9				3.280	2.950	2.2295
10				3.275	2.955	2.2295
11				0.410	2.950	2.2295
12					2.955	2.2300
13					2.950	2.2295
14					2.955	2.2300
15					2.950	2.2295
16					0.370	2.2300
17						2.2295
18						2.2300
19						2.2295
20						2.2300
21						0.2825

 **Note:** For early disposition, multiply the depreciation obtained from these tables by ½ if half-year convention applied. For a disposition of property under the mid-quarter convention, see *Convention in Year of Disposition* on Page 2-5.

50% **Table 23**
MACRS with Special (Bonus) Depreciation—All Lives
Mid-Quarter Convention—Property Placed in Service in Second Quarter

For property placed in service in 2008 – ~~2010~~ **2012**

Year	200% declining balance				150% declining balance	
	3-year	5-year	7-year	10-year	15-year	20-year
1	70.835%	62.500%	58.925%	56.250%	53.125%	52.3440%
2	19.445	15.000	11.735	8.750	4.690	3.5740
3	7.070	9.000	8.380	7.000	4.220	3.3060
4	2.650	5.685	5.985	5.600	3.795	3.0580
5		5.685	4.435	4.480	3.415	2.8290
6		2.130	4.435	3.585	3.075	2.6165
7			4.435	3.275	2.955	2.4205
8			1.670	3.275	2.950	2.2390
9				3.280	2.955	2.2315
10				3.275	2.950	2.2315
11				1.230	2.955	2.2315
12					2.950	2.2315
13					2.955	2.2315
14					2.950	2.2315
15					2.955	2.2310
16					1.105	2.2315
17						2.2310
18						2.2315
19						2.2310
20						2.2315
21						0.8365

 **Note:** For early disposition, multiply the depreciation obtained from these tables by ½ if half-year convention applied. For a disposition of property under the mid-quarter convention, see *Convention in Year of Disposition* on Page 2-5.

50%
Table 24
MACRS with Special (Bonus) Depreciation—All Lives
Mid-Quarter Convention—Property Placed in Service in Third Quarter

For property placed in service in 2008 – ~~2010~~ **2012**

Year	200% declining balance				150% declining balance	
	3-year	5-year	7-year	10-year	15-year	20-year
1	62.500%	57.500%	55.355%	53.750%	51.875%	51.4065%
2	25.000	17.000	12.755	9.250	4.815	3.6445
3	8.335	10.200	9.110	7.400	4.330	3.3710
4	4.165	6.120	6.510	5.920	3.900	3.1185
5		5.650	4.650	4.735	3.510	2.8845
6		3.530	4.425	3.790	3.155	2.6680
7			4.430	3.275	2.950	2.4680
8			2.765	3.275	2.950	2.2830
9				3.280	2.955	2.2300
10				3.275	2.950	2.2300
11				2.050	2.955	2.2300
12					2.950	2.2300
13					2.955	2.2305
14					2.950	2.2300
15					2.955	2.2305
16					1.845	2.2300
17						2.2305
18						2.2300
19						2.2305
20						2.2300
21						1.3940

Note: For early disposition, multiply the depreciation obtained from these tables by ½ if half-year convention applied. For a disposition of property under the mid-quarter convention, see *Convention in Year of Disposition* on Page 2-5.

50%
Table 25
MACRS with Special (Bonus) Depreciation—All Lives
Mid-Quarter Convention—Property Placed in Service in Fourth Quarter

For property placed in service in 2008 – ~~2010~~ **2012**

Year	200% declining balance				150% declining balance	
	3-year	5-year	7-year	10-year	15-year	20-year
1	54.165%	52.500%	51.785%	51.250%	50.625%	50.4690%
2	30.555	19.000	13.775	9.750	4.940	3.7150
3	10.185	11.400	9.840	7.800	4.445	3.4360
4	5.095	6.840	7.030	6.240	4.000	3.1785
5		5.470	5.020	4.990	3.600	2.9400
6		4.790	4.365	3.995	3.240	2.7195
7			4.365	3.275	2.950	2.5155
8			3.820	3.275	2.950	2.3270
9				3.280	2.950	2.2290
10				3.275	2.955	2.2290
11				2.870	2.950	2.2290
12					2.955	2.2290
13					2.950	2.2290
14					2.955	2.2290
15					2.950	2.2290
16					2.585	2.2290
17						2.2290
18						2.2295
19						2.2290
20						2.2295
21						1.9505

Note: For early disposition, multiply the depreciation obtained from these tables by ½ if half-year convention applied. For a disposition of property under the mid-quarter convention, see *Convention in Year of Disposition* on Page 2-5.

Section 179 Expensing



Tab 5 Topics

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EXPENSING ASSETS UNDER SECTION 179

Taxpayers can elect to currently deduct some or all of the cost of certain qualifying property that would otherwise be subject to depreciation. (See *Qualifying Property* on Page 5-5 for a discussion of Section 179 property.)

This Section 179 deduction is limited, however, to a maximum annual amount (\$500,000 per year for 2010 and 2011). The deduction is also limited by taxable income and is scaled back when the taxpayer places more than a certain amount (\$2,000,000 per year for 2010 and 2011) of Section 179 property in service during the tax year.

Note: The increased limits are for tax years beginning in 2010 and 2011 [IRC §179(b)(1)]. Thus, for fiscal year taxpayers, the \$500,000 limit and \$2,000,000 phase-out threshold apply to assets acquired during the fiscal year beginning in 2010 and ending in 2011 and also the fiscal year beginning in 2011 and ending in 2012. This is different than the rules for special (bonus) depreciation, which applies to assets acquired and placed in service during 2010, regardless of whether or not the taxpayer is a calendar year or fiscal year taxpayer. See Tab 2 for a discussion of special (bonus) depreciation.

ANNUAL DEDUCTION LIMIT

The total cost of Section 179 property that a taxpayer can expense for tax years beginning in 2010 and 2011 is limited to \$500,000 per year [IRC §179(b)(1)]. In 2012, the maximum deduction will drop to ~~\$25,000~~ **\$125,000 (adjusted for inflation)** unless Congress takes further action.

Exception: The Section 179 expensing limit is increased for property placed in service in certain locations or businesses. See the *Increased Section 179 Limits for Targeted Areas* table on Page 5-2.

Caution: The maximum Section 179 expense for certain heavy vehicles (including SUVs) is limited to \$25,000 per vehicle [IRC §179(b)(6)]. See *Section 179 Expense Limit for Heavy Vehicles and SUVs* on Page 6-4.

If Section 179 property is placed in service during a short tax year or part way through a tax year, the annual deduction limit is not pro-rated. The limit applies no matter when during the tax year the property is placed in service.



Example: Lasso, Inc. started business on December 1, 2010, and has a December 31 year-end. On December 10, 2010, Lasso placed in service a machine acquired that day for \$500,000. No other depreciable assets were placed in service during that year. If Lasso so desires, the entire \$500,000 may be expensed under Section 179, subject to the business taxable income limitation (see *Business Taxable Income Limit* on Page 5-2), even though Lasso's initial tax year consisted of only one month.

INVESTMENT LIMIT

The annual Section 179 limit is reduced dollar for dollar by the amount of Section 179 property placed in service during the year over \$2,000,000 (for 2010 and 2011) [IRC §179(b)(7)]. Thus, in 2010 and 2011, no Section 179 deduction is allowed if the amount of Section 179 property placed in service is \$2,500,000 or more. In 2012, the threshold will decrease from \$2,000,000 to \$200,000 unless Congress takes further action.

Exception: The threshold is larger for property placed in service in certain locations. See the *Increased Section 179 Limits for Targeted Areas* table on Page 5-2.



Section 179 Annual Limits

Year	Maximum Deduction	Phase-Out Threshold Section 179 Property Additions
2008.....	\$250,000.....	\$800,000
2009.....	\$250,000.....	\$800,000
2010 and 2011.....	\$500,000 ¹	\$2,000,000 ²

- ¹ Scheduled to revert to ~~\$25,000~~ for 2012. **\$125,000 (adjusted for inflation)**
² Scheduled to revert to ~~\$200,000~~ for 2012. **\$500,000 (adjusted for inflation)**

Example: In 2010, Chris placed in service machinery costing \$2,102,000. This cost is \$102,000 more than \$2,000,000, so he must reduce his deduction limit to \$398,000 (\$500,000 - \$102,000).

A husband and wife, whether filing joint or separate returns, are treated as one taxpayer for the \$500,000 annual deduction and \$2,000,000 investment limits (for 2010 and 2011). The limits are generally split in half unless both spouses elect a different allocation by multiplying the total limitations by the percentage elected. The sum of the percentages the taxpayer and spouse elect must equal 100%.

When a corporation is a member of a controlled group (greater than 50% ownership), the annual dollar and investment limitations are apportioned among the members of the group. Also, the controlled group is treated as one taxpayer for the business taxable income limitation. In addition, property purchased from another group member does not qualify as Section 179 property.

INCREASED LIMITS FOR TARGETED AREAS

Caution: The increased Section 179 limits for targeted areas expired at the end of 2009. However, at the time this publication went to press, legislation was pending that would extend this provision for targeted areas through 2010. Tax professionals should be alert to further legislative developments.

To increase investment in certain distressed areas, both the annual deduction limit and the investment limit were increased for Section 179 assets placed in service in specific locations. To qualify for the increased limits, the property generally must have been acquired by purchase after the date the area was designated and the taxpayer must have been the first person to use the property in the targeted area. Also, for Empowerment Zone and Designated Renewal Community assets, the business must have met certain requirements.



Increased Section 179 Limits for Targeted Areas				
Location	Additional Deduction Limit ¹	Increase to Phase-Out Threshold	Effective Dates	IRC §
Empowerment Zone ²	\$ 35,000	— ³	Expired at the end of 2009 ⁴ 2011	1397A(a)
Designated Renewal Community ²	\$ 35,000	— ³	Expired at the end of 2009 ⁴	1400J(a)
Federally Declared Disaster Areas ²	\$100,000	\$600,000 ¹	Expired at the end of 2009 ⁴	179(e)(1)

- ¹ If less, the amount of qualifying Section 179 property placed in service in the specified location.
² Defined at Tab 13.
³ Only 50% of the Section 179 property that is described in these categories is considered for the phase-out threshold. Thus, if all Section 179 property placed in service is described in these categories, the phase-out threshold is doubled.
⁴ ~~The increased Section 179 limits for targeted areas expired at the end of 2009. However, at the time this publication went to press, legislation was pending that would extend this provision for targeted areas through 2010. Tax professionals should be alert to further legislative developments.~~

Note: Increased Section 179 expensing was available for the Gulf Opportunity (GO) Zone and the Kansas Disaster Area for qualified property placed in service before 2009. See Pubs. 4492, *Information for Taxpayers Affected by Hurricanes Katrina, Rita, and Wilma*, and 4492-A, *Information for Taxpayers Affected by the May 4, 2007 Kansas Storms and Tornadoes*, for additional information.

BUSINESS TAXABLE INCOME LIMIT

The Section 179 deduction is limited to the taxpayer's aggregate taxable income derived from the active conduct of all trades or businesses, including:

- Wages, salaries, tips and other compensation.
- A partner or S corporation shareholder's pass-through share of entity taxable income or loss from the active conduct of any of the entity's trades or businesses, provided that they are engaged in the active conduct (that is, they meaningfully participate in management or operations) of at least one of the entity's trades or businesses.
- Section 1231 gains (or losses) from a trade or business.
- Section 1245 and 1250 depreciation recapture from a trade or business.
- Interest earned from working capital related to a trade or business.
- Income or loss from Schedule C and Schedule F.



Business taxable income is not reduced by:

- Any NOL carryover or carryback to the tax year.
- The deduction for half of self-employment taxes.
- Unreimbursed employee business expenses.
- The Section 179 deduction.

Taxable income or losses from investments or hobbies do not count as income from an active trade or business.

The active conduct of a trade or business for the Section 179 taxable income limit is not the same as "material participation" under the Section 469 passive activity rules. Income is derived from an active trade or business for the Section 179 test if the taxpayer meaningfully participates in the business's management or operations [Reg. §1.179-2(c)(6)(ii)]. This includes making high-level management decisions, even if the everyday operational decisions are left to an agent or employee.

Example: Adam owns a salon as a sole proprietorship and employs Brenda to operate it. Adam manages the salon by performing tasks such as reviewing developments relating to the business and approving the annual budget, while Brenda performs the day-to-day operating functions, including hiring employees, purchasing supplies and writing checks for bills and salaries. In 2010, Brenda purchased, for use in the salon and with its funds, qualified Section 179 equipment for \$9,500. Adam's net income from the salon, before the Section 179 deduction, was \$8,000.

Adam also is a partner in PRS, a partnership that owns a grocery store. Adam does not participate in the management or operations of the grocery store, and PRS did not purchase any Section 179 property during 2010. Adam's allocable share of partnership net income was \$6,000.

Based on the facts and circumstances, Adam meaningfully participates in the management of the salon but not the grocery store. Therefore, Adam's aggregate taxable income derived from the active conduct of any trade or business is \$8,000, the net income from the salon.

Strategy: Business taxable income does not have to be generated by the business in which the Section 179 property is used to count toward the business taxable income limit. In fact, the trade or business in which the Section 179 property is used can generate a loss, as long as the taxpayer's net business taxable income from all sources is positive.

Example: Jon actively conducts the business of his sole proprietorship, which has a \$45,000 loss for 2010 before considering any Section 179 deduction. He also reports \$542,000 of wages and \$3,000 of Section 1245 depreciation recapture from a partnership interest. He is active in the partnership's business. Jon's aggregate business taxable income for the Section 179 taxable income limit is \$500,000 (\$542,000 plus \$3,000 from the partnership minus \$45,000 loss from the proprietorship). Jon can claim the full \$500,000 Section 179 deduction in 2010 (assuming total qualifying property does not exceed \$2,000,000) for Section 179 property placed in service for his Schedule C activity.

Joint return. If a joint return is filed, the taxable incomes (or losses) of both spouses are aggregated, even though the Section 179 deduction may be related to the activities of only one spouse.

Example: Sue and Bo file a joint return. Sue has Form W-2 income of \$126,000 in 2010. Her husband, Bo, reports a \$13,000 business loss from his proprietorship; their aggregate trade or business income for claiming a Section 179 deduction for Bo's proprietorship is \$113,000 (\$126,000 – \$13,000). Bo can claim up to \$113,000 (smaller of \$113,000 or \$500,000 limit) of Section 179 expense assuming total qualifying property additions do not exceed \$2,000,000.

