

PA DOR Bulletin: Federal 100 Percent Expensing Deduction Disallowed

Overview

Pursuant to the federal tax reform legislation enacted on December 22, 2017, Internal Revenue Code ("IRC") §168(k) is amended to provide 100 percent expensing for certain business assets placed in service after September 27, 2017 and before January 1, 2023.¹ On this same day, the Pennsylvania Department of Revenue ("Department") issued Corporation Tax Bulletin 2017-02 ("Bulletin 2017-02") which explains the Pennsylvania Corporate Net Income Tax ("CNIT") treatment of the 100 percent depreciation claimed as a deduction for federal income tax purposes.² According to Bulletin 2017-02, Pennsylvania law requires the federal 100 percent deduction to be added back to taxable income for CNIT purposes and provides no additional mechanism for cost recovery until the qualified property is sold or otherwise disposed. This appears to be a reversal of the Department's prior policy, which had allowed full recovery of 100 percent depreciation for CNIT purposes in the same year the deduction was claimed for federal income tax purposes.³

This tax alert summarizes Bulletin 2017-02, discusses background of the CNIT treatment of so called "bonus depreciation" deductions pursuant to IRC §168(k) and provides taxpayer considerations.

Pennsylvania CNIT treatment of bonus depreciation

Pennsylvania law generally provides that any deduction for depreciation of qualified property pursuant to IRC §168(k) must be added back to Pennsylvania taxable income for CNIT purposes.⁴ To recover the amount added back, Pennsylvania law provides for an additional deduction equal to 3/7ths of the remaining federal depreciation deduction (the "3/7ths formula") if a deduction for depreciation was included in taxable income for CNIT purposes. The law also provides for recovery of any remainder upon sale or other disposition of the property.⁵ Historically, when the federal law allowed a 30 percent bonus depreciation deduction and a 70 percent regular depreciation deduction, the 3/7ths formula resulted in full recovery of the cost of the qualified property over its regular depreciable life.⁶ When the federal bonus allowance was subsequently increased to 50 percent, with the remaining 50 percent subject to regular depreciation, the 3/7ths formula no longer recovered the entire cost prior to disposition of the property; however, the Department allowed for recovery of the remainder in the final year of federal depreciation.⁷ Likewise, when the federal bonus allowance temporarily increased to 100 percent during parts of 2010 and 2011, the Department, pursuant to Corporation Tax Bulletin 2011-01, allowed full recovery in the same year as the federal deduction.⁸

Bulletin 2017-02 appears to reverse the Department's prior policy which had allowed for full recovery of 100 percent expensing deductions and instead applies a narrow interpretation of the CNIT statutory addback and recovery provisions. According to Bulletin 2017-02, while Pennsylvania still requires an addback of the full federal bonus deduction, no additional deduction is allowed for CNIT purposes because there is no corresponding federal deduction for regular depreciation for such property.⁹ Further, applying the 3/7ths formula would result in an additional CNIT deduction of zero because there is no remaining federal

¹ H.R. 1, Sec. 13201. The Act also provides for declining expensing deductions for property placed in service after December 31, 2022.

² Pennsylvania Department of Revenue, Corporation Tax Bulletin 2017-02 (Dec. 22, 2017), available [here](#). Bulletin 2017-02 is limited in scope to a discussion of "Disallowance and Recovery of 100 Percent Depreciation Under IRC 168(k)" and does not address the recovery of declining deductions after then 100 percent expensing period expires.

³ The prior policy was announced in Corporation Tax Bulletin 2011-01 (Feb. 24, 2011), available [here](#).

⁴ 72 P.S. § 7401(3)1.(q), a/k/a Tax Reform Code ("TRC") § 401(3)1.(q).

⁵ 72 P.S. § 7401(3)1.(r) / TRC § 401(3)1.(r).

⁶ Under the 30% bonus model, the formula multiplies the remaining 70% federal non-bonus depreciation by 3/7, resulting in an additional 30% deduction ($70\% / 3 \times 7 = 30\%$) over the regular depreciable life, thereby restoring the disallowed 30% bonus deduction.

⁷ Corporation Tax Bulletin 2011-01.

⁸ *Id.*

⁹ Corporation Tax Bulletin 2017-02.

External Multistate Tax Alert

depreciation amount after the 100 percent deduction.¹⁰ Thus, the Department concludes that no cost recovery will be permitted for CNIT purposes until the property is sold or otherwise disposed.¹¹

Taxpayer considerations

The Department's revised bonus depreciation policy announced in Bulletin 2017-02 creates the potential for Pennsylvania CNIT income to be significantly higher than federal taxable income for periods during which the federal 100 percent expensing deduction is claimed. As a result of the new policy, effective for property placed in service after September 27, 2017, taxpayers will need to track a different Pennsylvania basis in such property in order to properly recover the addback in a future year when such property is sold or otherwise disposed.¹² Taxpayers are also advised to closely monitor other states' responses to the new federal 100% expensing provisions.

Contacts:

If you have questions regarding Bulletin 2017-02 or other Pennsylvania tax matters, please contact any of the following Deloitte Tax professionals:

Kenn Stoops

Managing Director
Deloitte Tax LLP, Philadelphia
+1 215 299 5225
kstoops@deloitte.com

Todd Hyman

Partner
Deloitte Tax LLP, Philadelphia
+1 215 299 4539
thyman@deloitte.com

Ed Kenawell

Principal
Deloitte Tax LLP, Pittsburgh
+1 412 338 7884
ekenawell@deloitte.com

Steven Thompson

Managing Director
Deloitte Tax LLP, Philadelphia
+1 215 246 2463
stethompson@deloitte.com

Stacy Ip-Mo

Senior Manager
Deloitte Tax LLP, Philadelphia
+1 215 246 2374
sipmo@deloitte.com

Bob Kovach

Senior Manager
Deloitte Tax LLP, Pittsburgh
+1 412 338 7925
rkovach@deloitte.com

For further information, visit our website at www.deloitte.com

Follow [@DeloitteTax](https://twitter.com/DeloitteTax)

This alert contains general information only and Deloitte is not, by means of this alert, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This alert is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional adviser. Deloitte shall not be responsible for any loss sustained by any person who relies on this alert.

About Deloitte

Deloitte refers to Deloitte Tax LLP, a subsidiary of Deloitte LLP. Please see www.deloitte.com/about to learn more about our legal structure. Certain services may not be available to attest clients under the rules and regulations of public accounting.

Copyright © 2018 Deloitte Development LLC. All rights reserved.
Member of Deloitte Touche Tohmatsu Limited

¹⁰ *Id.*

¹¹ *Id.* Note that Bulletin 2017-02 makes no distinction between property located inside or outside Pennsylvania.

¹² The change in policy will not affect deductions allowed under Bulletin 2011-01 for property placed in service prior to the effective date.