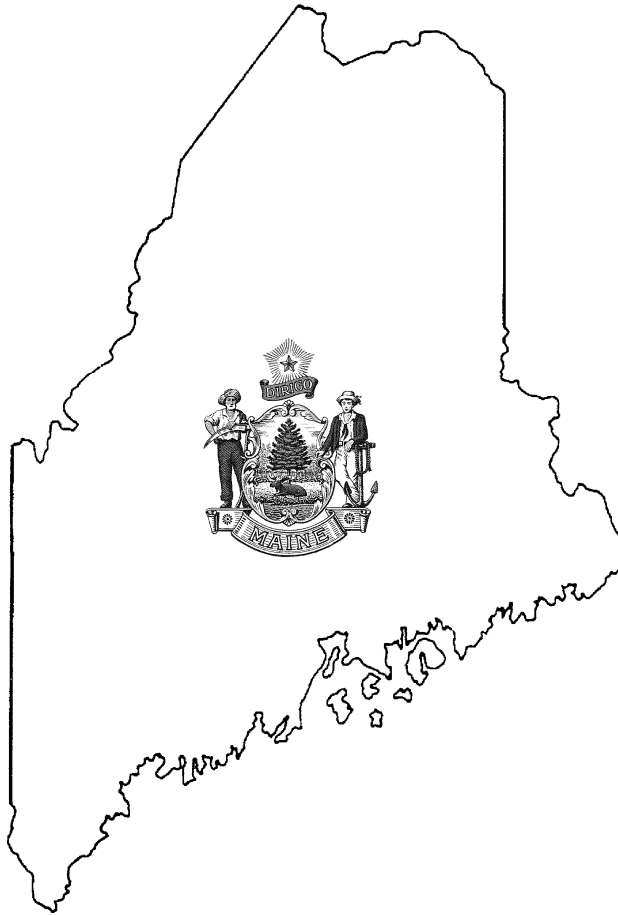


MODIFICATIONS RELATED TO BONUS DEPRECIATION & SECTION 179 EXPENSING



GUIDANCE DOCUMENT

Maine Revenue Services, Income/Estate Tax Division

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Introduction

Background

The federal Job Creation and Worker Assistance Act (“JCWAA”) of 2002 enacted a “bonus depreciation” for MACRS property acquired after September 10, 2001, and before September 11, 2004, (and, in most cases, placed in service prior to January 1, 2005). The bonus depreciation, under IRC § 168(k), was equal to an additional 30% deduction allowable in the first year.

The Jobs and Growth Tax Relief Reconciliation Act (“JGTRRA”) of 2003 expanded the first-year bonus depreciation to 50% for property acquired after May 5, 2003, and prior to January 1, 2005 and placed in service prior to January 1, 2005, (January 1, 2006 for certain property). JGTRRA also increased the IRC section 179 expense limit from \$25,000 to \$100,000 for property placed in service in tax years beginning after 2002 and before 2006. In addition, JGTRRA increased the phase-out threshold during this time from \$200,000 of qualifying property to \$400,000 of qualifying property and included certain off-the-shelf computer software in the list of qualifying property.

Subsequent federal legislation has made additional changes to IRC §§ 168(k) & 179, extending and occasionally increasing the higher levels of expense and depreciation. The federal thresholds for 2011 are 100% for bonus depreciation and \$500,000 expense with a phaseout beginning at \$2,000,000 for § 179.

Maine’s Legislative response

With respect to 2001 qualified property, Maine was in full conformity with federal bonus depreciation law. However, beginning with tax year 2002 Maine decoupled from federal bonus depreciation and, for all tax years beginning on or after January 1, 2003, the increases in section 179 expense limitations (including increases in the phase-out threshold and indexing). For tax years 2002 through 2005, an approach was developed to reverse the effect of the federal increase in first-year depreciation without requiring business owners to maintain two depreciation schedules for each qualifying piece of property.

In 2008, however, the Legislature adopted a new approach to decoupling from the federal bonus depreciation. The new approach is a more complete decoupling from federal law, requiring taxpayers to maintain two sets of depreciation schedules, one for federal purposes and one for state purposes.

In 2011, the Legislature enacted full conformity with IRC § 179 expense thresholds for tax years beginning on or after January 1, 2011. Also enacted that year was a credit for certain Maine-based property eligible for federal bonus depreciation. The new credit affects the calculation of the bonus depreciation addition and subtraction modifications. These calculations are covered in Part 1.

Following is a description of the state law with examples. See Part 4 for additional examples.

Maine Law

Maine's decoupling law has three approaches depending on the year the eligible property was placed in service.

Bonus depreciation claimed for property placed in service in 2002 through 2005 and for section 179 expenses claimed on property placed in service in 2002 through 2010.

For these years, Maine law requires an addition modification representing a reversal of the federal bonus depreciation and section 179 increases. Maine law allows subtraction modifications that recapture the addition modification throughout the remaining life of the asset. By tying the subtraction modifications (recapture) directly to the addition modification (reversal), federal depreciation does not need to be adjusted at the state level.