Planning for the Business Income Limit


Use one of the methods shown below and on Page 5-3 when the Section 179 deduction is reduced by the business taxable income limit. Either method will result in net income of zero for the current year, but will provide different rates of cost recovery in future years. Projections are necessary to determine the best method to use.

Method #1: Determine the amount of Section 179 expense that will result in a taxable income of zero when combined with depreciation. Remaining basis is recovered via depreciation over future years. This will avoid the possibility that Section 179 carryovers are "locked up" by income limitations in future years. Use the *Formula for optimal Section 179 deduction (Method #1)* on Page 5-3.

Example: On January 1, 2009, Sal purchased \$10,000 of used video equipment for exclusive use in his advertising business. He expensed the \$10,000 under Section 179. On June 15, 2010, Sal purchased new video equipment for use in his business and converted the equipment purchased in 2009 to personal use property.

The recapture is calculated as follows:

Section 179 deduction claimed (2009).....	\$10,000	
Minus: Allowable depreciation (instead of Section 179 expensing)		
2009 (\$10,000 × 100% business use × 20%).....	\$ 2,000	
2010 [\$10,000 × 100% business use × 32% × 50% (half-year convention)].....	<u>1,600</u>	< 3,600>
2010—Recapture amount	\$ 6,400	

 **Note:** Basis in the 2009 equipment is increased by the \$6,400 of recapture income.

Eligible Property

To be eligible for the Section 179 deduction, property must be one of the following types of depreciable property:

- 1) Tangible personal property.
- 2) Other tangible property (except buildings and their structural components) used as:
 - An integral part of manufacturing, production or extraction or of furnishing transportation, communications, electricity, gas, water or sewage disposal services or
 - A research or bulk storage facility used in connection with such activities.
- 3) Single purpose agricultural (livestock) or horticultural structures.
- 4) Storage facilities (except buildings and their structural components) used in connection with distributing petroleum or any primary product of petroleum.
- 5) Off-the-shelf computer software (if placed in service in a tax year beginning before ~~2012~~ **2013**).



Where to Report


When the qualified business-use of an asset decreases to 50% or less, the recapture amount is first entered on Form 4797, Part IV. This amount is then reported as income on the form where the deductions were originally claimed. If the Section 179 deduction was originally claimed on Schedule C or F, the recaptured amount is subject to SE tax.



QUALIFYING PROPERTY

To qualify for the Section 179 deduction, property (new or used) must meet all the following requirements:

- It must be eligible property (see *Eligible Property* in the next column).
- More than 50% of the property's use in the year placed in service must be in an active trade or business.
- It must have been acquired by purchase from an unrelated party.

 **Observation:** Property acquired in a like-kind exchange qualifies for Section 179 expensing only to the extent of any excess basis (generally, boot given in the trade). See Tab 9 for details.

Partial business use. When property is used for both business and nonbusiness purposes, the Section 179 deduction can be elected only if the property is used more than 50% for business in the year it is placed in service. Even then, only the business-use portion of the property qualifies for the Section 179 election.

Property converted from personal use. An asset must meet all the requirements for expensing in the year it is placed in service. Property originally acquired for personal use (or 50% or less business use) and later converted to more than 50% business use does not qualify.

Example: Courtney purchased a computer for \$2,000 in 2010. During that year, she uses it 80% for her business and 20% for personal purposes. Only \$1,600 (\$2,000 × 80%) of the computer's cost qualifies for the Section 179 election.


Variation: Assume that Courtney uses the computer 40% for business in 2010 and 80% for business in 2011. She cannot take a Section 179 deduction on this property in any year because it did not meet the requirements for expensing (that is, wasn't used more than 50% for business) in the year the property is placed in service.

Property purchased by an employee. No Section 179 expense is allowed for listed property (for example, cars, computers or cameras) purchased by an employee (for use in employer's business) unless the use of the asset is: [IRC §280F(d)(3)(A)]

- 1) Required as a condition of employment and
- 2) For the employer's convenience.

See Tab 6 for more on listed property.


Qualified real property. For tax years beginning in 2010 and 2011, qualified real property is eligible for up to \$250,000 of Section 179 expensing. Any Section 179 deduction for this property that is unused due to the taxable income limit cannot be carried to a year beginning after 2011. Any carryforward remaining at the end of the tax year beginning in 2011 is treated as placed in service in that 2011 tax year. [IRC §179(f)]

 **Observation:** Because the annual Section 179 deduction limit is \$500,000 for 2010 and 2011, up to half of the available annual deduction can be used for qualified real property.

The following classes of real property are included as qualified real property:


- 1) Qualified leasehold improvement property.
- 2) Qualified restaurant property.
- 3) Qualified retail improvement property.

See *Qualified Leasehold Improvements and Qualified Restaurant Property* on Page 7-8 and *Qualified Retail Improvement Property* on Page 7-9 for discussion of the requirements assets must meet to be considered these types of property.

 **Caution:** Qualified real property does not include any property that is:

- 1) Used predominantly to furnish lodging or in connection with furnishing lodging (see *Property Used to Furnish Lodging* on Page 5-6).
- 2) Used outside of the U.S.
- 3) Used by certain tax-exempt organizations.
- 4) Used by certain governmental units, foreign persons or entities.
- 5) An air-conditioning or heating unit.



 **Strategy:** Real property (other than a building or structural component) used as an integral part of manufacturing, production or extraction (including farming) can qualify for Section 179 expensing [IRC §179(d)(1)(B) and 1245(a)(3)(B)]. *Used as an integral part* means that the asset is used directly in the activity and is essential to its completeness. Examples include storage facilities, fencing used in a farming activity and water wells that provide water for an activity. Practitioners should not overlook this category of Section 179-eligible assets.

Whether property is tangible personal property for the Section 179 deduction is not controlled by its treatment under local law. For example, property may not be tangible personal property for the deduction even if treated so under local law, and some property (such as fixtures) may be tangible personal property for the deduction even if treated as real property under local law.

Real Property



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Depreciable Real Property¹

Description	Definition	Authority	Section 1245 / 1250	Regular Tax Recovery Period / Method	AMT Recovery Period / Method ²	ADS Recovery Period
Residential Rental Property	A building or structure if at least 80% of the gross rents are from a house or apartment (including a mobile home). <i>Does not</i> include a hotel, motel or other building where more than half of the units are used on a transient basis.	IRC §168(e)(2)	1250	27.5-year / SL	27.5-year / SL	40-year
Nonresidential Real Property	IRC Section 1250 property that is not (1) residential rental property or (2) property with a class life of less than 27.5 years.	IRC §168(e)(2)	1250	39-year / SL	39-year / SL	40-year
Land Improvements	Depreciable improvements to land, whether classified as Section 1245 or Section 1250 property. See <i>Land Improvements</i> on Page 7-4 for when land improvements are depreciable. Examples include sidewalks, roads, canals, drainage facilities, sewers, wharves and docks, bridges, fences, landscaping and radio and TV transmitting towers.	Rev. Proc. 87-56 (Asset Class 00.3)	Both	15-year / 150% DB	If Section 1245 property: 15-year / 150% DB; If Section 1250 property: 15-year / SL	20-year
Billboards classified as Section 1245 Property	See <i>Billboards</i> on Page 7-2.	Rev. Rul. 80-151	1245	15-year / 150% DB	15-year / 150% DB	20-year
Billboards classified as Section 1250 Property	See <i>Billboards</i> on Page 7-2.	Rev. Rul. 80-151	1250	15-year / 150% DB	15-year / SL	20-year
Open-Air Parking Structures	See <i>Open-Air Parking Structures</i> on Page 7-2.	IRC §168(e)(2) and CIP LMSB4-0709-029	1250	39-year / SL	39-year / SL	40-year
Qualified Leasehold Improvements	See <i>Qualified Leasehold Improvements</i> on Page 7-8 for definition and effective dates.	IRC §168(b)(3) and (e)(3)(E)	Both	15 ³ 39-year ³ / SL	39-year ³ / SL	40-year ³
Qualified Restaurant Property	See <i>Qualified Restaurant Property</i> on Page 7-8 for definition and effective dates.	IRC §168(b)(3) and (e)(3)(E)	1250	15 ³ 39-year ³ / SL	39-year ³ / SL	40-year ³
Qualified Retail Improvement Property	See <i>Qualified Retail Improvement Property</i> on Page 7-8 for definition and effective dates.	IRC §168(b)(3) and (e)(3)(E)	1250	15 ³ 39-year ³ / SL	39-year ³ / SL	40-year ³
Retail Fuel Outlets	See <i>Gas Stations and Convenience Stores</i> on Page 7-3.	IRC §168(e)(3)(E)	1250	15-year / 150% DB	15-year / SL	20-year
Farm Buildings	Except single-purpose agricultural and horticultural structures. See <i>Farm Buildings</i> on Page 7-3.	Rev. Proc. 87-56 (Asset Class 01.3)	1250	20-year / 150% DB	20-year / SL	25-year
Single Purpose Agricultural and Horticultural Structures	See <i>Farm Buildings</i> on Page 7-3.	IRC §168(e)(3)(D)	1245	10-year / 150% DB	10-year / SL	15-year

¹ This table doesn't cover all real property used in specific activities, which may be assigned a shorter recovery period under Revenue Procedure 87-56 (reproduced in Tab 12). Tax professionals should consult that Revenue Procedure to determine whether it applies to a particular asset.

² Assumes asset placed in service after 1998. If placed in service before 1999, AMT depreciation is over the ADS recovery period.

³ The regular tax 15-year and ADS 39-year recovery periods for these types of property expired for assets placed in service after 2009. However, at the time this publication went to press, legislation was pending that would extend these provisions through 2010. Tax professionals should be alert to legislative activity in this area.

WHAT IS REAL PROPERTY?

Depreciable real property includes buildings and their structural components, other inherently permanent structures and certain land improvements. It does not include tangible personal property. Most depreciable realty is Section 1250 property, which does not qualify for the Section 179 deduction. However, some real property is classified as Section 1245 property and thus qualifies for the Section 179 deduction. Also, note that for real property classified as Section 1245 property, all depreciation is recaptured when the property is sold. In contrast, for Section 1250 property, depreciation is recaptured only to the extent the amount claimed was greater than straight-line. See Tab 8 for more on depreciation recapture.



Special (Bonus) Depreciation for Real Property

2012

Certain new property placed in service during 2008–~~2010~~ qualifies for a special (bonus) depreciation allowance [IRC §168(k)]. See *Special (Bonus) Depreciation Allowance* on Page 2-10 for details. Generally, to be eligible, property must have a recovery period of 20 years or less, so most real property will not qualify for special (bonus) depreciation. However, the following real property has a recovery period of 20 years or less and therefore can qualify for special (bonus) depreciation (provided all other requirements are met):

- Billboards (see *Billboards* in the next column).
- Retail fuel outlets (see *Retail motor fuels outlet* on Page 7-3).
- Farm buildings and single purpose agricultural and horticultural structures (see *Farm Buildings* on Page 7-3).
- Land Improvements, such as sidewalks, fences and roads (see *Land Improvements* on Page 7-4).
- Qualified leasehold improvement property (see *Qualified leasehold improvements eligible for special (bonus) depreciation* on Page 7-7).

In addition, real property used in specific activities may be assigned a recovery period of 20 years or less under Revenue Procedure 87-56.

Caution: Qualified restaurant property and qualified retail improvement property do not qualify for special (bonus) depreciation. [IRC §168(e)(7)(B) and 168(e)(8)(D)]

Structures That Are Not Buildings

While a building's structural components are considered part of the building and thus, Section 1250 property, structures that are essentially items of machinery or equipment are not. Likewise, structures that house an asset used as an integral part of an activity should not be treated as a building if the structure's use is closely related to the asset's use. This may be the case if:

- 1) It is expected that the structure will be replaced when the asset it initially houses is replaced,
- 2) The structure is specially designed to withstand the stress and other demands of the asset it houses or
- 3) The structure cannot be used economically for other purposes.

Thus, structures such as oil and gas storage tanks, grain storage bins, silos, fractionating towers, blast furnaces, basic oxygen furnaces, coke ovens, brick kilns and coal tipples are not treated as buildings. These structures are generally assigned a recovery period based on the activity in which they are used. See Revenue Procedure 87-56 (reproduced in Tab 12).

Observation: The depreciation rules for real property are generally less favorable than for personal property. Therefore, when a building is purchased, built or renovated, it is important to identify any personal property qualifying for more favorable depreciation included in the cost. See *Finding Personal Property Included in a Building's Cost (Cost Segregation)* on Page 7-9.

OPEN-AIR PARKING STRUCTURES

Open-air parking structures have been classified by some taxpayers as land improvements and depreciated over 15 years. However, the IRS recently clarified in a Coordinated Issue Paper (CIP) that they fall under the definition of buildings in Regulation Section 1.48-1(e) and, as such, are nonresidential real property with a recovery period of 39 years. (CIP LMSB4-0709-029)

Description of property. Open-air parking structures are typically multi-level parking structures accessed by a ramp system. They have at least two sides that are a minimum 50% open to the outside because they were designed to eliminate the need for heating and ventilation systems. Drivers and passengers are protected from rain, ice and wind, to some degree.

These parking structures typically have the following features:

- Hydraulic elevators.
- Internal stairwells.
- Interior lighting.
- Fire sprinklers.
- Signage to facilitate safe and speedy evacuations during an emergency.
- A separate area or room for electric metering and switching.



Caution: The CIP concludes that, given the lack of support for a position of depreciating open-air parking structures over 15 years, taxpayers may be assessed an accuracy-related penalty under Section 6662. While the CIP is unofficial IRS guidance, it does indicate that the IRS is likely to assess such a penalty. Thus, practitioners may want to consider filing a change in accounting method for taxpayers who are depreciating these structures over 15 years. See Tab 10 for details.

BILLBOARDS

Billboards are classified as Section 1245 (personal property) or 1250 (land improvements) based on whether or not they are inherently permanent (Rev. Rul. 80-151). See *Can the Asset Be Moved?* on Page 7-10 for factors for determining whether an asset is inherently permanent.

In Revenue Ruling 80-151, the IRS found that wooden billboards consisting of a single sign face (made of plywood) nailed to 30-foot poles set in the ground and secured by concrete rings were tangible personal property. An illuminated sign attached to a welded steel frame bolted to a five-foot in diameter steel support column was not tangible personal property. The steel support column was bolted to a steel reinforced concrete foundation that was embedded in the soil five feet deep. The sign was designed to withstand 100 mile-per-hour winds.

