

# Credits and Incentives Update\*

By *Tim Schram and Daniel McGrath*

## 100% Federal Bonus Depreciation Makes 2011 the Year to Invest

Thanks to 100% federal bonus depreciation provided by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010<sup>1</sup>, businesses should seriously consider making capital investments during 2011. The Tax Relief Act provides 100% federal bonus depreciation for qualifying purchases made before January 1, 2012. Businesses that have postponed making capital investments due to the recent economic downturn should now consider making investments thanks to the combined use of incentives and 100% bonus depreciation. This article highlights the 100% bonus depreciation provided by the 2010 Tax Relief Act and suggests a number of ways to layer state and local credits and incentives to significantly increase the rate of return when making capital investments.

Recognizing that the improving but still troubled economy needed a boost, the White House and Congressional Republicans negotiated a tax-cut compromise that aims to provide various types of tax relief during the next several years. The 2010 Tax Relief Act makes available and enhances certain incentives for companies that invest in fixed assets utilized in their businesses, and extends the timeframes during which such investments qualify. The changes provide companies with the opportunity to significantly increase tax deductions and tax credits in order to reduce corporate income tax obligations. The aspect that provides the most widespread opportunity is the ability to take additional first-year depreciation, commonly known as bonus depreciation.



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## Background

Bonus depreciation was originally created by the Job Creation and Worker Assistance Act of 2002. It was intended to be a temporary economic incentive by which companies could immediately deduct 30% of the basis of qualifying assets that were placed in service after September 10, 2001, and before January 1, 2005 (for most types of assets), after which the Jobs and Growth Tax Relief Reconciliation Act of 2003 increased the percentage of the deduction to 50% for assets placed in service after May 5, 2003. Due to its popularity, bonus depreciation was reintroduced by the Economic Stimulus Act of 2008 and has subsequently been extended three times.<sup>2</sup>

Property eligible for bonus depreciation was defined as, and under the new law will continue to be defined as, "new property" that includes:

1. Modified Accelerated Cost Recovery System (MACRS) property with a useful life of 20 years or less;
2. Computer software;
3. Qualified leasehold improvement property; and
4. Water utility property.

Although the concept of taking the additional deduction in the first year is quite simple, changes to the applicable percentage, timeframes during which each is available and variations related to unique types of assets which qualify have made application of the rules somewhat complex.<sup>3</sup>

## Bonus Depreciation Enhancement and Provisions of the 2010 Act

The definition of property that is eligible for bonus depreciation under the 2010 Tax Relief Act is the same as under prior law, but the bonus depreciation percentage and placed-in-service dates have changed. The percentage increases from 50% to 100% for qualifying

property placed in service after September 8, 2010, and before January 1, 2012. So, those who invest in these types of assets will be able to fully deduct the cost during the *current tax year*. This will reduce taxable income and taxes paid, resulting in an increase in cash flow which can be reinvested in the business.

**In addition to taking advantage of 100% federal bonus depreciation, businesses making capital investments in calendar year 2011 should also consider pursuing state and local credit and incentive programs that may be used in combination with bonus depreciation.**

Assets that are placed in service during 2012 are eligible for the 50% first year deduction, with the remaining basis of the asset being depreciated using normal rules. Incidentally, with regard to both percentages, eligibility for certain aircraft and long production period property extends for an additional year.

However, it should be noted that there are cer-

tain rules that could cause property, which normally qualifies, to not qualify for some taxpayers in some situations. If property is acquired under a written binding contract, the contract cannot have been entered into prior to December 31, 2007. Also, property that is required to use MACRS Alternative Depreciation System (ADS) does not qualify. This would include property acquired through the use of tax-exempt bond financing and assets used outside the United States.

## Extension and Modification of Other Provisions

The 2010 Tax Relief Act includes extensions or modifications to many provisions that were enacted in the American Recovery and Reinvestment Act of 2009, as well as various stimulus or energy bills and other prior tax legislation. Many of these promote capital investment, and they do so for specific geographical areas or within certain business industries. A listing of these provisions is as follows:

- Section 1603 grants in lieu of energy credits
- Section 179 expensing
- Section 45M energy-efficient appliance credit
- Section 25C energy-efficient home improvement tax credit
- Research credit
- New markets tax credit
- 15-year cost recovery for qualified leasehold, restaurant building and retail improvements

- 7-year cost recovery for motorsports entertainment
- Special expensing for film and television productions
- Expensing of “Brownfield” environmental remediation costs
- Ethanol tax credits
- Incentives for biodiesel and renewable diesel
- Accelerated depreciation for Indian reservation business property
- Empowerment zone tax incentives
- New York Liberty Zone incentives
- GO Zone tax incentives
- Recovery Zone Bonds

## “Layering” Opportunity

In addition to taking advantage of 100% federal bonus depreciation, businesses making capital investments in calendar year 2011 should also consider pursuing state and local credit and incentive programs that may be used in combination with bonus depreciation. Planning for future capital investments may lead to a significant return on an investment with the use of multiple credits and incentives and may actually accelerate a business’ decision for when to make a capital investment.