To determine the addition modification, the allowable depreciation and section 179 expense under federal law prior to JCWAA were subtracted from the depreciation and section 179 expense actually calculated and used for federal purposes. For assets placed in service in 2002, there was no subtraction modification in 2003; the addition modification is recaptured evenly throughout the remainder of the asset's life beginning with the 2004 tax year (3-year property

placed in service in 2002 is recaptured entirely in 2004). For property placed in service in 2003 through 2007, five percent of the addition modification is recaptured in the year following the year the property is placed in service, and the remaining ninety-five percent is recaptured evenly throughout the remainder of the asset's life, beginning in year 3. See Part 3 for more information.

Note: because there was no federal bonus depreciation in tax years beginning in 2006 or 2007, there were no Maine adjustments required in those tax years.

Bonus depreciation claimed for property placed in service in 2008 through 2010.

During these years, decoupling from federal law was comprised of an income modification (either addition or subtraction) representing the difference between the federal depreciation claimed and the depreciation that would have been allowed without the bonus depreciation.

For property placed in service in 2008 through 2010, two separate calculations may be required; for section 179 expense claimed, the same addition and subtraction modification approaches used for property placed in service in 2003 – 2007 are used; for bonus depreciation claimed, the addition modification is the same as in prior years, but the subtraction modifications are calculated as the difference between federal depreciation claimed and depreciation that would have been allowed if no bonus depreciation had been claimed for that property. For property placed in service in 2008 through 2010, and against which both section 179 expense and bonus depreciation are claimed, two separate modification calculations may be necessary. See the examples starting in Part 4 for more detailed information. See Part 2 for more information.

Bonus depreciation claimed for property placed in service in 2011 and 2012.

For property placed in service in 2011 and 2012, two separate calculations may be required for bonus depreciation decoupling. For bonus depreciation claimed on property placed in service in Maine for which the new Maine Capital Investment Credit (36 MRSA § 5219-GG) is being claimed, the bonus depreciation addition modification is equal to the entire amount of the federal bonus depreciation claimed. Because the Maine Capital Investment Credit is being claimed, there is no related recapture modification for this property. For bonus depreciation claimed on property for which the new credit is not being claimed, the same addition and

subtraction modification approaches used for property placed in service in 2008 - 2010 are applied. See Part 1 for more information. Also, see the examples starting in Part 4

PART 1 – GENERAL INSTRUCTIONS

FOR PROPERTY PLACED IN SERVICE 2011 & 2012

FOR FORMS 1040ME AND 1120ME INCOME MODIFICATION LINES

For property placed in service in 2011 and later years, Maine is now in full conformity with IRC § 179 expense limitations. Adjustments through income modifications related to § 179 expenses are no longer necessary. Subtraction modifications related to prior years' § 179 add-backs, however, are still allowed.

For property placed in service in 2011 and 2012, the calculations related to bonus depreciation have changed from prior years. As with modifications for tax years 2008 – 2010, the modifications for 2011 and 2012 are based on a taxpayer's tax year rather than the calendar year. Therefore, property placed in service in 2011 by a fiscal year filer whose taxable year begins in 2010 would be subject to the Maine decoupling modifications outlined in Part 2 – General Instructions for Property Placed in Service 2008 - 2010. For example, if a business operates on a fiscal year of July through June, property placed in service in March 2011 is applicable to the taxpayer's fiscal year beginning in 2010. Such property is not subject to the modification calculations in this part. If, however, property is placed in service in March, 2011 by a business that operates on a calendar year basis, that property is subject to the modifications in this part.

The following instructions explain the modification calculations for property placed in service for taxable years beginning in 2011 and 2012. See the examples in Part 4 for more information.

Addition modification

The addition modification (add-back) may or may not change with the new decoupling method. The addition modification calculation is based on whether the Maine Capital Investment Credit is claimed. This credit is new for 2011 and is equal to 10% of the bonus depreciation claimed under IRC § 168(k) for certain property placed in service in Maine during the taxable year. For property placed in service in 2011 and 2012 included in the Maine Capital Investment Credit

base (credit property), the add-back related to bonus depreciation is the entire federal bonus depreciation claimed. The addition modification related to property for which the Maine Capital Investment Credit is not claimed (non-credit property) is, on the other hand, the net difference between depreciation claimed at the federal level and the amount of depreciation that would have otherwise been allowed if bonus depreciation was not claimed. In other words, the bonus depreciation calculation for non-credit property is the same bonus depreciation calculation used in prior years.

Subtraction modification (recapture)

If a taxpayer claims the Maine Capital Investment Credit for eligible property placed in service in Maine, the bonus depreciation addition modification related to that property is not eligible for recapture.