Billboards have a 15-year recovery period and are depreciated using the 150% declining balance method regardless of whether they are Section 1245 or 1250 property. However, a billboard that is classified as Section 1245 property qualifies for the Section 179 expensing election (see Tab 5). Also, all depreciation generally must be recaptured if a Section 1245 asset is sold, while only the excess over SL is recaptured for Section 1250 property.

Land and environmental surveys. These studies generally cover the entire property being developed, not just where the buildings and improvements will be placed. Surveys that help define the property (for example, boundary or mortgage surveys) are related to the land itself and are not depreciable.

Other surveys such as percolation tests and contamination studies are used to determine if a structure can properly be built on the site.

- If the survey will not necessarily need to be redone when the depreciable improvement is replaced, the cost of the survey is associated with the land and, therefore, is not depreciable.
- A survey that must be redone when the depreciable improvement is replaced is added to the basis of the improvement.

Exception: The existence of an ordinance requiring that the survey be redone does not mean that the improvement's replacement requires the survey to be replaced. (Ltr. Rul. 200043016)

ENERGY-EFFICIENT COMMERCIAL BUILDING DEDUCTION

Taxpayers that own or lease commercial buildings may deduct, rather than capitalize (and depreciate), all or part of the cost of qualifying energy-efficient commercial building property (IRC §179D). The deduction is allowed for both new and existing buildings but only for qualifying property placed in service after 2005 and before 2014.

Qualifying Property

Energy-efficient commercial building property is depreciable property that is:

- Installed on or in a building located in the U.S. that is not a (1) single-family house, (2) multi-family structure of three stories or fewer above grade, (3) mobile home or (4) manufactured house.
- Part of the (1) interior lighting system, (2) heating, cooling, ventilation and hot water systems or (3) building envelope. Building envelope includes insulation materials primarily designed to reduce heat loss or gain, exterior windows, skylights, exterior doors and some metal roofs. [IRC §25C(c)(2)]
- Certified that it will reduce or is part of a plan to reduce the overall energy costs of these systems by 50% or more.



Certification

Before claiming the deduction, the property must be certified as meeting the requirements by an unrelated, qualified and licensed engineer or contractor. Taxpayers must retain the certification in their tax records.

Deduction Amount

The maximum allowable deduction for any building is \$1.80 per building square footage. This is an aggregate limit over all tax years so once it is reached, no further deductions for that building are allowed.

Example: Jack operates his sole proprietorship in a small office building he owns. Jack places in service \$3,000 of qualified energy saving property in 2009 and \$6,000 in 2010. The building has 3,000 square feet.

Jack's total deduction for the expenditures is limited to \$5,400 (3,000 square feet × \$1.80). Therefore, he deducts the full \$3,000 spent in 2009 and \$2,400 (\$5,400 – \$3,000) spent in 2010. The remaining 2010 costs of \$3,600 (\$6,000 – \$2,400) must be capitalized and depreciated.

Partially qualifying property. Property that would otherwise qualify, except that it does not meet the 50% energy reduction test, is still eligible for a reduced deduction, limited to 60¢ times the building square footage. [IRC §179D(d)]

Observation: The partial deduction is allowed for any energy-saving property installed in an eligible building system (interior lighting; heating, cooling, ventilation and hot water; or building envelope) if it meets the energy-saving target prescribed for that particular system, even if the overall 50% cost reduction is not achieved with regard to the building. See Notices 2006-52 and 2008-40 for the system-specific requirements for partially qualifying property.



Reporting. C corporations, S corporations and partnerships claim the deduction on the Other Deductions line of their respective returns. Presumably, individuals report the deduction on the Other Expense line of Schedule C, E or F.

Basis reduction. If a deduction is allowed, the basis of the property is reduced by the amount of the deduction.

Recapture. The energy-efficient commercial building deduction is subject to Section 1245 ordinary income recapture when the building or property is sold [IRC §1245(a)(2)(C)]. Thus, when the building is sold, gain to the extent of the deduction is taxed as ordinary income.

Public buildings. When qualified property is installed on or in property owned by a federal, state or local government, the related energy-efficient commercial building deduction is allocated to the person primarily responsible for designing the property instead of the actual building owner (the tax-exempt governmental unit). Public buildings include those owned by public schools. See Notice 2008-40 for how this rule works.

Note: The Commercial Building Tax Deduction Coalition website at www.efficientbuildings.org has more details on this deduction.

BUILDERS OF ENERGY-EFFICIENT NEW HOMES CREDIT

Caution: The following rules that applied after 2009 now also apply to 2010. Tax professionals should be alert to legislative activity in this area.

Contractors (including producers of manufactured homes) that built new energy-efficient homes in the U.S. were eligible for a credit of \$2,000 per dwelling unit (IRC §45L). The credit was reported on Form 8908, *Energy Efficient Home Credit*. Partnerships and S corporations transferred the amount to Schedule K. All others carried it to Form 3800, *General Business Credit*.

- To qualify, the dwelling unit must have been certified to have annual energy consumption for heating and cooling that was at least 50% less than comparable units and met certain other requirements.
- The credit could also apply to a substantial reconstruction and rehabilitation of an existing dwelling unit.
- A manufactured home that met a 30% reduced energy consumption standard could generate a \$1,000 credit.
- These credits only applied to homes sold by contractors for use as personal residences.
- The contractor's tax basis in the home was reduced by the amount of the credit.
- Construction must have been substantially completed after August 8, 2005, and the home must have been purchased after 2005 and before 2010. **2012**

Caution: Pending legislation would extend this credit to homes purchased before 2011. Tax professionals should be alert to legislative activity in this area.

Certification. The IRS has issued guidance on the certification process that builders must complete to qualify for the credit. The notices also provide a public list of software programs that may be used in calculating energy consumption for obtaining a certification. See Notice 2008-35 for standard homes rules. Notice 2008-36 covers manufactured homes.

NONBUSINESS ENERGY PROPERTY CREDIT

Taxpayers are allowed a nonrefundable credit equal to 30% of the cost of qualified energy-efficiency improvements and residential energy property expenditures for property placed in service in 2009 and 2010. The property must be new property, and it must be installed in or on the taxpayer's principal residence (including a manufactured home) in the U.S.

Caution: This credit was also available for 2006 and 2007, but not for 2008. The credit rate for 2009 and 2010 has been increased from 10% to 30%, and the limits that applied to the credit for many types of property have been eliminated for 2009 and 2010.

The allowable lifetime credit for any taxpayer for property placed in service in 2009 and 2010 is \$1,500.

Practice Tip: Both the nonbusiness energy property credit and the residential energy efficient property credit (discussed below) are reported on Form 5695, *Residential Energy Credits*.

Energy-Efficiency Improvements

These improvements are building envelope components, such as: [IRC §25C(c)(2)]

- 1) Insulation materials or systems designed to reduce the heat loss or gain of a dwelling unit;
- 2) Exterior doors and windows (including skylights); and
- 3) Metal or asphalt roofs installed on a dwelling unit (including manufactured homes), but only if they are designed to reduce the heat gain of such dwelling unit.

~~**Caution:** At the time this publication went to press, legislation was pending that would require exterior doors, windows and skylights placed in service 90 days after the enactment date of the legislation to meet the recently updated Energy Star requirements to qualify for this credit. A transition rule would apply. Tax professionals should be alert to legislative activity in this area.~~

Residential Energy Property Expenditures

Expenditures must be for the following types of property (including labor costs to install the property): [IRC §25C(d)(2)]

- 1) Energy-efficient building property (such as certain electric heat pumps, water heaters, biomass fuel stoves and central air conditioners);
- 2) A qualified natural gas, propane or oil furnace or hot water boiler; or
- 3) An advanced main air circulating fan.

Example: In 2010, Jane has a new heat pump installed in her home that meets the energy efficiency requirements outlined in Section 25C. The heat pump is the only qualifying nonbusiness energy property placed in service in 2009 or 2010. She pays \$3,500 for the installed unit. Jane can take a tax credit of \$1,050 (30% × \$3,500) for energy-efficient building property on her 2010 Form 1040.

Certification Requirements

Taxpayers must receive a proper certification from the manufacturer for property on which they plan to take the credit. Notice 2009-53 provides that taxpayers may rely on the manufacturer's certification to claim the credit, except as specified therein.

RESIDENTIAL ENERGY-EFFICIENT PROPERTY CREDIT

The credit is available for property placed in service before January 1, 2017, and there is no requirement that property be new to qualify. There are no dollar limitations and, except for fuel cells, the property does not have to be installed on the taxpayer's principal residence; instead, any residence, including a vacation home, qualifies.

Observation: This is a more generous credit than the non-business energy property credit discussed above.

Costs must be for the following qualifying types of property: [IRC §25D(a)]

- 1) Solar electric property,
- 2) Solar water heating property,
- 3) Fuel cell property,
- 4) Small wind energy property and
- 5) Geothermal heat pump property.



LEASEHOLD IMPROVEMENTS

Who Claims the Deduction?

A landlord (lessor) generally can depreciate property leased to a tenant (lessee) as well as any improvements that the landlord makes to the property during the lease term [Reg. §1.167(a)-4]. No depreciation can be claimed if the lease is treated as a capital lease for tax. In that case, the tenant is treated as the owner for tax purposes and claims the depreciation deductions. If the tenant is only obligated to repair and maintain the property, the lease is generally not a capital lease and the landlord can still claim depreciation on the property. See Tab 1 for details on who depreciates leased property.

Depreciating Leasehold Improvements

Capitalized improvements made during the lease generally must be depreciated over the improvement's recovery period, not over the remaining term of the lease [IRC §168(i)(8)]. It doesn't matter whether the landlord (lessor) or tenant (lessee) makes the improvements.

Leasehold improvements that are structural components of the building generally have a 27.5-year or 39-year recovery period. See *Qualified Leasehold Improvements and Qualified Restaurant Property* on Page 7-8 and *Qualified Retail Improvement Property* on Page 7-9 for possible exceptions. Also, some improvements (such as carpeting or moveable partitions) have a shorter recovery period because they are considered tangible personal property rather than structural components of the building. See *Can the Asset Be Moved?* on Page 7-10.



2012

Qualified leasehold improvements eligible for special (bonus) depreciation. Certain assets placed in service during 2008–2010 qualify for a special (bonus) depreciation allowance. See *Special (Bonus) Depreciation Allowance* on Page 2-10 for details. Leasehold improvements can qualify if they are: [IRC §168(k)(3)]

- 1) Made to an interior portion of a nonresidential building,
- 2) Made pursuant to a lease by the tenant (or subtenant) or landlord to property that will be occupied exclusively by the tenant (or subtenant) and
- 3) Placed in service more than three years after the date the building was first placed in service.

Caution: Costs attributable to enlarging the building, any elevator or escalator, any structural component benefiting a common area or the building's internal structural framework do not qualify for special (bonus) depreciation. [IRC §168(k)(3)(B)]

after 2008

See Reg. §1.168(k)-1(c) for details on qualified leasehold improvements. Although that regulation discusses the 50% and 30% special (bonus) depreciation rules that were in effect for property placed in service after September 10, 2001 and (generally) before 2005, the IRS has announced that taxpayers can rely on the regulations for computing special (bonus) depreciation for assets placed in service in 2008. (News Release IR-2008-58)

Note: Although the IRS has not specifically stated taxpayers can rely on the regulations for assets placed in service in 2009 and 2010, presumably the IRS will treat those assets the same as those placed in service in 2008.

Tenant improvements. Generally, improvements made by a tenant/lessee are capitalized and depreciated by the tenant over the improvement's MACRS recovery period [IRC §168(i)(8)]. However, if the lease agreement provides that the cost of improvements made by a tenant is credited against rent payments due, the tenant deducts the cost of improvements made to the owner's property as rent expense. [Brown, 47 AFTR 244 (7th Cir. 1955)]

What Happens at the End of the Lease?

If improvements made by the tenant are left behind at the end of the lease, the tenant takes an abandonment loss. The amount equals the adjusted basis of the improvements. The abandoned improvements generally become the landlord's property. However, the landlord generally is not required to include the value of the improvements in income. (IRC §109)

Example #1: Walter leases a commercial building from Taylor Properties, Inc. (TPI). The lease is for five years and is non-renewable. On January 1 of the fourth year of the lease, Walter adds permanent exterior doors and replaces the building's windows, spending \$10,000. His rent payments are not credited for the cost of the improvements. He must depreciate the \$10,000 of improvements over the building's recovery period (39 years), even though the lease will end (and the improvements will become TPI's property) after two more years. When the lease terminates, Walter will have taken two years of depreciation on the leasehold improvements, so his adjusted basis in them will be \$9,498 (\$10,000 - \$246 - \$256). That amount can be claimed as an abandonment loss in the year the lease terminates, assuming Walter does not salvage or retain any of the improvements.

When the landlord makes improvements to leased property, the remaining basis in the improvements are written off at the end of the lease term only if they are disposed of or abandoned at that time [IRC §168(i)(8)]. If the improvements are not abandoned or disposed of, the landlord continues to depreciate them.

Example #2: Walter owns a commercial building that he leased to a veterinarian for five years. Under the lease agreement, Walter had to make certain improvements to the building to make it suitable for the vet's practice (for example, adding covered area with fenced pens, "doggie doors," etc.). At the end of the veterinarian's lease, Walter leases the building to an engineering firm. The additions made for the veterinarian are unsuitable for the engineering firm, so Walter removes them. He can take an abandonment loss (equal to his adjusted basis in the improvements that he removed) that year.

2012

Qualified Leasehold Improvements

Qualified leasehold improvements placed in service after October 22, 2004, and before 2010 have a 15-year recovery period [IRC §168(e)(3)(E)]. For 2010, qualified leasehold improvements have a recovery period of 39 years.



Caution: Although the 15-year recovery period expired for leasehold improvements placed in service after 2009, at the time this publication went to press, legislation was pending that would extend it through 2010. Tax professionals should be alert to legislative activity in this area.

Qualified leasehold improvements are depreciated SL for both regular tax and AMT, regardless of recovery period. [IRC §168(b)(3)]

A qualified leasehold improvement must meet all of the following tests: [IRC §168(k)(3)]

- 1) The improvement is to an interior portion of a building.
- 2) The building is nonresidential real property.
- 3) The improvement is made by the lessee (tenant), sublessee or the lessor (landlord) pursuant a lease agreement (or a commitment to sign a lease).
- 4) The improvement is made to space to be occupied exclusively by the lessee or sublessee.
- 5) The improvement is placed in service more than three years after the date the building was first placed in service (by any person).



