

# CaseStudy

## DEPRECIATION OPTIONS FOR AVOIDING CORPORATE AMT ADJUSTMENTS AND PREFERENCES



This case study has been adapted from *PPC's Tax Planning Guide—Closely Held Corporations, 21st Edition*, by Albert L. Grasso, Joan Wilson Gray, R. Barry Johnson, Lewis A. Siegel, Richard L. Burris, Mary C. Danylak, Timothy Fontenot, James A. Keller, and Michael E. Mares, published by Thomson Tax & Accounting, Ft. Worth, TX, 2008 ((800) 323-8724; [ppc.thomson.com](http://ppc.thomson.com)).

AN ELECTION OF A PARTICULAR DEPRECIATION system affects both taxable income and the taxpayer's administrative burden. From the planning standpoint of a closely held corporation, the goal should probably be to reduce to the extent possible the administrative burden; many closely held corporations have limited administrative and clerical personnel. For these corporations, electing a depreciation method that requires the maintenance of fewer depreciation schedules can hold down costs.

### Benefiting from the AMT System

No depreciation adjustment is necessary for alternative minimum tax (AMT) purposes on property placed in service after 1986 for which the AMT 150% declining balance (DB) method is elected under the provisions of Sec. 168(b)(2)(D) for property otherwise eligible for the modified accelerated cost recovery system (MACRS) (200% DB method). Making the election to use AMT depreciation for both regular tax and AMT purposes means using the AMT 150% DB method for both tax calculations. In addition, the normal MACRS recovery periods can be used for regular tax and AMT purposes.

No election is needed to avoid two computations for MACRS 27.5-year real property (residential rental property) or MACRS 39-year real property (most other depreciable real estate). Such property is depreciated using the straight-line method for MACRS and AMT depreciation purposes, and the recovery periods are the same for both.

Use of the AMT 150% DB method will allow the same set of fixed asset records to be used for regular tax and AMT.

However, a separate set of adjusted current earnings (ACE) depreciation records will still need to be maintained for property placed in service before 1994. For property placed in service before 1999, this election requires class lives to be used for both regular tax and AMT purposes. For property placed in service after 1998, MACRS useful lives can be used for both regular tax and AMT purposes. Therefore, if the election is made only for property placed in service after 1998, separate AMT depreciation records will still need to be maintained for property placed in service prior to 1999.

For property placed in service after 1993, there is no longer any requirement to make another depreciation computation for ACE purposes (Sec. 56(g)(4)(A)).

If the decision is made to elect to use the AMT depreciation system for both regular tax and AMT purposes, the election should be made for the tax years in which property subject to a difference between regular tax and AMT depreciation methods is purchased. The election must be made each year for the property that is placed in service during that year. The election is made by attaching a statement to the return and completing Form 4562, Depreciation and Amortization.

### Benefiting from the ADS System

No depreciation adjustment is necessary for AMT purposes on property placed in service after 1986 for which the alternative depreciation system (ADS) using the straight-line method is elected under the provisions of Sec. 168(g)(7). Use of the ADS (or straight line) will allow the same set of fixed asset records to be used

for regular tax, AMT, ACE, and earnings and profits purposes. However, since class lives are generally longer than those prescribed by MACRS, depreciation deductions in any given year are likely to be lower if this method (or the AMT method) is elected.

### **Claiming Bonus and Sec. 179 Depreciation**

The American Recovery and Reinvestment Act of 2009, P.L. 111-5, extended the increased \$250,000 Sec. 179 deduction allowance by one year, through tax years beginning in 2009, and also extended the \$800,000 phaseout threshold by one year. The act also extended the 50% first-year bonus depreciation break to cover qualifying new (not used) assets that are acquired and placed in service by December 31, 2009 (by December 31, 2010, for certain longer-lived assets).

The 50% first-year bonus depreciation rule applies for both regular tax and AMT purposes. In addition, there is no AMT adjustment for regular MACRS depreciation deductions for the remaining 50% of the cost of qualified property (Sec. 168(k)(2)(G)). The depreciation rules are the same for both regular tax and AMT purposes for assets for which 50% first-year bonus depreciation is claimed.

Similarly, an AMT adjustment is not required for Sec. 179 expense.

### **Benefiting from the Units of Production Method**

Property that is depreciated under a method other than MACRS is not considered for purposes of the depreciation adjustment (Sec. 56(a)(1)(B)). For example, property depreciated under a units of production method, or on some basis other than the passage of time, would not be subject to this depreciation adjustment. Thus, for such properties, only one depreciation schedule is required for both regular tax and AMT.

### **Reducing the Number of AMT Depreciation Adjustments**

The following example discusses the use of different depreciation methods to reduce the number and complexity of AMT depreciation adjustments.

*Example:* X Corp., a calendar-year C corporation, was formed on November 1, 2008. X filed its first tax return for the two-month period ending December 31, 2008. On January 10, 2009, X purchased \$100,000 of assets in each of the regular MACRS personal property asset classes (three-year, five-year, and seven-year classes).

X would be exempt from the AMT during its first tax year (2008). Assume that it does not meet the small business corporation gross receipts test for 2009, its second year, and so is subject to the AMT in 2009. The adjustment for excess depreciation applies only to property that is placed in service after the change date. The change date is defined as the first day of the tax year that the taxpayer ceases to meet the small business corporation exemption. As a result, X will have to include an adjustment for excess depreciation on property placed in service after 2008.

The property placed in service in January 2009 qualifies for the Sec. 168(k) bonus depreciation. X can claim bonus depreciation and/or a Sec. 179 expense on these assets without creating an AMT depreciation adjustment.

If X elects not to take the Sec. 179 deduction, or the amount of property placed in service exceeds the Sec. 179 limitation, X will need to decide whether to use AMT depreciation for both regular tax and AMT purposes. If X elects to use the AMT method, there will be no AMT tax adjustment for excess depreciation because the regular tax and AMT depreciation amounts will be the same. Only one set of fixed asset depreciation records will need to be maintained.

Before making depreciation elections, taxpayers should complete depreciation schedules showing projected deductions and their impact on income in future years.

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#### **EditorNotes**

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