The bonus depreciation addition modification related to non-credit property is recaptured in future years through a series of subtraction modifications based on the difference between depreciation claimed for federal purposes and depreciation that would have been allowed had bonus depreciation on the property not been claimed. This recapture is the same as the recapture calculations for property placed in service in 2008 – 2010.

For example, a five-year asset (non-credit property) costing \$100,000 is placed in service in 2011. At the federal level, bonus depreciation of \$100,000 ($\$100,000 * 100\%$) is claimed. The Maine addition modification is the difference between the federal total claim (\$100,000) and the regular MACRS depreciation applied without any bonus depreciation, or \$20,000 ($\$100,000 * 20\%$). The first year addition modification, therefore, is \$80,000 ($\$100,000 - \$20,000$). In Year 2, the Maine subtraction modification will be the difference between federal MACRS depreciation and the MACRS depreciation applicable if no bonus depreciation had been claimed in the first year. In this example, the Year 2 subtraction modification would be the Maine depreciation of \$32,000 ($\$100,000 * 32\%$) less the federal depreciation of \$0 (asset was fully depreciated in Year 1), or \$32,000. This process continues until the asset is either disposed of or fully depreciated. Again, this recapture only applies to property for which the Maine Capital Investment Credit has *not* been claimed (non-credit property).

A loss in a year in which a recapture subtraction modification would have been claimed does not create a carryover of that subtraction modification.

Disposal of property

For property placed in service in 2002 through 2005 (and for property placed in service in tax years 2003 through 2010, if section 179 expense of more than \$25,000 is claimed), disposal of property does not change the recapture period. For example, a seven-year asset is purchased in 2005 and a bonus depreciation/§ 179 addition modification is required for Maine tax purposes. The recapture for this addition modification is spread out over four years, 2006 - 2011. If the asset is then sold in 2010, the outstanding addition modification is not fully recaptured in that year; instead, recapture is still spread out over the initial six-year schedule. Gain or loss on disposition of an asset for Maine purposes is the same as it is for federal purposes.

For assets placed in service during tax years 2011 and 2012, however, any remaining recapture related to bonus depreciation on non-credit property is allowed in the year of an asset's disposal. The new recapture statute applies only to bonus depreciation claimed on non-credit property.

Fiscal-year filers

The addition modifications relate to property placed in service during taxable years beginning in 2011 and 2012. A taxable year is the year in which a taxpayer's fiscal year begins. Property placed in service during a tax year ending 9/30/11 (beginning 10/1/10), therefore, is considered property placed in service during a tax year beginning in 2010 and is subject to the modifications under Part 2 for tax years 2008 - 2010.

Employee business expenses

Bonus depreciation for employee business expenses (including listed automobiles) is normally treated the same as other bonus depreciation. The one exception is for employee business expenses reported on Form 2106 and claimed as an itemized deduction on Form 1040, Schedule

A. Do not, in this case, calculate an addition modification for any bonus depreciation claimed on Form 2106.

Multistate Businesses

Businesses that are taxable by Maine and one or more other states must also calculate Maine addition modifications. The addition modifications are based on all of the business' new assets, regardless of where those assets are located. Likewise, the recapture modifications are based on the non-credit property addition modification. An addition modification related to credit property is not eligible for recapture.

Pass-through entities, bonus depreciation and the Maine Capital Investment Credit

For pass-through entities, the decision to claim the Maine Capital Investment Credit lies with the individual (or corporate) owners rather than with the entity. As a result, the modification calculations related to bonus depreciation are dependent on the election of each individual owner of a pass-through entity. To be eligible for the credit, an entity must claim bonus depreciation at the federal level and report the bonus depreciation related to property eligible for the tax credit to its owners. The individual owners of that entity then must each decide whether to claim the credit or forego the credit and utilize the bonus depreciation subtraction modification recapture applicable to out-of-state property. Because of the nature of this credit, a nonresident individual owner of a pass-through entity participating in a composite return cannot claim the credit. To claim the credit, an individual owner must file a separate Maine income tax return.

Passive activity loss

If a taxpayer is a member of a pass-through entity that claims bonus depreciation and also has a loss for the year, the taxpayer limits the Maine addition modification by the same ratio that the federal loss is limited due to passive activity loss rules. If, for federal purposes, a taxpayer may

not use a loss from a pass-through entity at all, the Maine addition modification for bonus depreciation would not apply.

If only a portion of the loss can be used in the tax year of the loss, the taxpayer must pro rate the addition modification according to the percentage of the loss that is used (*see* example #10 in Part 4). Recapture of a limited bonus depreciation addition by a pass-through member is equal to that member's share of the difference in Maine and federal depreciation multiplied by the limitation percentage from the add-back year.