Qualified leasehold improvements do not include any expenditure for enlarging the building, any elevator or escalator, any structural component benefiting a common area or the internal structural framework of the building. [IRC §168(k)(3)(B)]

Qualified leasehold improvements made by the landlord generally are not qualified leasehold improvements in the hands of any subsequent owner of the improvement unless the property is transferred at the landlord's death or in certain nonrecognition transactions, such as a like-kind exchange. [IRC §168(e)(6)]

Caution: Improvements made under a lease between related persons cannot be qualifying leasehold improvements. Related persons include members of an affiliated group as well as spouses, siblings, children, grandchildren, parents and grandparents and certain controlled entities (for example, shareholder and corporation, if the shareholder directly or indirectly owns more than 80% of the stock).

Law Change Alert: Qualified leasehold improvements placed in service in a tax year beginning in 2010 or 2011 are eligible for Section 179 expensing. See *Qualified real property* on Page 5-5 for further discussion.

2012

Qualified Restaurant Property

Qualified restaurant property placed in service after October 22, 2004, and before 2010 is depreciated SL over 15 years [IRC §168(b)(3) and (e)(3)(E)]. For 2010, qualified restaurant property has a recovery period of 39 years.

Caution: Although the 15-year recovery period expired for property placed in service after 2009, at the time this publication went to press, legislation was pending that would extend it through 2010. Tax professionals should be alert to legislative activity in this area.

after 2008

Qualified restaurant property is any Section 1250 improvement to a building if more than 50% of the building's square footage is devoted to the preparation of, and seating for, on-premises consumption of prepared meals. [IRC §168(e)(7)]

For property placed in service in 2009, the definition of qualified restaurant property is expanded to include buildings as well as improvements. In addition, improvements placed in service before 2009 had to be placed in service more than three years after the date the underlying building was placed in service to be qualified restaurant property—this requirement is removed for improvements placed in service in 2009. [IRC §168(e)(7)]

after 2008

Law Change Alert: Qualified restaurant property placed in service in a tax year beginning in 2010 or 2011 is eligible for Section 179 expensing. See *Qualified real property* on Page 5-5 for further discussion.

Qualified Retail Improvement Property

Qualified retail improvement property placed in service in ~~2009~~ is depreciated SL over 15 years [IRC §168(b)(3) and (e)(3)(E)]. ~~For 2010, qualified retail improvement property has a recovery period of 39 years.~~

~~**Caution:** Although the 15-year recovery period expired for property placed in service after 2009, at the time this publication went to press, legislation was pending that would extend it through 2010. Tax professionals should be alert to legislative activity in this area.~~

Qualified retail improvement property is any improvement to an interior portion of a building that is nonresidential real property if: [IRC §168(e)(8)]

- 1) That portion is open to the general public and is used in the retail trade or business of selling tangible personal property to the general public and
- 2) The improvement is placed in service more than 3 years after the date the building was first placed in service.

Law Change Alert: Qualified retail improvement property placed in service in a tax year beginning in 2010 or 2011 is eligible for Section 179 expensing. See *Qualified real property* on Page 5-5 for further discussion.

FINDING PERSONAL PROPERTY INCLUDED IN A BUILDING'S COST (COST SEGREGATION)

What Is Cost Segregation?

When a building used for business or investment is bought, constructed or renovated, it is important to allocate the costs incurred to the appropriate asset. Often, some of the cost will be attributable to assets (either personal property or land improvements) that can be depreciated using much more favorable rules than the straight-line method and 27.5-year or 39-year recovery period assigned to most buildings.

Example: Walter purchases a restaurant building on January 20 for \$200,000. Based on a 39-year life, his first year depreciation deduction is \$4,914 ($\$200,000 \div 39 \times 11.5/12$).

Variation: Assume that shortly after the building is purchased, Walter determines that \$90,000 of his cost is properly allocated to drive-up windows and order-taking equipment that should be depreciated over five years. Then, his depreciation deduction for the first year would be:

39-year property	$110,000 \div 39 \times 11.5/12$	\$ 2,703
Five-year property	$90,000 \times 20\%$	18,000
Total		\$ 20,703

Properly allocating costs to the five-year property allows Walter to recover \$90,000 of his investment over a five-year recovery period, rather than over 39 years. Even better, Walter could claim special (bonus) depreciation (if the assets qualified) or could elect to expense the \$90,000 of equipment under Section 179 (if he had not already claimed the deduction for other assets). See Tab 2 for more on special (bonus) depreciation and Tab 5 for more on Section 179.

A cost segregation study is an analysis of the assets constructed, acquired or renovated to properly allocate costs to the appropriate assets. Obviously, the intent is to allocate as much cost as possible to shorter-lived Section 1245 (generally tangible, personal) property.

Observation: For large projects (generally, costs over \$500,000), a firm specializing in cost segregation studies is typically engaged to do the study. These firms usually employ engineers and other specialists who are capable of identifying and classifying different types of assets. The tax savings associated with the additional depreciation claimed or the acceleration of depreciation deductions often far exceeds the cost of the analysis.

For smaller projects, the tax professional can often get enough information from the client to break out some assets that are personal property or land improvements. However, when this approach is used, the IRS may challenge it unless the professional can show that the remaining costs (those allocated to the building) are reasonable. See *IRS's View of Cost Segregation Studies* on Page 7-11 for details.

General Steps for Cost Segregation

A three-step allocation process enables taxpayers to assign as much cost as possible to depreciable property, or property with recovery periods that are much shorter than the MACRS 39-year and 27.5-year lives normally assigned to buildings. The three steps are as follows:

- 1) Making an initial land-to-building cost allocation.
- 2) Identifying land improvement costs.
- 3) Analyzing building costs to identify assets that are not part of the building or a structural component.

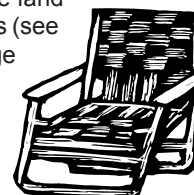


Observation: The timing of the study is important. The closer in time it is to the acquisition (or construction or renovation), the more credibility it will generally have. However, in some cases, the tax return will be filed before a study can be completed. Any change to depreciation after a return has been filed to reflect the results of a cost segregation study is a change in accounting method [Reg. §1.446-1(e)(2)]. However, the IRS grants automatic consent to make this change by filing a Form 3115 along with the return for the year the change is effective. A copy of the Form 3115 must also be filed with the IRS national office. See Tab 10 and Revenue Procedure 2008-52 for details on making the accounting method change.

Making the initial land-to-building cost allocation. The first step to maximizing depreciation deductions is to make an initial cost allocation between land and building. The allocation should be based on relative FMVs [Reg. §1.167(a)-5]. This cost allocation may be agreed upon between the buyer and seller and included in the sales contract, but will not be binding unless it is based on arm's-length bargaining. Also, if the acquisition of the property is part of the acquisition of a trade or business (under Section 1060), the cost allocation must agree to what the buyer and seller report on Form 8594, *Asset Acquisition Statement*.

Absent a qualified appraisal, taxpayers can use any reasonable method provided it is realistic and supportable. However, a taxpayer may not allocate cost to land and building solely based on property tax assessed values when better evidence exists to determine the FMV of each. (Ltr. Rul. 9110001)

This initial allocation is critical in that it will establish the amount that may be depreciated, unless some of the land cost can be designated as land improvements (see *Identifying land improvement costs* on Page 7-10). Thus, any shift from nondepreciable land to building or other depreciable property results in a permanent increase in the amount of depreciation that can be claimed on the property.



Guide to Assets Used in Casino/Hotel Industry
Per IRS Cost Segregation Audit Techniques Guide
(Continued)

Asset	Description	Property Type (Section)	Asset Class/ ¹ Recovery Period ²
Wall Coverings – (Continued)	Includes strippable wall paper and vinyl that causes no damage to the underlying wall or wall surface and located in the Casino area. For purposes of this directive, such wallpaper is considered not permanently attached or intended to be permanent. Also includes strippable wall coverings associated with the activities described in Asset Class 79.0 of Rev. Proc. 87-56, such as Theater and Showroom.	1245	79.0 Recreation/ 7 years
	Includes strippable wall paper and vinyl that causes no damage to the underlying wall or wall surface and located in the hotel and retail areas. For purposes of this directive, such wallpaper is considered not permanently attached or intended to be permanent.	1245	57.0 Distributive Trades and Services/ 5 years

¹ Per Revenue Procedure 87-56 (reproduced in Tab 12).

² A 15-year straight-line recovery period may replace the recovery period shown in the table above if the asset is described at *Qualified Leasehold Improvements* or *Qualified Restaurant Property* on Page 7-8 or at *Qualified Retail Improvement Property* on Page 7-9. ~~Although the 15-year recovery period expired for property placed in service after 2009, at the time this publication went to press, legislation was pending that would extend it through 2010. Tax professionals should be alert to legislative activity in this area.~~

Guide to Assets Used in the Restaurant Industry
Per IRS Cost Segregation Audit Techniques Guide

Asset	Description	Property Type (Section)	Asset Class/ ¹ Recovery Period ²
Beverage Equipment	Equipment for storage and preparation of beverages and beverage delivery systems. Beverage equipment includes the refrigerators, coolers, dispensing systems and the dedicated electrical, tubing or piping for such equipment. The dispensing system may be gravity, pump or gas driven.	1245	57.0 Distributive Trades and Services/5 Years
Canopies and Awnings	Readily removable overhang or covering, often of canvas or plastic, used to provide shade or cover over a storefront, window or door; or used inside a structure to identify a particular area. For example, applications over an exterior door or window, or attached to interior walls or suspended from ceilings to identify a buffet line or bar area of the restaurant. Does not include canopies that are an integral part of a building's structural shell, such as in the casino industry, or over docks.	1245	57.0 Distributive Trades and Services/5 Years
Ceilings	Includes all interior ceilings regardless of finish or décor, for example drywall or plaster ceilings, acoustic ceilings, suspended ceilings (including all hangers, frames, grids and tiles or panels), decorative metal or tin finishes, kitchen plastic panels, decorative panels, etc.	1250	Building or Building Component/39 Years
Computers	Processors (CPU), direct access storage device (DASD), tape drives, desktop and laptop computers, CRT, terminals, monitors, printers and other peripheral equipment. Excludes Point of Sale (POS) systems and computers that are an integral part of other equipment (for example, fire detection, heating, cooling or energy management systems, etc.).	1245	00.12 Information Systems/5 Years
Concrete Foundations and Footings	Includes formwork, reinforcement, concrete block and pre-cast or cast-in-place work related to foundations and footings necessary for the proper setting of the building.	1250	Building or Building Component / 39 Years
	Foundations or footings for signs, light poles, canopies and other land improvements (except buildings).	1250	00.3 Land Improvements/ 15 Years
Data Handling Equipment	Includes adding and accounting machines, calculators, copiers and duplicating machines. Excludes computers and computer peripheral equipment. (See <i>Computers</i> above).	1245	00.13 Data Handling Equipment, except Computers/ 5 Years
Doors	Interior and exterior doors, regardless of decoration, including but not limited to, double opening doors, overhead doors, revolving doors, mall entrance security gates, roll-up or sliding wire mesh or steel grills and gates, and door hardware (such as doorknobs, closers, kick plates, hinges, locks, automatic openers, etc.).	1250	Building or Building Component/ 39 Years
	Special lightweight, double-action doors installed to prevent accidents in a heavily trafficked area. For example, Eliason doors providing easy access between the kitchen and dining areas.	1245	57.0 Distributive Trades and Services/ 5 Years
Doors—Air Curtains	Air doors or curtains are air systems located above doors and windows that circulate air to stabilize environments and save energy by minimizing the heated/air conditioned air loss through open doorways and windows. They also effectively repel flying insects, dust and pollutants.	1250	Building or Building Component/ 39 Years
Drive-Through Equipment	Drive-through equipment includes order taking, food delivery and payment processing systems whether mechanical or electronic. Excludes building elements such as doors, bays or windows. (See <i>Walls—Exterior</i> on Page 7-24 and <i>Windows</i> on Page 7-24 for drive-through bays and windows.)	1245	57.0 Distributive Trades and Services/ 5 Years
Electrical	Includes all components of the building electrical system used in the operation or maintenance of the building or necessary to provide general building services such as electrical outlets of general applicability and accessibility, lighting, heating, ventilation, air conditioning and electrical wiring. (See <i>Kitchen Equipment Hook-Ups</i> on Page 7-21).	1250	Building or Building Component / 39 Years

Table continued on the next page

Guide to Assets Used in the Restaurant Industry
Per IRS Cost Segregation Audit Techniques Guide
(Continued)

Asset	Description	Property Type (Section)	Asset Class/ ¹ Recovery Period ²
Trash Enclosures	Enclosures for waste receptacles that are attached to the building. Typically constructed of the same materials as the building shell with either interior or exterior access. These trash enclosures are an integral part of the building shell and cannot be moved without damage to the underlying building.	1250	Building or Building Component / 39 Years
	Freestanding enclosures for waste receptacles, typically constructed on a concrete pad with its posts set in the concrete. Serves both safety and decorative functions.	1250	00.3 Land Improvements / 15 Years
Upholstery	Any material used in the coverage and protection of furnishings.	1245	57.0 Distributive Trades and Services / 5 Years
Wall Coverings	Includes interior and exterior paint; ceramic or quarry tile, marble, stone, brick and other finishes affixed with mortar, cement or grout; paneling, wainscoting and other wood finishes affixed with nails, screws or permanent adhesives; and sanitary kitchen wall panels such as Fiberglass Reinforced Plastic (FRP), stainless steel or plastic wall panels.	1250	Building or Building Component / 39 Years
	Strippable wallpaper that causes no damage to the underlying wall or wall surface.	1245	57.0 Distributive Trades and Services / 5 Years
Walls—Exterior	Includes all exterior walls and building support regardless of construction materials. Exterior walls may include columns, posts, beams, girders, curtain walls, tilt up panels, studs, framing, sheetrock, insulation, windows, doors, exterior façade, brick, masonry, etc. Also includes drive-through bay, windows and doors.	1250	Building or Building Component / 39 Years
Walls—Interior Partitions	Includes all load-bearing interior partitions regardless of construction. Also includes non-load-bearing partitions regardless of height (typically constructed of studs and sheetrock or other materials) that divide or create rooms or provide traffic control. Includes rough carpentry and plaster, dry wall or gypsum board, and other finishes.	1250	Building or Building Component / 39 Years
	Interior walls where the partition can be (1) readily removed and remain in substantially the same condition after removal as before, or (2) moved and reused, stored or sold in its entirety.	1245	57.0 Distributive Trades and Services / 5 Years
Windows	Exterior windows, including store front windows, drive-through service and carousel windows, and vestibule.	1250	Building or Building Component / 39 Years
Window Treatments	Window treatments such as drapes, curtains, louvers, blinds, post construction tinting or interior decorative theme décor that are readily removable.	1245	57.0 Distributive Trades and Services / 5 Years

¹ Per Revenue Procedure 87-56 (reproduced in Tab 12).