## Investment Tax Credits

Many states offer qualified businesses a statutory, investment tax credit equal to a percentage of an eligible capital investment that is made in that particular state. Eligibility for the credit may depend on industry or particular use of the underlying asset. For example, states like Massachusetts, New Jersey and Oklahoma offer investment tax credits to manufacturing businesses for assets purchased that will be used exclusively in manufacturing activities. As an alternative formula, Illinois<sup>4</sup> offers businesses predominately engaged in either manufacturing or retail an investment tax credit for the purchase of all qualified purchases placed in service during the year (the assets are not required to be used exclusively for manufacturing or retail activities).

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Some states offer enterprise zone income tax credits for all counties across the state and the level of benefit is based on relative economic development. For example, all counties in Georgia<sup>5</sup>, North Carolina<sup>6</sup> and South Carolina<sup>7</sup> are ranked in tiers by relative economic development for investment tax credits and job creation tax credits. The investment tax credits are restricted to companies whose business operations meet certain industry categories. In addition, Georgia provides a “bonus” to the investment tax credit for those eligible businesses that can show an increase of port activity. California also has an income tax credit for sales taxes paid on qualified capital investment placed in service by an Enterprise Zone business<sup>8</sup>. Common qualified capital investment may include machinery and equipment used for manufacturing or data processing.

## Discretionary Incentives

Perhaps the best opportunity for significant benefits for making a capital investment may come in the form of discretionary incentives that may be available at the federal, state or local level. In many cases, discretionary incentives will also require some level of job creation or, at least, job retention criteria be met in addition to capital investment but there are some notable exceptions. The Federal New Markets Tax Credit may provide a significant financial incentive for qualified investment made in certain eligible census tracts. Also, Delaware<sup>9</sup> and Virginia<sup>10</sup> offer cash grants based on future capital investment made by existing businesses without requiring a commitment of new job creation.

The incentives offered by local jurisdictions may provide the most significant level of benefit for capital investment activities. Many municipalities have the ability to offer property tax abatement or tax increment financing as tools to encourage capital investment. The property tax related incentives are typically long-term in duration and provide significant savings for making qualified capital investment.

## Training Grants and Credits

In addition to the direct credit and incentive opportunities on the federal, state and local level, businesses making significant capital investments should also consider pursuing training grant programs that may be available when new investment requires technical training for new or existing employees. The purchase of new or upgrades to machinery and equipment may require businesses to conduct significant training activities for applicable employees. Many states offer training grant funding to reimburse employers for eligible training expenses for new and existing workers. Training typically needs to be technical in nature for purposes of qualifying for reimbursement and businesses should be prepared to collect evidence on the time employees spend in training related to internal and external courses that are designed to improve existing and new workers' skill sets. These grant programs are typically capped in terms of funding by employee (e.g., \$1,200 per qualified employee), applicant (e.g., qualified applicant company can only receive up to \$100,000) and are limited to a

percentage of qualified expenses (e.g., reimbursement for up to 50% of qualified expenses). Training grants may be available in a number of states as part of a larger incentive package for creating new jobs in that jurisdiction. Additionally, some states offer training grant funding to existing businesses on a competitive basis to encourage employers to upgrade existing workforce skill sets.

## Summary

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 provides many opportunities for companies to invest in and grow their businesses, and to gain tax benefits by doing so. Calendar year 2011 may be the optimal time to consider making capital investment to take advantage of the federal, state and local tax incentives encouraging qualified investments. Under the right capital investment scenario, a savvy business may be able to claim 100% federal bonus depreciation, New Markets Tax Credit, state investment tax credits, and municipal property tax abatement on the same capital investment.

## ENDNOTES

\* The views expressed in this article are those of the authors and do not necessarily reflect the views of any organization or firm with which the authors are associated.

<sup>1</sup> Bill H.R. 4853 was signed into law on December 17, 2010 as the Tax Relief, Unemployment Insurance Reauthorization, and

Job Creation Act of 2010.

<sup>2</sup> By the American Recovery and Reinvestment Act of 2009, the Small Business Jobs Act of 2010 and the Tax Relief Act of 2010.

<sup>3</sup> The rules governing bonus depreciation can be found in IRC §168(k).

<sup>4</sup> 35 ILCS 5/201(e)(1).

<sup>5</sup> Ga. Code Ann. §48-7-40(e).

<sup>6</sup> N.C. Gen. Stat. §105-129.87 (Article 3J credits).

<sup>7</sup> S.C. Code Ann. §12-6-3360.

<sup>8</sup> Cal. Rev. & Tax Code §23612.2.

<sup>9</sup> Del. Code Ann. tit. 29, §§5027-5029 (Delaware Strategic Fund).

<sup>10</sup> Va. Code Ann. §§2.2-5100 to 2.2-5104.

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