For example, if a partnership calculates a bonus depreciation add-back in Year 1 of \$40,000 and A is a 50% partner, A's addition modification in Year 1 is normally \$20,000. If the partnership has a loss for the year of \$20,000, A would ordinarily be able to reduce income by \$10,000 (50% share of partnership loss). If, however, A is limited to claiming only a \$3,000 loss from the partnership in that year, the limitation percentage is 30% ($\$3,000/\$10,000$). Therefore, the Year 1 add-back for A is \$6,000 ($\$20,000 * 30\%$). In Year 2, the partnership calculates a subtraction modification of \$16,000. A's share of that modification is \$8,000 ($\$16,000 * 50\%$). However, since the initial addition modification was limited by 30%, each year's recapture must also be limited to 30%. Therefore, A's Year 2 subtraction is limited to \$2,400 ($\$8,000 * 30\%$).

Resident member of an out-of-state pass-through entity

For a Maine resident member of a pass-through entity domiciled in another state, 100% of the member's share of the addition modification for bonus depreciation is added to income. Consequently, 100% of the recapture of non-credit property addition modification is allowed for the resident member.

The addition modification is calculated under Maine law and applies to any member of a pass-through entity claiming bonus depreciation.

Nonresident member of a Maine pass-through entity

For a nonresident member of a Maine pass-through entity, the addition modification applies. Therefore, 100% of the member's share of the addition modification is added back to income for purposes of determining Maine income tax.

Pass-through Entities and Change of Ownership

Subtraction modifications related to bonus depreciation add-backs do not transfer to new members of pass-through entities. If, for example a partnership gains a new partner in a year after a required bonus depreciation addition modification, the new partner is not allowed a subtraction modification recapture of the initial add-back.

Mergers

If an entity that has previously claimed an addition modification is subsequently merged with another entity or entities, the recapture schedule from the original entity generally survives the merger and may be claimed as originally scheduled. If, however, a business is not subject to Maine tax prior to a merger, the merged business is not entitled to a recapture, regardless of the merged business' subsequent taxability by Maine. For example, if a Maine company merges with an out-of-state company that had, in previous years, no nexus with Maine, the new merged company may not claim a recapture related to bonus depreciation claimed by the out-of-state company in a year where it had no connection to Maine.

At-risk Loss Limitations

Owners of pass-through entities who are subject to the at-risk limitations will have limited modifications for bonus depreciation. The total bonus depreciation modification, calculated without regard to the loss limitation is multiplied by a percentage. This percentage is calculated by dividing the pass-through entity loss used by the taxpayer by the total loss passed through to

the taxpayer by the pass-through entity. For example, if the pass-through entity reports a loss of \$100 allocated to the taxpayer and the taxpayer can use, due to the at-risk limitation, only \$50 of that loss, the percentage applied against the bonus depreciation modification is $\$50/\100 , or 50%. Losses carried over to subsequent years do not carry with them additional add-backs. Related subtraction modifications in subsequent years are also limited by the same percentage and the total subtraction modifications may not exceed the original addition modification. For more information, see “Passive activity loss” above.

PART 2 – GENERAL INSTRUCTIONS

FOR PROPERTY PLACED IN SERVICE 2008 - 2010

FOR FORMS 1040ME AND 1120ME INCOME MODIFICATION LINES

For property placed in service in 2008 - 2010, the Maine decoupling from bonus depreciation is different than in prior years. The modifications apply only to property placed in service during taxable years beginning in 2008 - 2010. Therefore, property placed in service in 2008 by fiscal year filers whose taxable year begins in 2007 would not be subject to the Maine bonus depreciation decoupling modifications. For example, if a business operates on a fiscal year of July through June, property placed in service in March 2008 is applicable to the taxpayer's fiscal year beginning in 2007. Such property is not subject to the Maine decoupling modifications. If, however, property is placed in service in March, 2008 by a business that operates on a calendar year basis, that property is subject to the decoupling modifications.

The modifications for section 179 expenses, however, remain the same as in prior years. The following instructions explain the modification calculations for property placed in service for taxable years beginning in 2008 - 2010. See the examples in Part 4 for more information.

Addition modification

The Maine addition modification (add-back) does not change with the new decoupling method. For property placed in service in 2008 - 2010, the add-back related to bonus depreciation is the net difference between depreciation claimed at the federal level and the depreciation that would be allowed if the 50% bonus depreciation was not claimed. The addition modification related to section 179 expense is the net difference between the higher federal section 179 expense deduction amount in excess of \$25,000 allowed under federal law and the amount of depreciation and section 179 expense that would have otherwise been allowed prior to the enactment of the Job Creation and Worker Assistance Act of 2002.

For property placed in service in 2008 - 2010, the bonus depreciation addition modification is the same as for property placed in service in 2003 through 2005, but separate depreciation schedules will be necessary to properly calculate the subtraction modification in subsequent years. Maine does not require any modifications related to depreciation claimed for property placed in service in 2006 or 2007.

Subtraction modification (recapture)

The addition modification related to bonus depreciation is recaptured in future years through a series of subtraction modifications based on the difference between depreciation claimed for federal purposes and depreciation that would have been allowed had bonus depreciation on the property not been claimed.