² A 15-year straight-line recovery period may replace the recovery period shown in the table above if the asset is described at *Qualified Leasehold Improvements* or *Qualified Restaurant Property* on Page 7-8 or at *Qualified Retail Improvement Property* on Page 7-9. **Although the 15-year recovery period expired for property placed in service after 2009, at the time this publication went to press, legislation was pending that would extend it through 2010. Tax professionals should be alert to legislative activity in this area.**

Guide to Assets Used in a Retail Business
Per IRS Cost Segregation Audit Techniques Guide

Asset	Description	Property Type (Section)	Asset Class/ ¹ Recovery Period ²
Awnings and Canopies	Readily removable overhang or covering, often of canvas or plastic, used to provide shade or cover over a storefront, window or door; or used inside a structure to identify a particular department or selling area. Examples include applications over an exterior door or window, or attached to interior walls or suspended from ceilings for bakery, deli, floral, meat or produce departments. Also includes canopies designed to protect customers and gasoline fueling equipment from weather conditions and to act as advertising displays that are anchored with bolts and are not attached to buildings or other structures. Does not include canopies that are an integral part of a building's structural shell, such as in the casino industry or over docks. (See <i>Concrete Foundations and Footings</i> on Page 7-25 and <i>Loading Docks</i> on Page 7-26.)	1245	57.0 Distributive Trades and Services / 5 Years
Beverage Equipment	Equipment for storage and preparation of beverages and beverage delivery systems. Beverage equipment includes the refrigerators, coolers, dispensing systems and the dedicated electrical, tubing or piping for such equipment. The dispensing system may be gravity, pump or gas driven. (See <i>Refrigerated Structures</i> on Page 7-27.)	1245	57.0 Distributive Trades and Services / 5 Years
Ceilings	Includes all interior ceilings regardless of finish or décor; for example drywall or plaster ceilings, acoustic ceilings, suspended ceilings (including hangers, frames, grids and tiles or panels), decorative metal or tin finishes, plastic panels, decorative panels, etc. (See <i>Awnings and Canopies</i> above, <i>Millwork—Decorative</i> on Page 7-26 and <i>Millwork—General Building or Structural</i> on Page 7-26.)	1250	Building or Building Component / 39 Years

Table continued on the next page

Guide to Assets Used in a Retail Business
Per IRS Cost Segregation Audit Techniques Guide
(Continued)

Asset	Description	Property Type (Section)	Asset Class/ ¹ Recovery Period ²
Site Preparation, Grading and Excavation	In general, land preparation costs include the one time cost of clearing and grubbing, site stripping, fill or excavation, and grading to allow development of land. Clearing and grubbing is the removal of debris, brush, trees, etc. from the site. Stripping is the removal of the topsoil to provide a stable surface for site and building improvements. The grading of land involves moving soil for the purpose of producing a more level surface to allow development of the land.	N/A	Land
	Clearing, grading, excavating and removal costs directly associated with the construction of buildings and building components are part of the cost of construction of the building and depreciated over the life of the building.	1250	Building or Building Component/ 39 Years
	Clearing, grading, excavating and removal costs directly associated with the construction of sidewalks, parking areas, roadways and other depreciable land improvements are part of the cost of construction of the improvements and depreciated over the life of the associated asset.	1250	00.3 Land Improvements/ 15 Years
Site Utilities	Site utilities are the systems that are used to distribute utility services from the property line to the retail building. Includes water, sanitary sewer, gas and electrical services.	1250	Building or Building Component/ 39 Years
Site Work	Site work includes curbing, paving, general site improvements, fencing, landscaping, roads, sewers, sidewalks, site drainage and all other site improvements not directly related to the building. For sanitary sewers, see <i>Site Utilities</i> above.	1250	00.3 Land Improvements / 15 Years
Sound Systems	Equipment and apparatus, including wiring, used to provide amplified sound or music. For example, public address by way of paging a customer or background music. Excludes applications linked to fire protection and alarm systems.	1245	57.0 Distributive Trades and Services/ 5 Years
Trash Enclosures	Enclosures for waste receptacles that are attached to the building. Typically constructed of the same materials as the building shell with either interior or exterior access. These trash enclosures are an integral part of the building shell and cannot be moved without damage to the underlying building.	1250	Building or Building Component/ 39 Years
	Freestanding enclosures for waste receptacles, typically constructed on a concrete pad with its posts set in the concrete. Serves both safety and decorative functions.	1250	00.3 Land Improvements / 15 Years
Wall Coverings	Includes interior and exterior paint; ceramic or quarry tile, marble, stone, brick and other finishes affixed with mortar, cement or grout; paneling, wainscoting and other wood finishes affixed with nails, screws or permanent adhesives; and sanitary kitchen wall panels such as fiberglass, stainless steel and plastic wall panels.	1250	Building or Building Component / 39 Years
	Strippable wallpaper that causes no damage to the underlying wall or wall surface.	1245	57.0 Distributive Trades and Services/ 5 Years
Walls—Exterior	Includes all exterior walls and building support regardless of construction materials. Exterior walls may include columns, posts, beams, girders, curtain walls, tilt up panels, studs, framing, sheetrock, insulation, windows, doors, exterior façade, brick, masonry, etc. Also includes drive-through bay, windows and doors.	1250	Building or Building Component / 39 Years
Walls—Interior Partitions	Includes all load bearing interior partitions regardless of construction. Also includes non-load bearing partitions regardless of height (typically constructed of studs and sheetrock or other materials) that divide or create rooms or provide traffic control. Includes rough carpentry and plaster, dry wall or gypsum board and other finishes.	1250	Building or Building Component / 39 Years
	Interior walls for merchandise display where the partition can be (1) readily removed and remain in substantially the same condition after removal as before or (2) moved and reused, stored or sold in their entirety.	1245	57.0 Distributive Trades and Services/ 5 Years
Windows	Exterior windows, including store front windows, drive-through service and carousel windows and vestibule.	1250	Building or Building Component / 39 Years
Window Treatments	Window treatments such as drapes, curtains, louver, blinds, post construction tinting and interior decorative theme décor which are readily removable.	1245	57.0 Distributive Trades and Services/ 5 Years

¹ Per Revenue Procedure 87-56 (reproduced in Tab 12).

² A 15-year straight-line recovery period may replace the recovery period shown in the table above if the asset is described at *Qualified Leasehold Improvements* or *Qualified Restaurant Property* on Page 7-8 or at *Qualified Retail Improvement Property* on Page 7-9. ~~Although the 15-year recovery period expired for property placed in service after 2009, at the time this publication went to press, legislation was pending that would extend it through 2010. Tax professionals should be alert to legislative activity in this area.~~

Guide to Assets Used in the Biotech/Pharmaceutical Industry
Per IRS Cost Segregation Audit Techniques Guide
(Continued)

Asset	Description	Property Type (Section)	Asset Class/ ¹ Recovery Period ²
Sidewalks and Curbs	Depreciable improvements directly to or added to land, whether such improvements are Section 1245 or 1250. Sidewalks and curbs are usually constructed of concrete, asphalt, stone or similar material.	1250 / 1245	00.3 Land Improvements ³
Signs	Exit signs, restroom identifiers, room numbers, fire lanes, building identification, and other signs relating to the operation or maintenance of a building.	1250	Building or Building Component / 39 Years
	Interior signs used to display directories of names, departments, etc. Not related to the operation or maintenance of a building. Exterior signs used to display names, symbols, directions, etc. For pylon signs, includes only the sign face and related dedicated wiring. See also <i>Poles and Pylons</i> on Page 7-32.	1245	Personal Property With No Class Life / 7 Years
Site Preparation, Grading and Excavation	Nondepreciable land preparation costs, in general, include the one time cost of demolition, clearing and grubbing, blasting, site stripping, fill or excavation, dewatering and grading to allow development of land. Clearing and grubbing is the removal of debris, brush, trees, etc. from the site. Stripping is the removal of the topsoil to provide a stable surface for site and building improvements. The grading of land involves moving soil for the purpose of producing a more level surface to allow development of the land. These costs would not have to be reincurred if the building was repaired, rebuilt or even torn down and replaced with some other type of building.	N/A	Land / Not Depreciable
	Depreciable clearing, grading, excavating and removal costs directly associated with and necessary for the proper setting of the building and building components are part of the cost of construction of the building. See also <i>Concrete Foundations and Footings</i> on Page 7-29.	1250	Building or Building Component / 39 Years
	Depreciable clearing, grading, excavating and removal costs directly associated with the construction of sidewalks, parking areas, roadways and other depreciable land improvements are part of the cost of construction of the improvements.	1250	00.3 Land Improvements ³
Site Utilities	Site utilities begin where the responsibility rests with the taxpayer and not the utility company which is providing the service. Site utilities end at either a building or other permanent structure. Site utilities also include any distribution systems between buildings or other permanent structures. The cost of the site utilities would not have to be reincurred if the building or other permanent structure was repaired, rebuilt, or even torn down and replaced with some other type of building. Typically the utilities provided would be electricity, natural gas, water, sewer and steam. See also <i>Electrical</i> on Page 7-29, <i>Plumbing</i> on Page 7-32 and <i>Gas and Sewer</i> on Page 7-30.	1250	Building or Building Component / 39 Years
	Drainage facilities and sewers that are not municipal sewers.	1250	00.3 Land Improvements ³
Sound Systems	Equipment and apparatus, including wiring, used to provide amplified sound or music (for example, public address by way of a paging system or background music). Excludes applications linked to fire protection and alarm systems.	1245	Personal Property With No Class Life / 7 Years
Trash Enclosures	Enclosures attached to the building for waste receptacles. Typically constructed of the same materials as the building shell with either interior or exterior access. These trash enclosures are an integral part of the building shell and cannot be moved without damage to the underlying building.	1250	Building or Building Component / 39 Years
	Freestanding enclosures, typically constructed on a concrete pad with its posts set in the concrete, for waste receptacles. Serves both safety and decorative functions.	1250	00.3 Land Improvements ³
Wall Coverings	Includes interior and exterior paint; ceramic or quarry tile, marble, stone, brick and other finishes affixed with mortar, cement, or grout; paneling, wainscoting and other wood finishes affixed with nails, screws or permanent adhesives; sanitary finishes such as Fiberglass Reinforced Plastic (FRP), stainless steel, or plastic; sound absorbing or fabric wall panels; and wall protection (such as bumpers, corner guards, etc.).	1250	Building or Building Component / 39 Years
	Strippable wallpaper that causes no damage to the underlying wall or wall surface.	1245	Personal Property With No Class Life / 7 Years
Walls—Exterior	All exterior walls and building support regardless of construction materials. Exterior walls may include columns, posts, beams, girders, curtain walls, tilt up panels, studs, framing, sheetrock, insulation, windows, doors, exterior façade, brick, masonry, etc.	1250	Building or Building Component / 39 Years
Walls—Interior	All load bearing interior partitions regardless of construction. Also includes non-load bearing partitions regardless of height (typically constructed of studs and sheetrock or other materials) that divide or create rooms or provide traffic control. Includes rough carpentry and finishes such as plaster, dry wall, gypsum board, concrete block, glass or metal.	1250	Building or Building Component / 39 Years
	Interior walls where the partition can be (1) readily removed and remain in substantially the same condition after removal as before or (2) moved and reused, stored or sold in their entirety.	1245	Personal Property With No Class Life / 7 Years
Window Treatments	Window treatments which are readily removable such as drapes, curtains, louvers, blinds, post construction tinting, etc.	1245	Personal Property With No Class Life / 7 Years
Windows	Exterior and interior windows.	1250	Building or Building Component / 39 Years

¹ Per Revenue Procedure 87-56 (reproduced in Tab 12).

² A 15-year straight-line recovery period may replace the recovery period shown in the table above if the asset is described at *Qualified Leasehold Improvements* or *Qualified Restaurant Property* on Page 7-8 or at *Qualified Retail Improvement Property* on Page 7-9. ~~Although the 15-year recovery period expired for property placed in service after 2009, at the time this publication went to press, legislation was pending that would extend it through 2010. Tax professionals should be alert to legislative activity in this area.~~

³ Some land improvements are included in activity classes in Revenue Procedure 87-56. If not used in an activity described in Revenue Procedure 87-56, land improvements have a 15-year recovery period.

⁴ The recovery period depends on the use of the property. See Revenue Procedure 87-56 for specific activities.

