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EXTERNAL ALERT

Pennsylvania Announces New Policy on Federal Bonus Depreciation

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Overview

The Pennsylvania Department of Revenue ("PA DOR") issued Corporation Tax Bulletin 2011-01 ("Bulletin 2011-01"), announcing its policy with respect to the recently enacted federal 100% bonus depreciation deduction for purposes of the Pennsylvania Corporate Net Income Tax ("PCNIT").[1] In Bulletin 2011-01, the PA DOR announced that it will permit recovery of:

- 100% bonus depreciation in the year that such depreciation is claimed and allowable for federal purposes
- Any remaining unrecovered 30% and 50% bonus depreciation in certain situations in which there is a complete write-off of the remaining basis of such property for federal tax purposes pursuant to an accounting method change in accordance with Internal Revenue Code ("IRC") § 481(a)

In this Tax Alert we review the historic Pennsylvania treatment of federal bonus depreciation and then summarize Bulletin 2011-01.

Federal Bonus Depreciation and Historic Pennsylvania Treatment

The federal Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, as enacted on December 17, 2010, includes the adoption of new IRC § 168(k)(5), which allows taxpayers to claim a 100% bonus depreciation deduction for certain assets acquired between September 9, 2010 and December 31, 2011.[2] Federal bonus depreciation deductions pursuant to IRC § 168(k) have previously been available equal to either 30% or 50% of the adjusted basis of qualified property placed in service at various times since September 11, 2001.

When determining taxable income for PCNIT purposes, taxpayers were historically required to add back the bonus depreciation deduction to federal taxable income in the year claimed.[3] In that year and each succeeding year, Pennsylvania taxpayers were then permitted to subtract an amount equal to 3/7 of the non-bonus deduction for depreciation of the qualified property allowable under IRC § 167 until the disallowed bonus depreciation had been fully recovered for Pennsylvania purposes.[4] If the qualified property was sold or otherwise disposed of prior to recovering the full federal bonus deduction, an additional deduction was allowed for Pennsylvania purposes in the year of disposition equal to the remainder of the disallowed bonus depreciation.[5]

The Pennsylvania "3/7ths formula" was crafted to restore the full depreciation deduction that would have been allowed for federal purposes absent the application of the 30% bonus / 70% non-bonus approach. However, when the federal deduction was subsequently increased to

[1] PA DOR Corporation Tax Bulletin 2011-01 (Feb. 24, 2011).

[2] P.L. 111-312.

[3] 72 PS § 7401(3)1.(q), as added by the Act of June 29, 2002, No. 89 (HB 1848).

[4] 72 PS § 7401(3)1.(r).

[5] 72 PS § 7401(3)1.(s).

50% bonus / 50% non-bonus, the 3/7ths formula no longer resulted in full restoration of the foregone federal bonus deduction over the regular depreciation life of the qualifying property.[6] To achieve full recovery of the total amount of 50% bonus depreciation added back to Pennsylvania taxable income, the PA DOR had previously announced that taxpayers were allowed to deduct any remaining unrecovered amount in the last taxable year that the property was depreciated for federal tax purposes.[7]

Notwithstanding the prior PA DOR announcement, it was unclear how these Pennsylvania provisions would be interpreted with respect to the new federal 100% bonus depreciation, since there would be no non-bonus depreciation to which the 3/7ths formula could be applied.[8] Additionally, no guidance had ever been provided with respect to how unrecovered bonus depreciation would be treated in situations where a taxpayer: (1) had claimed a federal bonus depreciation deduction in the year in which qualifying property had been placed in service, and (2) in a subsequent tax year changed its federal capitalization methodology resulting in the entire remaining basis being deducted in the year of such change pursuant to IRC §481(a).

Corporation Tax Bulletin 2011-01

Bulletin 2011-01 provides guidance with respect to claiming a deduction for PCNIT purposes of the federal 100% bonus depreciation. Bulletin 2011-01 states that the federal 100% bonus depreciation deduction will be disallowed for PCNIT purposes under the provision that generally negates all bonus depreciation deductions.[9] However, the Bulletin goes on to provide that under the complementary provision that establishes a method for recovery of disallowed bonus depreciation deductions,[10] the PA DOR will permit full recovery of the disallowed 100% bonus depreciation in the year that such depreciation is claimed and allowable for federal tax purposes. The net result is that no adjustment is necessary to Pennsylvania taxable income for 100% bonus deprecation of qualified property claimed and allowable for federal tax purposes under IRC § 168(k)(5).

Additionally, the PA DOR announced in Bulletin 2011-01 that it will permit a recovery of any remaining unrecovered 30% and 50% bonus depreciation in the year in which there is a complete write-off of the remaining basis of the qualified property for federal tax purposes pursuant to a taxpayer-IRS Consent Agreement that permitted an accounting method change and required a write-off pursuant to IRC § 481(a).

The PA DOR notes that the policy announced in Bulletin 2011-01 with respect to the 100% bonus depreciation and with respect to the situation in which there has been a Consent Agreement as to an accounting method change for an asset on which bonus depreciation had been claimed is consistent with prior interpretation by the PA DOR of how the 50% bonus depreciation deduction should be fully recovered for PCNIT purposes notwithstanding the mismatched 3/7ths formula mentioned above. Administratively, taxpayers will still be required to complete Pennsylvania Schedule C-3, *Adjustment for Bonus Depreciation and Schedule C-4, Adjustment for Disposition of Section 168(k) Property & Recapture of Depreciation on Listed Property*, in order to determine their Pennsylvania adjustments; however, Column B and Column C of the Schedule C-3 will not include the 100% bonus depreciation.

Bulletin 2011-01 does not appear to alter the PA DOR's bonus depreciation policy with respect

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[6] Under the 30% bonus model, the formula multiplies the remaining 70% federal non-bonus depreciation by 3/7, thus resulting in an additional 30% deduction (70% / 7 X 3 = 30%) over the regular depreciable life, thereby restoring the disallowed 30% bonus deduction. However, in the 50% bonus model, applying the 3/7ths formula to the remaining 50% federal non-bonus depreciation would only result in a 21.4% additional deduction (50% / 7 X 3 = 21.4%), leaving 28.6% unrecovered (i.e., 50% bonus minus 21.4% recovery) at the end of the regular depreciation period.

[7] See PA DOR announcement, "Federal Changes Increase First-Year Bonus Depreciation" last modified Jan. 4, 2005.

[8] Applying the 3/7ths formula literally would result in an additional deduction of zero since 0% of the qualified property is subject to non-bonus depreciation (0% / 7 X 3 = 0%).

[9] 72 PS § 7401(3)1.(q).

[10] 72 PS § 7401(3)1.(r).

to the Personal Income Tax. For Pennsylvania Personal Income Tax purposes, the PA DOR has announced previously that individuals, business owners, partnerships, limited liability companies, Pennsylvania S corporations, estates and trusts cannot take a deduction for additional depreciation under IRC § 168(k), but must continue to calculate depreciation on the same basis as they would have under the IRC of 1986 as amended to January 1, 1997.[11]

Contacts

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[11] See PA DOR announcement, "Decoupling from the Job Creation and Worker Assistance Act of 2002" (Jul. 3, 2002). Unlike the PCNIT, for Personal Income Tax purposes there is not a formulaic approach for recovering the foregone bonus deduction based on a fraction of regular non-bonus depreciation; thus the disallowance methodology was not altered by the federal change from 30% bonus to 50% bonus or 100% bonus.