For example, a five-year asset costing \$100,000 is placed in service in 2008. At the federal level, bonus depreciation of \$50,000 ($\$100,000 * 50\%$) is claimed and the remaining \$50,000 ($\$100,000 - \$50,000$) is subject to regular MACRS depreciation. For the first year, MACRS depreciation is \$10,000 ($\$50,000 * 20\%$), so the total depreciation claimed in the first year is \$60,000 ($\$50,000$ bonus + $\$10,000$ MACRS). The Maine addition modification is the difference between the federal total claim (\$60,000) and the regular MACRS depreciation applied without any bonus depreciation, or \$20,000 ($\$100,000 * 20\%$). The first year addition modification, therefore, is \$40,000 ($\$60,000 - \$20,000$). In Year 2, the Maine subtraction modification will be the difference between federal MACRS depreciation and the MACRS depreciation applicable if no bonus depreciation had been claimed in the first year. In this example, the Year 2 subtraction modification would be the Maine depreciation of \$32,000 ($\$100,000 * 32\%$) less the federal depreciation of \$16,000 ($\$50,000 * 32\%$), or \$16,000 ($\$32,000 - \$16,000$). This process continues until the asset is either disposed of or fully depreciated.

The recapture of addition modifications related to section 179 expense claimed is the same as the recapture for property placed in service in 2003 through 2007. For assets placed in service in 2008 - 2010, 5% of the addition modification is recaptured in Year 2, with the remaining amount recaptured in equal yearly installments over the remaining class-life of the asset,

beginning in Year 3. For example, if an addition modification of \$20,000 relates to 5-year property, \$1,000 is recaptured in Year 2, and \$6,333 is recaptured in each of Years 3, 4 and 5.

A loss in a year in which a recapture subtraction modification would have been claimed does not create a carryover of that subtraction modification.

In order to calculate the modifications for assets against which both bonus depreciation and section 179 expense have been claimed, each asset must be split into two portions: one against which section 179 expense is claimed and one against which bonus depreciation is claimed. See the examples in Part 4 for illustration of this process.

In 2005, Maine law changed to allow individual owners of an electing S corporation to recapture Maine bonus depreciation and section 179 expense addition modifications previously imposed on the entity in a prior tax year when it was taxed as a C corporation for federal and Maine income tax purposes. This allowance applies to tax years beginning on or after January 1, 2005 (See 36 MRSA § 5122(2)(X)).

Disposal of property

For property placed in service in 2002 through 2005 (and for property placed in service in tax years beginning on or after January 1, 2003, if section 179 expense of more than \$25,000 is claimed), disposal of property does not change the recapture period. For example, a five-year asset is purchased in 2003 and a bonus depreciation/§ 179 addition modification is required for Maine tax purposes. The recapture for this addition modification is spread out over four years, 2004 - 2007. The asset is then sold in 2005. The outstanding addition modification is not fully recaptured in that year; instead, recapture is still spread out over the initial four-year schedule. Gain or loss on disposition of an asset for Maine purposes is the same as it is for federal purposes.

For assets placed in service during tax years beginning in 2008 - 2010, however, any remaining recapture related to bonus depreciation is allowed in the year an asset is disposed of. The recapture of section 179 expense is still claimed over the remaining life of the asset, as it was in

prior years. The new recapture statute applies only to bonus depreciation claimed on assets placed in service after 2007.

Fiscal-year filers

The addition modification relates to property placed in service during taxable years beginning in 2008 - 2010. A taxable year is the year in which a taxpayer's fiscal year begins. Property placed in service during a tax year ending 9/30/08 (beginning 10/1/07), therefore, is considered property placed in service during a tax year beginning in 2007 and is not subject to any modification of bonus depreciation (even though some assets may have been purchased and placed in service in calendar year 2008). Any section 179 expense in excess of \$25,000 claimed on this property is, however, still subject to the decoupling modifications.

Federal business income limitation

At the federal level, a taxpayer can use section 179 expense only to the extent that the taxpayer has business income. The taxpayer can claim an overall total, however, of up to \$250,000 in expense for 2008. If business income is lower than the allowable section 179 claim, the remainder is carried over to future year(s).

Note: Reference to "business income" in this guidance document means, for pass-through entities, taxable income from trade or business activity determined in accordance with Treas. Reg. 1.179-2(C)(2) & (3).

Maine's addition modifications related to the increased levels of section 179 expensing (36 MRSA §§ 5122(1)(N)(3) and 5200-A(1)(N)(3)) pertain only to the net increase in section 179 expense related to property placed in service that year. As a result, carryover amounts from previous years entered on federal Form 4562 do not enter into the calculation of the addition modification. Further, if a negative amount is calculated for first year add-back, no addition modification is required.

Example #1:

Company A purchases a 5-year asset for \$100,000 in 2008 and decides to apply section 179 expense to the whole amount. However, the company has only \$30,000 of business income that year, so \$30,000 of expense is applied to 2008 and the remaining \$70,000 is carried over to 2009.