Guide to Assets Used in the Auto Dealership Industry
Per IRS Cost Segregation Audit Techniques Guide
(Continued)

Asset	Description	Property Type (Section)	Asset Class/ ¹ Recovery Period ²
Site Preparation Grading & Excavation (continued)	Clearing, grading, excavating and removal costs directly associated with the construction of buildings and building components are part of the cost of construction of the building and depreciated over the life of the building. This includes building the showroom facility on a mound foundation for higher visibility and enhanced visual impact for the dealership building.	1250	Building or Building Component / 39 Years
	Clearing, grading, excavating and removal costs directly associated with the construction of sidewalks, parking areas, roadways and other depreciable land improvements are part of the cost of construction of the improvements and depreciated over the life of the associated asset. Note: Asset Class 00.3 Land Improvements includes both Section 1245 and 1250 property per Rev. Proc. 87-56.	See Note	00.3 Land Improvements / 15 Years
Site Utilities	Site utilities are the systems that are used to distribute utility services from the property line to the building. Includes water, sanitary sewer, gas, electrical services, and data and communication lines.	1250	Building or Building Component / 39 Years
Site Work	Site work includes curbing, paving, general site improvements, fencing, depreciable landscaping, roads, sewers, sidewalks, site drainage and all other site improvements, such as storm water retention basins, not directly related to the building. See also <i>Landscaping & Shrubbery</i> on Page 7-36. For sanitary sewers, see <i>Site Utilities</i> above. Does not include land preparation costs. See also <i>Site Preparation Grading & Excavation</i> above. Note: Asset Class 00.3 Land Improvements includes both Section 1245 and 1250 property per Rev. Proc. 87-56.	See Note	00.3 Land Improvements / 15 Years
Sound Systems	Equipment and apparatus, including wiring, used to provide amplified sound or music. For example, public address by way of paging a customer or employee. Excludes applications linked to fire protection and alarm systems.	1245	57.0 Distributive Trades and Services / 5 Years
Trash Enclosures	Enclosures for waste receptacles that are attached to the building. Typically constructed of the same materials as the building shell with either interior or exterior access. These trash enclosures are an integral part of the building shell and cannot be moved without damage to the underlying building.	1250	Building or Building Component / 39 Years
	Freestanding enclosures for waste receptacles, typically constructed on a concrete pad with its posts set in the concrete. Serves both safety and decorative functions. Note: Asset Class 00.3 Land Improvements includes both Section 1245 and 1250 property per Rev. Proc. 87-56.	See Note	00.3 Land Improvements / 15 Years
Wall Coverings	Includes interior and exterior paint; ceramic or quarry tile, marble, stone, brick and other finishes affixed with mortar, cement or grout; paneling, wainscoting and other wood finishes affixed with nails, screws or permanent adhesives; and wall panels such as fiberglass, stainless steel and plastic wall panels.	1250	Building or Building Component / 39 Years
	Strippable wallpaper that causes no damage to the underlying wall or wall surface.	1245	57.0 Distributive Trades and Services / 5 Years
Walls - Exterior	Includes all exterior walls and building support regardless of construction materials. Exterior walls may include columns, posts, beams, girders, curtain walls, tilt up panels, studs, framing, sheetrock, insulation, windows, doors, exterior façade, brick, masonry, etc. Also includes drive-through bay, windows, and doors.	1250	Building or Building Component / 39 Years
Walls - Interior Partitions	Includes all load bearing interior partitions regardless of construction. Also includes non-load bearing partitions regardless of height (typically constructed of studs and sheetrock or other materials) that divide or create rooms or provide traffic control. Includes rough carpentry and plaster, dry wall or gypsum board, and other finishes	1250	Building or Building Component / 39 Years
	Interior walls where the partition can be 1) readily removed and remain in substantially the same condition after removal as before, or 2) intended to be moved and reused, stored, or sold in their entirety.	1245	57.0 Distributive Trades and Services / 5 Years
Windows	Exterior windows, including store front windows, and exterior glass partitions. Includes interior glass partitions from floor to ceiling or as a part of an interior wall.	1250	Building or Building Component / 39 Years
Window Treatments	Window treatments such as drapes, curtains, louver, blinds, post construction tinting and interior decorative theme décor which are readily removable.	1245	57.0 Distributive Trades and Services / 5 Years

¹ Per Revenue Procedure 87-56 (reproduced in Tab 12).

² A 15-year straight-line recovery period may replace the recovery period shown in the table above if the asset is described at *Qualified Leasehold Improvements* or *Qualified Restaurant Property* on Page 7-8 or at *Qualified Retail Improvement Property* on Page 7-9. ~~Although the 15-year recovery period expired for property placed in service after 2009, at the time this publication went to press, legislation was pending that would extend it through 2010. Tax professionals should be alert to legislative activity in this area.~~

Real Property Classified as Section 1245 Property	
Item	Examples
Nonresidential ACRS real property if accelerated ACRS depreciation was used.	A commercial building placed in service between 1981 and 1986 for which the taxpayer used the accelerated ACRS method.
Tangible property (except buildings and their structural components) used as any of the following: <ul style="list-style-type: none"> An integral part of manufacturing, production or extraction, or of furnishing transportation, communications, electricity, gas, water or sewage disposal services. A research facility in any of the above activities. A facility for bulk storage of fungible commodities in any of the above activities.¹ 	<ul style="list-style-type: none"> Oxygen furnaces. Brick kilns. Oil or gas storage tanks. Grain storage bins.
Real property (other than property included above) to the extent its basis was reduced by the deductions for: <ul style="list-style-type: none"> Certified pollution control facilities. (IRC §169) Section 179 expensing. Clean fuel vehicle refueling. (IRC §179A) Capital costs incurred to comply with Environmental Protection Agency sulfur regulations. (IRC §179B) Expensing election for qualified refinery property. (IRC §179C) Energy efficient commercial building deduction. (IRC §179D) Election to expense advanced mine safety equipment. (IRC §179E) Amortization of railroad grading and tunnel bores. (IRC §185, before repeal) Childcare facilities. (IRC §188, before repeal) Removal of architectural barriers to persons with disabilities and the elderly. (IRC §190) Tertiary injectant expenses. (IRC §193) Reforestation expenses. (IRC §194) 	Buildings or other depreciable or amortizable real property (for example, capitalized intangible drilling costs) for which any applicable deductions were claimed.
Single purpose agricultural (livestock) or horticultural structures.	A building specifically designed and used to breed chickens or hogs or to produce milk from dairy cattle.
Storage facilities (except buildings and their structural components) used to distribute petroleum or petroleum products.	Gasoline storage tanks at a service station.
Railroad grading or tunnel bores. [IRC §168(e)(4)]	Improvements made to construct or improve a roadbed or right-of-way for railroad track.
Qualified disaster expenses. [IRC §198A(d)]	Removal of debris or repair of buildings destroyed or damaged as a result of a federally declared disaster.

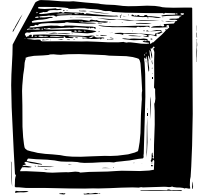
¹ Bulk storage means the storage of a commodity in a large mass before it is used. To be fungible, a commodity must be such that one part may be used in place of another. Stored materials that vary in composition, size and weight are not fungible. Materials are not fungible if they cannot be estimated and replaced by simple reference to weight, measure and number.



Gain Treated as Ordinary Income

The gain treated as ordinary income on the sale or exchange of Section 1245 property is the lesser of:

- 1) The depreciation and amortization allowed or allowable on the property (see *What Deductions Are Recaptured?* below).
- 2) The gain realized on the disposition (the amount realized from the disposition minus the adjusted basis of the property).



Use Part III of Form 4797 to figure the ordinary income part of the gain.

Example: Dakota Enterprises (DE) paid \$1,500 for a soft drink machine (Section 1245 property) for the employee's lounge. The machine was sold for \$700, after \$950 of depreciation had been claimed.

Gain is figured as follows:

Sales proceeds.....	\$ 700
Cost.....	\$ 1,500
Less: Accumulated depreciation.....	< 950>
Adjusted basis.....	< 550>
Gain.....	\$ 150
Ordinary income (lesser of gain or accumulated depreciation).....	\$ 150

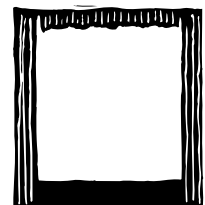
Variation: Now assume the soft drink machine is sold for \$1,800. Gain is figured as follows:

Sales proceeds.....	\$ 1,800
Cost.....	\$ 1,500
Less: Accumulated depreciation.....	< 950>
Adjusted basis.....	< 550>
Gain.....	\$ 1,250
Ordinary income (lesser of gain or accumulated depreciation).....	< 950>
Section 1231 gain.....	\$ 300

What Deductions Are Recaptured?

Depreciation and amortization that must be recaptured as ordinary income include (but are not limited to) the following items:

- 1) Ordinary depreciation deductions.
- 2) The 30% special (bonus) depreciation allowance for property acquired after September 10, 2001.
- 3) The 50% special (bonus) depreciation allowance for property acquired after May 5, 2003 and in 2008-~~2010~~. [IRC §168(k)(1)]
- 4) The 50% special (bonus) depreciation allowance for property placed in service in the Gulf Opportunity (GO) Zone after August 27, 2005 and in the Kansas Disaster Area after May 4, 2007.
- 5) The 50% special (bonus) depreciation allowance for property placed in service in the Midwestern Disaster Area after the applicable disaster date.
- 6) Qualified disaster expenses in any federally declared disaster area.
- 7) Amortization deductions for:
 - Acquiring a lease.
 - Lessee improvements.
 - Pollution control facilities.
 - Reforestation expenses.
 - Section 197 intangibles.
 - Childcare facility expenses made before 1982.
 - Franchises, trademarks and trade names acquired before August 11, 1993.



(or 100%)

2012

Special (Bonus) Depreciation Allowance

Both the exchanged basis and the excess basis (if any) qualify for special (bonus) depreciation if the replacement property qualifies. [Reg. §1.168(k)-1(f)(5)]

Section 179 Expense

Only the excess basis amount (generally, the amount of boot given) qualifies for Section 179 deduction (assuming it meets all the other requirements—see Tab 5). Section 179 expense cannot be taken on the exchanged basis in the replacement property. [Reg. §1.168(i)-6(g)]



Deferred Exchanges

A taxpayer who disposes of relinquished property before acquiring replacement property cannot depreciate the relinquished property's exchanged basis amount between the time the relinquished property is disposed of and the time the replacement property is acquired. During this period, the recovery period for the replacement property's exchanged basis amount is suspended.

Electing New Asset Treatment

Taxpayers can elect to treat the entire basis (that is, exchanged basis plus excess basis) in replacement property as a new asset placed in service on the date of exchange.

Electing New Asset Treatment for Replacement Property	
Reg §1.168(i)-6(i)	
Issue	Discussion
Relinquished property	Year-of-disposition depreciation on the relinquished property basis must be calculated and deducted.
Replacement property	The entire basis of the replacement property (both the exchanged basis and the excess basis, if any) is depreciated as the cost of newly acquired MACRS property that is placed in service at the time of replacement.
Special (bonus) depreciation	If the asset is eligible, the entire basis in the replacement property qualifies for special (bonus) depreciation. [See <i>Special (Bonus) Depreciation Allowance</i> above.]
Section 179 expense	Section 179 expense is available only for any excess basis in the replacement property. (See <i>Section 179 Expense</i> above).
Deferred exchanges	The depreciation deduction timing rules apply. (See <i>Deferred Exchanges</i> above.)

Making the election. The election is made on a per property basis, with a separate election made for each property in accordance with the Form 4562 instructions. The election must be made by the due date (including extensions) of the return for the year of replacement. Attach a statement indicating "Election Made under Regulation Section 1.168(i)-6(i)" for each asset involved in the exchange.

Example: RobinCo placed Building R (a retail building) in service in January 2002. In January 2010, RobinCo exchanges Building R for Tower S (a radio transmitting tower) in a like-kind exchange. Since replacement Tower S has a shorter recovery period (15 years) than relinquished Building R (39 years), Tower S's exchanged basis amount must be depreciated over Building R's longer remaining recovery period (31 years) under the general rules.

Also, since replacement Tower S's depreciation method (150% declining balance) is faster than the method for relinquished Building R (straight-line), Tower S must be depreciated using straight-line (the slower method).

Therefore, under the general rule, RobinCo would depreciate replacement Tower S's exchanged basis amount over 31 years (the remaining recovery period for relinquished Building R) using the straight-line method.

However, RobinCo could elect out of the general rule and treat Tower S as newly acquired property placed in service in January 2010. RobinCo could then depreciate Tower S's exchanged and excess basis amounts over 15 years using the 150% declining balance method. Electing out would be beneficial in this case.

Depreciation recapture taint. If the taxpayer elects out of the general rule, the exchanged basis and excess basis are often shown as one new asset on the depreciation schedule. The cost and accumulated depreciation of the relinquished property are often not reflected. However, upon eventual disposition of the replacement property, Section 1245 or 1250 depreciation recapture is measured based on the property's recomputed basis, including all adjustments for prior depreciation or amortization (including depreciation on the relinquished property). In other words, electing to depreciate a replacement asset as a new asset does not remove the depreciation recapture taint associated with the relinquished property. See *Depreciation Recapture* on Page 9-4.

Depreciating Vehicles Received in a Trade

When a vehicle is acquired in a trade, the Section 280F limits (see Tab 6) must be considered for computing both the year-of-disposition depreciation for the old vehicle and the depreciation for the new vehicle. In the year of exchange, the total depreciation claimed (on the old and the new vehicle) is subject to a single Section 280F limit, which is the depreciation limit that would apply to the replacement (new) vehicle [Reg. §1.168(i)-6(d)(3)]. Once that amount has been reached, no more depreciation is available that year. However, see *Electing new asset treatment for traded autos* on Page 9-8 for a way to possibly claim more depreciation.



Depreciating Vehicles Acquired in a Trade		
Reg §1.168(i)-6(d)(3)(ii)		
Step	Compute:	Deduction limited to:
1	Depreciation on old car. Use applicable convention for the year of disposition.	Lesser of: 280F limit for the old car or the limit for the new car. ¹
2	50% special (bonus) depreciation allowance (discussed in Tab 2) on new car's exchanged basis (basis in the old car after step 1).	280F limit for the new car, less amount deducted in step 1.
3	MACRS depreciation on new car's exchanged basis [after 50% special (bonus) depreciation allowance]. Use same convention as for old car and the remaining recovery period. See <i>Depreciating Exchanged Basis</i> on Page 9-6.	Lesser of: 280F limit for the old car or the limit for the new car, less amounts deducted in steps 1 and 2.
4	Section 179 expense on the new car's excess basis.	280F limit for new car, less amounts deducted in steps 1 – 3.
5	50% special (bonus) depreciation allowance on new car's excess basis (after Section 179).	280F limit for new car, less amounts deducted in steps 1 – 4.
6	MACRS depreciation on new car's excess basis [after Section 179 and 50% special (bonus) depreciation allowance]. Use applicable convention for the acquisition year and 5-year recovery period. See <i>Depreciating Excess Basis</i> on Page 9-6.	280F limit for new car, less amounts deducted in steps 1 – 5.

¹ If the replacement vehicle is acquired in a year after the year of disposition, depreciation is limited to the 280F limit for the old car.

CHANGING SPECIAL (BONUS) DEPRECIATION

When an asset qualifies for special (bonus) depreciation, but the taxpayer fails to claim it or claims the wrong percentage, a change to the correct percentage is an accounting method change. However, changing to or from claiming special (bonus) depreciation is not an accounting method change if the taxpayer is trying to make a late election out of special (bonus) depreciation or to apply the 30% rate instead of the 50% rate, or to revoke such an election [Reg. §1.446-1(e)(2)]. Requests to make or revoke an election on an untimely basis must be made under Regulation Section 301.9100-3, which requires the taxpayer to request a private letter ruling.



