IRS Gives Guidance on Bonus Depreciation

Businesses may enjoy the revival of "bonus depreciation" for property placed in service before the end of the year. What's more, this tax break is increased to 100% if the tax law requirements are met. That is not a misprint: A business can write off the full cost of certain property instead of depreciating the amount over a lengthy cost-recovery period.

Now the IRS has provided additional guidance in a new ruling, which is generally favorable to small-business owners.

Background: Congress has tried to jump-start the economy several times through 50% bonus depreciation. This additional write-off may be coordinated with Section 179 deductions and regular depreciation deductions so a business owner can recover a substantial portion of a property's cost in the year of purchase.

Even better, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "Tax Relief Act") generally authorizes 100% bonus depreciation deduction for qualified property placed in service in 2011. For this purpose, "qualified property" includes property with a cost recovery period of 20 years or less, qualified leasehold improvement property and select industry-specific property. The tax break is reduced to 50% bonus depreciation for qualified property placed in service in 2012. (Other special rules may apply.)

Responding to inquiries from the public, the IRS released Revenue Procedure 2011-26 clarifying the rules for electing 100% bonus depreciation. Here are several key points:

Component depreciation: Business owners may be able to deduct the cost of qualified building components over a recovery period shorter than that required for the building itself. Under the new ruling, if a taxpayer began the manufacture, construction or production of a larger self-constructed property before September 9, 2010, the components may be eligible for 100% bonus depreciation.

Retail improvement properties and restaurants: Under existing tax code provisions, a taxpayer cannot claim 100% bonus depreciation for qualified retail improvement properties and restaurants. But the IRS notes that these properties may fall within the definition of "qualified leasehold property," which is eligible for the tax break (see above). If it does, the new ruling allows the taxpayer to elect 100% bonus depreciation.

Step-down election: Previously, a version of the 50% bonus depreciation tax break allowed a taxpayer to step down to 30% bonus depreciation if it was preferred. But no step down was formally authorized in the 2010 Tax Relief Act. Based on information in the new guidance, a taxpayer can elect to step down to 50% bonus depreciation if the situation warrants it.

Business vehicles: The addition of bonus depreciation boosts the “luxury car limit” for cars placed in service in 2011 to $11,060 ($11,260 for light trucks and vans). For instance, if a taxpayer buys a new car in 2011 and uses it 80% of the time for business, the available first-year deduction is $8,848 (80% of $11,060). But this creates smaller deductions in subsequent years and extends the cost-recovery period. Consequently, the new ruling allows taxpayers to elect to claim a reduced allowance for the first year.

Consult a professional tax adviser for application of these complex rules.