The Maine add-back is based, not on the total \$100,000 claimed by Company A, but on the \$30,000 actually used in the year the asset was placed in service.

Under the prior federal law that Maine follows, \$25,000 of the asset may be expensed under section 179, while the remaining \$75,000 must be depreciated. The total amount of expense and depreciation allowed would be $\$25,000 + (\$75,000 \times 20\% \text{ 1st year depreciation}) = \$25,000 + \$15,000 = \$40,000$. Since the amount allowable under the old law is higher than the amount actually used in 2008, no addition modification is required.

The allocation of the recapture amounts must be made based on the class-life of the assets. In the example above, since there was no addition modification, there will be no recapture.

Example #2:

In 2008, Company A purchases a 5-year asset for \$50,000 and a 7-year asset for \$50,000. Company A decides to apply section 179 expense to the whole amount. However, the company has only \$60,000 of business income that year, so \$60,000 of expense is applied to 2008 and the remaining \$40,000 is carried over to 2009.

Under the prior federal law that Maine follows, \$25,000 of the assets may be expensed under section 179, while the remaining \$75,000 must be depreciated. The \$75,000 is apportioned between the 5-year asset and the 7-year asset based on the total original basis. In this case, since each asset cost the same, 50% of the disallowed section 179 expense would be associated with the 5-year property and 50% with the 7-year property.

Therefore, the total amount of expense and depreciation allowed would be:

| | |
|--|--------------|
| Section 179 expense | \$25,000 |
| Plus first year depreciation – 5-year property ($\$75,000/2$) x 20% = | 7,500 |
| Plus first year depreciation – 7-year property ($\$75,000/2$) x 14.29% = | <u>5,359</u> |
| | \$37,859 |

The addition modification is the difference between what was actually used and would have been used under prior law: $\$60,000 - \$37,859 = \$22,141$. Remember that, although \$100,000 of section 179 expense is claimed, only \$60,000 is used in the year the assets are placed in service.

The allocation of the recapture amounts must be separated between the asset classes. Company A would, therefore, recapture the \$22,141 add-back as follows:

| | |
|---|-----------------|
| Federal section 179 expense for 5-year property ($\$60,000 \times 50\%$) | \$30,000 |
| Less Maine section 179 expense for 5-year property ($\$25,000 \times 50\%$) | 12,500 |
| Less Maine first year allowable depreciation on non-expensed portion ($\$75,000 \times 50\%$) x 0.2 | <u>7,500</u> |
| Equals recapture over years 2 through 5 | <u>\$10,000</u> |

and

| | |
|---|-----------------|
| Federal section 179 expense for 7-year property | \$30,000 |
| Less Maine section 179 expense for 7-year property | 12,500 |
| Less Maine first year allowable depreciation on non-expensed portion ($\$37,500 \times 0.1429$) | <u>5,359</u> |
| Equals recapture over years 2 through 7 | <u>\$12,141</u> |

The addition modification associated with the increase in section 179 expense must apply only to the amount of section 179 expense claimed and deducted in the taxable year. Carryover amounts must be ignored for purposes of the calculation. The modification is calculated based on the difference between the federal amount deducted and the amount allowed by Maine.

In future years, federal carryover amounts are not used in calculating any addition modification for Maine purposes. The addition modification relates only to section 179 expense used in the year the asset is placed in service (*see example #5 and example #6 in Part 3*).

Employee business expenses

Bonus depreciation for employee business expenses (including listed automobiles) is normally treated the same as other bonus depreciation. The one exception is for employee business expenses reported on Form 2106 and claimed as an itemized deduction on Form 1040, Schedule A. Do not, in this case, calculate an addition modification for any bonus depreciation claimed on Form 2106.

Allocation of section 179 add-back among affected property

For recapture of the add-back modification related to section 179 expense, taxpayers must allocate the add-back among the class lives of the affected property. If the Maine add-back relates to property falling into various class lives, the taxpayer must prorate the add-back to the various class lives and recover the add-back amount accordingly. For example, if the Maine add-back for 2008 is \$50,000, 25% of which relates to 5-year property and 75% of which relates to 3-year property, the recovery of the section 179 expense add-back is determined as follows:

5-year property, 1st year in recovery period: $(\$50,000 \times 25\%) \times 5\% = \625

3-year property, 1st year in recovery period: $(\$50,000 \times 75\%) \times 5\% = \$1,875$

Total Year 2 recovery: \$2,500.

5-year property, Year 3 recovery: $[(\$50,000 \times 25\%) - \$625] / 3 = \$3,958$. Note: This is the same amount that the taxpayer would recover in each of the Years 4 and 5. The \$625 represents the amount already recovered in the previous tax year and the 3 represents the number of years remaining in the life of the property (1st year is the year in which the property was placed in

service and the 2nd year is the year in which \$625 of the add-back was recovered, leaving 3 years in the life of the property).