For these rules, special (bonus) depreciation includes several provisions, as listed below:

Special (Bonus) Depreciation Summary

Description	Code §	Applies to qualified property placed in service:
All taxpayers – 50% (or 100%)	168(k)	During 2008– 2010 ²⁰¹²
All taxpayers – 30%	168(k) ²	After 9/10/01 and before 5/6/03
All taxpayers – 50%	168(k) ²	After 5/5/03 and before 1/1/05 ^{3,4}
NY Liberty Zone – 30%	1400L	After 9/10/01 and before 1/1/07 ⁵
Gulf Opportunity Zone – 50%	1400N	After 8/27/05 and before 1/1/08 ^{6,7}
Kansas Disaster Area – 50%	1400N	After 5/4/07 and before 1/1/09 ⁵ ²⁰¹³
Other Disaster Areas – 50%	168(n)	After 12/31/07 (see Tabs 2 and 13)

- ¹ During 2008–~~2011~~, for certain long-production property. [IRC §168(k)(2)(B)]
- ² As in effect before amendment in 2008–2010.
- ³ Before 1/1/06 for certain long-production property (before 1/1/07 if long-production property affected by Hurricanes Katrina, Rita or Wilma). [IRC §168(k)(2); Announcement 2006-29]
- ⁴ Taxpayers could elect to use 30% rate instead of 50%. ^{1/1/12}
- ⁵ Before 1/1/10 for nonresidential real and residential rental property.
- ⁶ Before 1/1/09 for nonresidential real and residential rental property.
- ⁷ Before ~~1/1/11~~ for nonresidential real and residential rental property in certain counties and parishes that sustained significant damage. [IRC §1400N(d)(6)]


Example: Asta, Inc. (a calendar-year taxpayer) purchased a \$50,000 computer on July 31, 2010. The computer qualified for 50% special (bonus) depreciation, which was claimed on Asta's 2010 tax return filed in March 2011. During November 2012, Asta realizes that it would have been better off had it not claimed special (bonus) depreciation on the computer in 2010. Changing from claiming special (bonus) depreciation to not claiming it is *not* an accounting method change because Asta is effectively trying to make a late election out of the special (bonus) depreciation. Therefore, Asta cannot make this change on a Form 3115. Instead, Asta must request a private letter ruling to make the change.



ERRORS CORRECTED ON AN AMENDED RETURN

Depreciation changes that are not accounting method changes are made on an amended return for the year being changed. Thus, these changes can be made only within the statute of limitations for the year being changed.

Depreciation Changes Made on an Amended Return

Change	Example
Mathematical, calculation or posting errors.	A number is transposed when the preparer enters it on the tax return.
Changing a depreciation method that has only been used on one return.*	In 2009, taxpayer claims depreciation on a piece of equipment based on a seven-year recovery period, but the actual recovery period is five years. If the 2010 return has not been filed, an amended 2009 return can be filed to correct the error.
Adjustment in the useful life of an asset that is not a MACRS asset, as long as it is not a change to or from a useful life that is specifically assigned by the Code [for example, the 36-month life assigned to depreciable computer software by Section 167(f)(1)].	A change in the useful life of an amortizable copyright asset that is not a Section 197 intangible. 
A change in an asset's placed-in-service date.	An asset was ordered and paid for in 2009, but was not delivered and placed in service until 2010. Any depreciation claimed in 2009 would be erroneous and can be corrected by filing an amended return.

* In this situation, the taxpayer can also choose to file a Form 3115 to request an accounting method change. See *Waiver of Two-Year Rule* on Page 10-2.

EXAMPLE—CHANGE IN ACCOUNTING METHOD

Eagle Repair is a sole proprietorship owned by Frank Smith. It is in the business of automobile repair and service. On January 1, 2006, Frank purchased a used commercial building for \$100,000. The property needed modifications to be used as a repair shop, including paving a grassy area in front of the building to make a parking lot and installing sidewalks to make the building accessible. These improvements were finished at a cost of \$20,000 and placed in service on July 1, 2006.

Frank reported the building purchase and improvements to his tax practitioner who prepared the 2006 tax return. Both the building cost and the improvements were depreciated as non-residential buildings with a 39-year recovery period.

Frank meets with a new tax practitioner in February 2011 to start the preparation of his 2010 tax return. The new preparer notices in reviewing the depreciation schedule that the parking lot and sidewalk placed in service on July 1, 2006, were being depreciated using the wrong recovery period. Land improvements are subject to a 15-year (not 39-year) life.

Eagle Repair—Depreciation Adjustment for 2006 Misclassified Land Improvements

Regular Tax	Cost	Method	Convention	Life	Depreciation Expense				Total
					2006	2007	2008	2009	
Corrected	\$ 20,000	150% DB	HY	15	\$ 1,000	\$ 1,900	\$ 1,710	\$ 1,540	\$ 6,150
As filed	20,000	SL	MM	39	< 235 >	< 513 >	< 513 >	< 513 >	< 1,774 >
Understatement									\$ 4,376
AMT									
Corrected	\$ 20,000	SL	HY	15	\$ 667	\$ 1,333	\$ 1,333	\$ 1,333	\$ 4,666
As filed	20,000	SL	MM	39	< 235 >	< 513 >	< 513 >	< 513 >	< 1,774 >
Understatement									\$ 2,892
Cumulative AMT Adjustment (\$4,376 – \$2,892)									\$ 1,484

Qualifying Costs

Reforestation costs are the direct costs of planting or seeding for forestation or reforestation that would otherwise have to be capitalized, including costs for:

- Site preparation.
- Seeds or seedlings.
- Labor.
- Tools.
- Depreciation on equipment used in planting and seeding.



Qualified timber property. Qualified timber property is property that contains trees in significant commercial quantities. It can be a woodlot or other site that is owned or leased. The property must:

- Be located in the U.S.
- Be held for the growing and cutting of timber used in (or sold for use in) the commercial production of timber products.
- Consist of at least one acre planted with tree seedlings in the manner normally used in forestation or reforestation.

Caution: Qualified timber property does not include property on which shelter belts or ornamental trees (for example, Christmas trees) are planted.

Recapture

For qualified timber property disposed of within 10 years after incurring qualifying reforestation expense, report any gain as ordinary income up to the amount expensed or amortized.

RESEARCH AND EXPERIMENTAL EXPENDITURES

Note: See *Claiming the Incremental Research Credit* in the next column for a caution regarding the expiration and possible extension of the research credit.

What Costs Are Included?

Research and experimental (R&E) expenditures are costs incurred in a trade or business for activities intended to provide information that would eliminate uncertainty about the development or improvement of a product (Reg. §1.174-2). For this purpose, a product includes any of the following:

- Formula.
- Invention.
- Patent.
- Pilot model.
- Process.
- Technique.
- Property similar to the items listed above.



The term *product* also includes products used in the taxpayer's trade or business or held for sale, lease or license.

Uncertainty exists if the information available does not establish how to develop or improve a product or the appropriate design of a product.

Caution: Although the costs of obtaining a patent, including attorneys' fees paid or incurred in making and perfecting a patent application, are R&E costs, any costs to obtain another's patent are not.

Costs not included. R&E costs do not include expenses for any of the following activities:

- Advertising or promotions.
- Consumer surveys.
- Efficiency surveys.
- Management studies.
- Quality control testing.
- Research in connection with literary, historical or similar projects.
- The acquisition of another's patent, model, production or process.



Deducting the costs. Research and experimental costs are deducted in one of the following ways:

- 1) Deduct as a current business expense.
- 2) Elect to amortize over 60 months.
- 3) Elect to amortize over 10 years.

See *Deducting Research and Experimental Expenditures* below for a discussion of the advantages and disadvantages to each of the three methods.

Claiming the Incremental Research Credit

Caution: Although the research credit (RC) expired on December 31, 2009, at the time this publication went to press, legislation was pending that would extend this provision through 2010. Congress has also discussed extending this credit permanently. Tax professionals should be alert to legislative activity in this area.

Taxpayers may elect to claim a research credit (RC) for R&E costs rather than expensing them. Not all costs that are R&E costs will qualify for the RC. See *Qualified research expenditures* below.

Caution: If a taxpayer elects to claim the RC for certain costs, those same costs cannot be expensed or capitalized and amortized. In other words, taxpayers cannot get a double tax benefit from the same costs.

Qualified research expenditures. The RC can be claimed for qualified research expenditures (QREs) conducted as part of a taxpayer's trade or business. QREs are the sum of in-house research expenses and contract research expenses. [IRC §41(b)(1) and Reg. §1.41-4]

Deducting Research and Experimental Expenditures

Method	Description	Pros and Cons
Current Business Expense [IRC §174(a)]	Research and experimental costs that are ordinary and necessary business expenses can be deducted in the current year as "Other Business Expenses." The taxpayer must adopt this method in the first year that such expenditures are paid or incurred. Occasionally, the taxpayer may adopt this method in later year with IRS consent.	<ul style="list-style-type: none"> • <i>Advantages:</i> Immediate deduction and simplicity. • <i>Disadvantage:</i> Amounts expensed by individuals are subject to 10-year amortization for AMT, unless taxpayer materially participates in the activity.
Elect to Amortize [IRC §174(b)]	Amortization period begins with the month an economic benefit from the expenditures is first received. Costs are amortized ratably over a period of 60 months or more. This is a one-time election that applies to all expenditures in the year of election and all subsequent years and can be revoked only with IRS consent.	<ul style="list-style-type: none"> • <i>Advantages:</i> No AMT adjustment. Sixty-month amortization allows faster recovery than 10-year write off. • <i>Disadvantages:</i> Amortization does not begin until economic benefit realized. Once election is made, it applies to all later years, unless permission to revoke obtained from IRS.
Optional Write-Off Method [IRC §59(e)]	Research and experimental costs are deducted, if elected, ratably over a 10-year period beginning with the tax year the costs are incurred. The election applies only to current-year expenditures and is not binding in future years.	<ul style="list-style-type: none"> • <i>Advantages:</i> No AMT adjustment required for costs written off over 10 years. This is also a flexible method. Taxpayer can choose each year the amount of costs that will be written off over 10 years (allowing taxpayer to reduce or avoid AMT). • <i>Disadvantage:</i> May provide for longer write-off in many cases.

In-house research expenses are:

- 1) Wages paid to an employee engaged in qualified research or in the direct supervision of qualified research.
- 2) Amounts paid for supplies used to conduct qualified research.
- 3) Amounts paid for the use of computers to conduct qualified research.



Contract research expenses are 65% of amounts paid to persons other than employees for qualified research. The limit is increased to 75% for payments made to a *qualified research consortium*, which is an organization that has the following characteristics:

- 1) It is a Section 501(c)(3) or 501(c)(6) organization and is exempt from tax under Section 501(a).
- 2) It is organized and operated primarily to conduct scientific research.
- 3) It is not a private foundation.

Payments made to a qualified research consortium are made on behalf of the taxpayer and one or more unrelated taxpayers.

Qualified research must meet the following tests: [IRC §41(d)]

- 1) The expenditures must be expenses described at *What Costs Are Included?* on Page 11-8.
- 2) The research must be of a technological nature (for example, it must be related to the physical, biological, engineering or computer sciences).
- 3) Substantially all of the research must be related to a new or improved function, performance, reliability or quality.
- 4) The application of the research is intended to be useful in the development of a new or improved business component of the taxpayer.

Expenses related to efficiency surveys, management studies, market research, routine data collection and quality control testing do not qualify for the RC.

Computing the credit. The RC equals the sum of: [IRC §41(a)]

- 1) 20% of the QREs for the current tax year exceeding the base amount for that year, *plus*
- 2) 20% of the basic research payments over the qualified organization base period amount, *plus*
- 3) 20% of amounts paid to an energy research consortium.

Caution: Although the research credit (RC) expired on December 31, 2009, at the time this publication went to press, legislation was pending that would extend this provision through 2010. Congress has also discussed extending this credit permanently. Tax professionals should be alert to legislative activity in this area.

The *base amount* equals the fixed base percentage multiplied by the average annual gross receipts of the taxpayer for the four tax years preceding the tax year for which the credit is being determined [IRC §41(c)]. However, the base amount cannot be less than 50% of its QREs for the year. This means no more than half of the current year's QREs can qualify for the RC.

Basic research payments are cash payments made to qualified organizations such as educational institutions and certain scientific research organizations if the basic research is to be performed by the organization. Cash payments to scientific tax-exempt organizations and certain grant organizations also qualify, but these organizations do not have to perform the research directly.

Taxpayers may elect to take the Section 41(c)(5) Alternative Simplified Credit (ASC). This is equal to 14% (12% before 2009) of the excess of the qualified research expenses for the tax year over 50% of the average qualified research expenses for the three preceding tax years.

Reduction of expenses. Any research deductions claimed under IRC §174 must be reduced by the amount of the RC [IRC §280C(c)(1)]. For capitalized research expenditures, the amount chargeable to a capital account is reduced by the excess of the RC over the amount of QREs allowable as a deduction for the year. The taxpayer may avoid these reductions by electing a reduced credit. Under the election, the credit is reduced by an amount equal to the top corporate income tax rate multiplied by the full credit. The election to take the reduced credit is made on Form 6765, *Credit for Increasing Research Activities*, and is irrevocable.

Note: See *Foregoing Special (Bonus) Depreciation Allowance to Claim Additional Credits* on Page 2-11 for a discussion on foregoing special (bonus) depreciation to claim additional research credits.

Reporting requirements. Form 6765, *Credit for Increasing Research Activities*, is filed to claim the RC. The taxpayer may elect to reduce the credit by completing the appropriate lines on Form 6765. If the taxpayer does not elect a reduced credit, a statement must be attached to Form 6765 showing the QREs reduced by the research credit.

INCOME FORECAST METHOD

The income forecast method uses an estimate of income to recover the cost of certain assets. Under this method, each year's deduction is equal to:

$$(\text{Cost} - \text{Salvage Value}) \times \frac{\text{Current Year Net Income From Property}}{\text{Estimated Total Income From Property}}$$

The denominator is the total income anticipated from the property through the end of the 10th tax year following the tax year the property is placed in service. [IRC §167(g)]

Look-back calculation. Taxpayers who use the income forecast method for property with a cost of more than \$100,000 are subject to a look-back calculation that may result in the receipt or payment of interest if actual income differs from anticipated income. Any interest computed under the look-back method is reported on Form 8866, *Interest Computation Under the Look-Back Method for Property Depreciated Under the Income Forecast Method*.

