

IRS provides guidance on electing to accelerate research or AMT credits in lieu of bonus depreciation

Corporations with unused research or alternative minimum tax (AMT) credits from pre-2006 tax years have a decision to make: Should they take advantage of the 50% first-year depreciation bonus that was extended through 2009 or should they elect to accelerate research or AMT credits in lieu of bonus depreciation?

Although the underlying concept is simple (which strategy will produce greater tax savings?), the rules and calculations involved in making this determination — and ultimately the election — have been somewhat unclear.

Fortunately, the IRS has now issued Revenue Procedure 2009-33, which provides corporations with guidance on the property eligible for the election, how and when to make the election, and how to compute the allowable credits. It also instructs corporations on what they must do if they made the election in 2008 but don't want to forgo bonus depreciation in 2009.

Bonus depreciation 101

The Economic Stimulus Act of 2008 created an additional 50% first-year depreciation deduction for qualified property acquired after 2007 and placed in service before 2009 (2010 for certain aircraft and property with “long production periods”).

Eligible property included:

- Tangible property eligible for the modified accelerated cost recovery system (MACRS) and with a recovery period of 20 years or less,
- Purchased computer software, subject to limited exceptions,
- Qualified leasehold improvement property, and
- Water utility property.

Congress soon recognized, however, that bonus depreciation deductions provided no immediate tax savings to corporations with net operating losses (NOLs). To provide these corporations with a tax incentive to invest in qualified property, the Housing and Economic Recovery Act of 2008 allowed corporations to opt out of bonus depreciation and, instead, to increase certain pre-2006 research and AMT credit limits and claim them as refundable credits.

This option was generally available for qualified property acquired and placed in service after March 31, 2008 (so long as no written purchase contract existed at that time), and before Jan. 1, 2009 (Jan. 1, 2010, for certain aircraft and long-production-period property). Corporations that elected to forgo bonus depreciation could increase their research and AMT credit limits by as much as 20% of the bonus depreciation for which they were otherwise eligible.

The refundable credit couldn't exceed a "maximum increase amount," which is the lesser of \$30 million or 6% of the total available pre-2006 credits. Also, corporations that elected to forgo bonus depreciation were required to depreciate qualified property using the straight-line method rather than MACRS.

The 2009 extension

Earlier this year, the American Recovery and Reinvestment Act of 2009 (ARRA) extended bonus depreciation to qualified property placed in service before Jan. 1, 2010 (Jan. 1, 2011, for certain aircraft and long-production-period property). ARRA also extended the election to claim increased pre-2006 research or AMT credits in lieu of bonus depreciation.

The election applies to "extension property," which generally refers to qualified property acquired after March 31, 2008, and placed in service during the 2009 calendar year (2010 for certain aircraft and long-production-period property). Essentially, corporations are allowed to make a separate election for their first tax year ending after Dec. 31, 2008 (2009 for calendar-year taxpayers), to forgo bonus depreciation on extension property in favor of a separately calculated accelerated credit amount.

Making the election

Rev. Proc. 2009-33 clarifies that if a corporation made the election last year (for its first tax year ending after March 31, 2008) then the election automatically applies to its first tax year ending after Dec. 31, 2008. But, these corporations can elect *not* to use last year's election and, instead, to claim bonus depreciation in 2009 on extension property.

Corporations that didn't make the election last year may elect to forgo bonus depreciation on extension property in 2009 and claim accelerated research or AMT credits instead.

Either election must be made on a timely filed return for the first tax year ending after Dec. 31, 2008 (with limited relief available for late elections). Rev. Proc. 2009-33 cautions fiscal-year taxpayers, however, that "even if the taxpayer does not place in service any extension property in its first taxable year ending after Dec. 31, 2008, the taxpayer must make the election . . . for that taxable year if the taxpayer wishes to apply such election to extension property placed in service in a subsequent taxable year."

Suppose, for example, that a corporation is on a fiscal year ending June 30. It hasn't previously elected to forgo bonus depreciation, but wishes to do so for property it plans to place in service in November and December of 2009. The election must be made on the corporation's return for the tax year ending June 30, 2009 (due Sept. 15), because it's the *first* tax year ending after Dec. 31, 2008 — even though the property is actually placed in service during its *second* tax year ending after Dec. 31, 2008.

Additionally, the revenue procedure provides guidance on computing the bonus depreciation amount for extension property, allocating it between research and AMT credits and reporting that allocation with a corporation's tax return.

Special rules

Rev. Proc. 2009-33 contains special rules for certain types of taxpayers. For example, S corporations are eligible to make the election, but increases in research or AMT credit limits are applied at the corporate level, not at the shareholder level. The revenue procedure outlines the time and manner for S corporations to make the election.

Taxpayers that are members of a corporate controlled group should pay careful attention to IRS guidelines: If any member of a controlled group makes the election, it applies to all of them. Rev. Proc. 2009-33 (together with previous revenue procedures) provides detailed guidance on determining the members of a controlled group, making the election and allocating credits among the members.

Corporations that are partners in a partnership must notify the partnership in writing that they're making the election to forgo bonus depreciation. Generally, this notice must be made by the time the election itself is due. The revenue procedure provides guidance on determining a corporate partner's distributive share of partnership items relating to any extension property the partnership placed in service during a tax year.

Weighing your options

If your business is a corporation with unused pre-2006 research or AMT credits — and you've acquired property eligible for bonus depreciation since March 31, 2008 (or plan to do so in the coming months) — investigate whether an election to forgo bonus depreciation and claim accelerated credits would reduce your tax bill.

After you do the math and determine which strategy is better, it's critical to follow the IRS's guidelines carefully to ensure that you obtain the desired tax treatment.