3-year property, Year 3 recovery: $[(\$50,000 \times 75\%) - \$1,875] / 1 = \$35,625$. The \$1,875 represents the amount already recovered in the previous tax year and the 1 represents the number of years remaining in the life of the property (1st year is the year in which the property was placed in service and the 2nd year is the year in which \$1,875 of the add-back was recovered, leaving 1 year in the life of the property).

Total recovery in Year 3: \$39,583 (*see* additional example #7 in Part 3).

Multistate Businesses

Businesses that are taxable by Maine and one or more other states must also calculate a Maine addition modification. The addition modification is based on all of the business' new assets, regardless of where those assets are located. Likewise, the recapture modifications are based on the entire addition modification (*see* example #11 in Part 3).

Pass-through entities and § 179

The \$25,000 limitation for section 179 expense is applied at both the entity level and the individual taxpayer level. The Maine addition modification for section 179 expense is calculated at the entity level and any limitations are also applied at the entity level.

The Maine addition modifications under 36 MRSA §§ 5122(1)(N) and 5200-A(1)(N) apply “with respect to property placed in service during the taxable year” and relate to “the increase in aggregate cost claimed.” Thus, the limitation is based on the property in question, rather than the individual owners of that property.

The limitation applies to the entity level, meaning that the pass-through entity is limited to \$25,000 in section 179 expense. Each member of a pass-through entity would then be limited to his or her share of the total entity limitation and, therefore, his or her share of the addition and

subtraction modifications. For examples showing modifications for a member of several pass-through entities, see examples #8 and #9 in Part 3.

Passive activity loss

If a taxpayer is a member of a pass-through entity that claims section 179 expense or bonus depreciation and also has a loss for the year, the taxpayer limits the Maine addition modification by the same ratio that the federal loss is limited due to passive activity loss rules. If, for federal purposes, a taxpayer may not use a loss from a pass-through entity at all, the Maine addition modification for section 179 or bonus depreciation would not apply.

If only a portion of the loss can be used in the tax year of the loss, the taxpayer must pro rate the addition modification according to the percentage of the loss that is used (*see example #10 in Part 3*). The recapture of section 179 expense add-back limited by passive activity loss rules is based on the amount of the initial add-back. Recapture of a limited bonus depreciation addition by a pass-through member is equal to that member's share of the difference in Maine and federal depreciation multiplied by the limitation percentage from the add-back year.

For example, if a partnership calculates a bonus depreciation add-back in Year 1 of \$40,000 and A is a 50% partner, A's addition modification in Year 1 is normally \$20,000. If the partnership has a loss for the year of \$20,000, A would ordinarily be able to reduce income by \$10,000 (50% share of partnership loss). If, however, A is limited to claiming only a \$3,000 loss from the partnership in that year, the limitation percentage is 30% ($\$3,000/\$10,000$). Therefore, the Year 1 add-back for A is \$6,000 ($\$20,000 * 30\%$). In Year 2, the partnership calculates a subtraction modification of \$16,000. A's share of that modification is \$8,000 ($\$16,000 * 50\%$). However, since the initial addition modification was limited by 30%, each year's recapture must also be limited to 30%. Therefore, A's Year 2 subtraction is limited to \$2,400 ($\$8,000 * 30\%$).

**Resident member of an out-of-state
pass-through entity**

For a Maine resident member of a pass-through entity domiciled in another state, 100% of the member's share of the addition modification for bonus depreciation and section 179 expense is added to income. Consequently, 100% of the recapture of the addition modification is allowed for the resident member.

The addition modification is calculated under Maine law and applies to any member of a pass-through entity claiming bonus depreciation and/or increased section 179 expense.

**Nonresident member of a Maine
pass-through entity**

For a nonresident member of a Maine pass-through entity, the addition modification applies. Therefore, 100% of the net effect of the member's share of bonus depreciation and section 179 expense is added back to income for purposes of determining Maine income tax.

Member of several pass-through entities claiming § 179 expense

Section 179 of the Code allows taxpayers to elect to expense the cost of up to \$250,000 for tax year 2008 of certain tangible personal property, subject to reduction for each dollar in excess of \$800,000 of such property placed in service during the year and limited to the taxpayer's trade or business income for the year (trade or business income prior to the application of section 179 expense).

For members of pass-through entities, these thresholds are applied at both the entity level and the individual member level. At the member level, these thresholds are applied against that member's aggregate amounts of expense, cost and business income from all pass-through entities.

Amounts disallowed because of the trade or business income limit may be carried forward indefinitely. The carryforward is at the entity level if the entity's trade or business income limits the deduction and is at the individual level if the individual's trade or business income limits the deduction.

At the individual member level, aggregate amounts of section 179 expense in excess of \$250,000 are disallowed at both the federal and state levels. The disallowed amounts are lost and not available for carryover. For Maine purposes, aggregate amounts in excess of \$25,000 (but not more than \$250,000 for 2009) for a member of several pass-through entities must be added back to income as an addition modification. Maine law allows for the recapture of these Maine income modifications over the class life of each applicable asset. See example #9 in Part 3 for a description of the application of these limitations.