Eligible assets. The following intangibles can be amortized under either the straight-line method or the income forecast method:

- 1) Motion picture films or video tapes.
- 2) Sound recordings.
- 3) Copyrights.
- 4) Books.
- 5) Patents.
- 6) Other property to be specified in regulations.



Caution: The income forecast method cannot be used for Section 197 intangibles. Thus, to the extent any of the intangibles listed above is a Section 197 intangible (because it was acquired in connection with acquiring assets making up a trade or business), it cannot be amortized under the income forecast method.

Example: Easygoing Inc. produces a new record for a cost of \$250,000. Salvage value of the recording at the end of 10 years is expected to be \$10,000. Expected net income for the first 11 years of sales is \$500,000. The record generates \$150,000 of net income in the first year of sales. Current year amortization is \$72,000 $[(\$250,000 - \$10,000) \times \$150,000 \div \$500,000]$.

Tables of Class Lives and Recovery Periods

Table 2—Depreciable Assets Used in the Following Activities

Asset class	Description of assets included	Recovery Periods (in years)		
		Class Life (in years)	GDS (MACRS)	ADS
DEPRECIABLE ASSETS USED IN THE FOLLOWING ACTIVITIES:				
01.1	Agriculture: Includes machinery and equipment, grain bins, and fences but no other land improvements, that are used in the production of crops or plants, vines, and trees; livestock; the operation of farm dairies, nurseries, greenhouses, sod farms, mushroom cellars, cranberry bogs, apiaries, and fur farms; the performance of agriculture, animal husbandry, and horticultural services.	10	7****	10
01.11	Cotton Ginning Assets	12	7	12
01.21	Cattle, Breeding or Dairy	7	5	7
01.221	Any breeding or work horse that is 12 years old or less at the time it is placed in service**	10	7	10
01.222	Any breeding or work horse that is more than 12 years old at the time it is placed in service**	10	3	10
01.223	Any race horse that is more than 2 years old at the time it is placed in service**	*	3*****	12
01.224	Any horse that is more than 12 years old at the time it is placed in service and that is neither a race horse nor a horse described in class 01.222**	*	3	12
01.225	Any horse not described in classes 01.221, 01.222, 01.223, or 01.224	*	7	12
01.23	Hogs, Breeding	3	3	3
01.24	Sheep and Goats, Breeding	5	5	5
01.3	Farm buildings except structures included in Class 01.4	25	20	25
01.4	Single purpose agricultural or horticultural structures (within the meaning of section 168(i)(13) of the Code)	15	10***	15
10.0	Mining: Includes assets used in the mining and quarrying of metallic and nonmetallic minerals (including sand, gravel, stone, and clay) and the milling, beneficiation and other primary preparation of such materials.	10	7	10
13.0	Offshore Drilling: Includes assets used in offshore drilling for oil and gas such as floating, self-propelled and other drilling vessels, barges, platforms, and drilling equipment and support vessels such as tenders, barges, towboats and crewboats. Excludes oil and gas production assets.*****	7.5	5	7.5
13.1	Drilling of Oil and Gas Wells: Includes assets used in the drilling of onshore oil and gas wells and the provision of geophysical and other exploration services; and the provision of such oil and gas field services as chemical treatment, plugging and abandoning of wells and cementing or perforating well casings. Does not include assets used in the performance of any of these activities and services by integrated petroleum and natural gas producers for their own account.	6	5	6
13.2	Exploration for and Production of Petroleum and Natural Gas Deposits: Includes assets used by petroleum and natural gas producers for drilling of wells and production of petroleum and natural gas, including gathering pipelines and related storage facilities. Also includes petroleum and natural gas offshore transportation facilities used by producers and others consisting of platforms (other than drilling platforms classified in Class 13.0), compression or pumping equipment, and gathering and transmission lines to the first onshore transshipment facility. The assets used in the first onshore transshipment facility are also included and consist of separation equipment (used for separation of natural gas, liquids, and in Class 49.23), and liquid holding or storage facilities (other than those classified in Class 49.25). Does not include support vessels.	14	7	14
13.3	Petroleum Refining: Includes assets used for the distillation, fractionation, and catalytic cracking of crude petroleum into gasoline and its other components.	16	10	16
15.0	Construction: Includes assets used in construction by general building, special trade, heavy and marine construction contractors, operative and investment builders, real estate subdividers and developers, and others except railroads.	6	5	6
20.1	Manufacture of Grain and Grain Mill Products: Includes assets used in the production of flours, cereals, livestock feeds, and other grain and grain mill products.	17	10	17
20.2	Manufacture of Sugar and Sugar Products: Includes assets used in the production of raw sugar, syrup, or finished sugar from sugar cane or sugar beets.	18	10	18
20.3	Manufacture of Vegetable Oils and Vegetable Oil Products: Includes assets used in the production of oil from vegetable materials and the manufacture of related vegetable oil products.	18	10	18
20.4	Manufacture of Other Food and Kindred Products: Includes assets used in the production of foods and beverages not included in classes 20.1, 20.2 and 20.3.	12	7	12
20.5	Manufacture of Food and Beverages—Special Handling Devices: Includes assets defined as specialized materials handling devices such as returnable pallets, palletized containers, and fish processing equipment including boxes, baskets, carts, and flaking trays used in activities as defined in classes 20.1, 20.2, 20.3 and 20.4. Does not include general purpose small tools such as wrenches and drills, both hand and power-driven, and other general purpose equipment such as conveyors, transfer equipment, and materials handling devices.	4	3	4

* Property described in asset classes 01.223, 01.224, and 01.225 are assigned recovery periods but have no class lives.

** A horse is more than 2 (or 12) years old after the day that is 24 (or 144) months after its actual birthdate.

*** 7 if property was placed in service before 1989.

**** Certain new farming machinery and equipment placed in service during 2009 was 5-year property. **At the time this publication went to press, legislation was pending that would extend this provision through 2010. Tax professionals should be alert to further legislative developments.**

***** All race horses placed in service after 2008 and before 2014 are 3-year property, regardless of age.

***** Includes support vessels used in all offshore oil and gas operations, not just offshore drilling for oil and gas. (Ltr. Rul. 201001018)

DISASTER-RELATED RELIEF

Prior to 2008, Congress passed several pieces of legislation to enact tax provisions aimed at taxpayers living in or conducting businesses in areas affected by disasters. In 2008, Congress passed legislation that included general tax provisions that apply to all federally declared ~~disaster areas after 2007 and before 2012~~. See Tabs 2 and 5 for a detailed discussion of disaster-related tax provisions.

Observation: Prior legislation typically contained slightly different provisions for each disaster. By passing general relief provisions, Congress applied consistent relief and also eliminated the need to pass frequent disaster relief legislation. In the future, Congress will either need to extend the expiration date of these provisions or revert back to passing separate legislation for separate disasters. Tax professionals should be alert to further developments in this area.

Selected provisions related to business property are summarized below. Other relief provisions are covered in the *1040 Quickfinder® Handbook* and the *Individuals—Special Tax Situations Quickfinder® Handbook*.



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Selected Disaster Relief Provisions

Relief Provision	IRC §	QF Page	Area	Effective Date
Additional first year (bonus) depreciation	168(n), as amended	2-12	Federally Declared Disaster Area	Property placed in service after 12/31/07 for disasters declared after 12/31/07 and occurring before 1/1/10. ⁴
Additional first-year (bonus) depreciation—extended time for certain depreciable real property including personal property and software used in such real property	1400N(d)	2-10	Specified portion of the GO Zone ²	Property placed in service before 2011.
Demolition and clean-up costs—50% deductible	1400N(f), as amended	—	Midwestern Disaster Area ³	Paid or incurred on or after the applicable disaster date and before 1/1/11.
Environmental remediation costs—extension of expensing	1400N(g), as amended	—	Midwestern Disaster Area ³	Paid or incurred on or after the applicable disaster date and before 1/1/11.
Qualified disaster expenses—expensed in year incurred	198A	—	Federally Declared Disaster Area	Paid or incurred after 12/31/07 for disasters declared after 12/31/07 and occurring before 1/1/10. ⁴
Section 179—increased deduction	179(e), as amended	5-1	Federally Declared Disaster Area	Property placed in service after 12/31/07 for disasters declared after 12/31/07 and occurring before 1/1/10. ¹

2012

¹ Although this provision expired at the end of 2009, at the time this publication went to press, legislation was pending that would extend this provision through 2010. Tax professionals should be alert to legislative activity in this area.

² The counties and parishes designated as the specified portion of the GO Zone are the following parishes in Louisiana: Calcasieu, Cameron, Orleans, Plaquemines, St. Bernard, St. Tammany and Washington; and the following counties in Mississippi: Hancock, Harrison, Jackson, Pearl River and Stone.

³ The Midwestern Disaster Area covers several counties in the states of Arkansas, Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska and Wisconsin. See Pub. 4492-B, *Information for Affected Taxpayers in the Midwestern Disaster Areas*, for the complete list of the affected counties.



Deferred exchange: A like-kind exchange in which property received in the exchange (replacement property) is not received immediately upon the transfer of property given up (relinquished property). For a deferred exchange to qualify as a like-kind exchange, certain actions must be completed within a set time period.

Depreciable property: Property that is (1) owned by the taxpayer, (2) used in a business or investment activity, (3) has a determinable useful life and (4) expected to last more than one year.

Depreciable real property: Buildings and their structural components, other inherently permanent structures and certain land improvements.

Designated renewal community: A community designated by the Secretary of Housing and Urban Development (HUD) as eligible for certain tax benefits. The designation generally remained in effect until December 31, 2009, but may have been revoked if the state or local government modified the boundaries of the area or did not keep certain commitments.

~~⚠️ **Caution:** Although the designation of renewal communities expired at the end of 2009, at the time this publication went to press, legislation was pending that would extend this provision through 2010. Tax professionals should be alert to legislative activity in this area.~~

Parts of the following areas were designated renewal communities:

Renewal Communities	
<ul style="list-style-type: none"> Greene-Sumter County, AL Mobile County, AL Southern Alabama Los Angeles, CA Orange Grove, CA Parlier, CA San Diego, CA San Francisco, CA Atlanta, GA Chicago, IL Eastern Kentucky Central Louisiana New Orleans, LA Northern Louisiana Ouachita Parish, LA Lawrence, MA Lowell, MA Detroit, MI Flint, MI West Central Mississippi 	<ul style="list-style-type: none"> Turtle Mountain Band of Chippewa, ND Camden, NJ Newark, NJ Buffalo-Lackawanna, NY Jamestown, NY Niagara Falls, NY Rochester, NY Schenectady, NY Hamilton, OH Youngstown, OH Philadelphia, PA Charleston, SC Chattanooga, TN Memphis, TN Corpus Christi, TX El Paso County, TX Burlington, VT Tacoma, WA Yakima, WA Milwaukee, WI

To determine if a business is located within a renewal community, use RC/EZ/EC Address Locator at www.hud.gov/crlocator or call HUD at 1-800-998-9999.

Disposition: The permanent withdrawal from use in a trade or business or from the production of income.

Documentary evidence: Written records that establish certain facts.

E

2011

Economic owner: The party who bears the economic risks and rewards related to the property.

Electric vehicle: A vehicle that is powered primarily by an electric motor drawing current from rechargeable batteries, fuel cells or other portable sources of electrical power.

Empowerment zone: An area designated by the Secretaries of Agriculture and HUD as eligible for certain tax incentives. The designations generally remained in effect until the end of 2009.

~~⚠️ **Caution:** Although the designation of empowerment zones expired at the end of 2009, at the time this publication went to press, legislation was pending that would extend this provision through 2010. Tax professionals should be alert to legislative activity in this area.~~

Parts of the following urban areas were empowerment zones:

Empowerment Zones	
Urban Areas	
<ul style="list-style-type: none"> Pulaski County, AR Tucson, AZ Fresno, CA Los Angeles, CA (city and county) Santa Ana, CA New Haven, CT Jacksonville, FL Miami/Dade County, FL Chicago, IL Gary/Hammond/East Chicago, IN Boston, MA Baltimore, MD Detroit, MI Minneapolis, MN St. Louis, MO East St. Louis, IL Cumberland County, NJ 	<ul style="list-style-type: none"> New York, NY Syracuse, NY Yonkers, NY Cincinnati, OH Cleveland, OH Columbus, OH Oklahoma City, OK Philadelphia, PA Camden, NJ Columbia/Sumter, SC Knoxville, TN El Paso, TX San Antonio, TX Norfolk/Portsmouth, VA Huntington, WV Ironton, OH Washington, DC (part of DC)
Rural Areas	
<ul style="list-style-type: none"> Desert Communities, CA (part of Riverside County) Southwest Georgia United, GA (part of Crisp County and all of Dooly County) Southernmost Illinois Delta, IL (parts of Alexander and Johnson Counties and all of Pulaski County) Kentucky Highlands, KY (part of Wayne County and all of Clinton and Jackson Counties) Aroostook County, ME (part of Aroostook County) Mid-Delta, MS (parts of Bolivar, Holmes, Humphreys, Leflore, Sunflower and Washington Counties) 	<ul style="list-style-type: none"> Griggs-Steele, ND (part of Griggs County and all of Steele County) Oglala Sioux Tribe, SD (part of Jackson County and all of Bennett and Shannon Counties) Middle Rio Grande FUTURO Communities, TX (parts of Dimmit, Maverick, Uvalde and Zavala Counties) Rio Grande Valley, TX (parts of Cameron, Hidalgo, Starr and Willacy Counties)

For details, use the RC/EZ/EC Address Locator at www.hud.gov/crlocator, or call 1-800-998-9999 (for urban areas) or 1-800-645-4712 (for rural areas) to determine whether a location is in an empowerment zone.

Exchange: To barter, swap, part with, give or transfer property for other property or services.

F

Fair market value (FMV): The price that property brings when it is offered for sale by one who is willing but not obligated to sell, and is bought by one who is willing or desires to buy but is not compelled to do so.



Farm property: Assets used in agriculture, such as machinery and equipment, grain bins and fences.

Federally declared disaster area: Formerly called a Presidentially declared disaster area, it is the area that is determined by the President to warrant assistance by the federal government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act for disasters declared in tax years beginning after December 31, 2007.

Fiduciary: The one who acts on behalf of another as a guardian, trustee, executor, administrator, receiver or conservator.

Foreclosure: Lender takes property securing a mortgage in satisfaction of the debt.

Fungible commodity: A commodity of a nature that one part may be used in place of another part.