Pass-through Entities and Change of Ownership

Subtraction modifications related to bonus depreciation and section 179 expense add-backs do not transfer to new members of pass-through entities. If, for example a partnership gains a new partner in a year after a required bonus depreciation addition modification, the new partner is not allowed a subtraction modification recapture of the initial add-back.

Mergers

If an entity that has previously claimed an addition modification is subsequently merged with another entity or entities, the recapture schedule from the original entity generally survives the merger and may be claimed as originally scheduled. If, however, a business is not subject to Maine tax prior to a merger, the merged business is not entitled to a recapture, regardless of the merged business' subsequent taxability by Maine. For example, if a Maine company merges with an out-of-state company that had, in previous years, no nexus with Maine, the new merged company may not claim a recapture related to bonus depreciation claimed by the out-of-state company in a year where it had no connection to Maine.

At-risk Loss Limitations

Owners of pass-through entities who are subject to the at-risk limitations will have limited modifications for bonus depreciation. The total bonus depreciation modification, calculated without regard to the loss limitation is multiplied by a percentage. This percentage is calculated by dividing the pass-through entity loss used by the taxpayer by the total loss passed through to the taxpayer by the pass-through entity. For example, if the pass-through entity reports a loss of \$100 allocated to the taxpayer and the taxpayer can use, due to the at-risk limitation, only \$50 of that loss, the percentage applied against the bonus depreciation modification is $\$50/\100 , or 50%. Losses carried over to subsequent years do not carry with them additional add-backs. Related subtraction modifications in subsequent years are also limited by the same percentage and the total subtraction modifications may not exceed the original addition modification. For more information, see “Passive activity loss” above.

PART 3 – GENERAL INSTRUCTIONS
FOR PROPERTY PLACED IN SERVICE 2002 - 2007
FOR FORMS 1040ME AND 1120ME INCOME MODIFICATION LINES

Addition modification

The Maine addition modification (add-back) is the *net difference* between the higher federal depreciation and section 179 expense deduction amounts in excess of \$25,000 allowed under federal law and the amount of depreciation and section 179 expense that would have otherwise been allowed prior to the enactment of the Job Creation and Worker Assistance Act of 2002. The addition modification does not cause the creation of a separate depreciation schedule for Maine, nor does it alter the calculated gain on the sale of an asset. Disposal of an asset does not change the recapture schedule. Further, a loss in a year in which a recapture subtraction modification would have been claimed does not create a carryover of that subtraction modification. Also, the addition modification does not apply to affected property placed in service in 2001.

Subtraction modification (recapture)

The addition modification is recaptured in future years through a series of subtraction modifications, depending on the class-life of the related asset. For assets placed in service in 2002, the recapture does not begin until 2004, with the entire addition recaptured evenly over the remaining class-life of the asset. For assets placed in service in 2003 - 2005 (2003 or later for section 179 property), 5% of the addition modification is recaptured in Year 2, with the remaining amount recaptured in equal yearly installments over the remaining class-life of the asset, beginning in Year 3.

For example, if an addition modification of \$12,000 relates to 5-year property placed in service in 2003, \$600 is recaptured in Year 2, and \$3,800 is recaptured in each of Years 3, 4 and 5. The same rules apply to assets placed in service in 2002, except that recapture begins in Year 3 and

is spread out *evenly* over the remaining life of the asset. For example, if an addition modification of \$12,000 relating to five-year property was made in 2002, the recapture amounts would be \$4,000 in each of years 3, 4 & 5.

In 2005, Maine law changed to allow individual owners of an electing S corporation to recapture Maine bonus depreciation and section 179 expense addition modifications previously imposed on the entity in a prior tax year when it was taxed as a C corporation for federal and Maine income tax purposes. The add-back requirement is related to federal bonus depreciation and increased IRC section 179 expenses disallowed for Maine income tax purposes. This provision applies to tax years beginning on or after January 1, 2005. (*See* 36 MRSA § 5122(2)(X)).

Disposal of property

For property placed in service in 2002 through 2005 (and for later years if section 179 expense of more than \$25,000 is claimed), disposal of property does not change the recapture period. For example, a five-year asset was purchased in 2003 and a bonus depreciation/§ 179 addition modification was required for Maine tax purposes. The recapture for this addition modification is spread out over four years, 2004 - 2007. The asset is then sold in 2005. The outstanding addition modification is not fully recaptured in that year; recapture is still spread out over the initial four-year schedule. Gain or loss on disposition of an asset for Maine purposes is the same as it is for federal purposes.

Fiscal-year filers

The addition modification relates to “property placed in service during the taxable year.” A taxable year is the year in which a taxpayer’s fiscal year begins. A tax year ending 9/30/03 (beginning 10/1/02), therefore, would be governed by the recapture schedule applying to taxable years beginning in 2002 (even though some assets may have been purchased and placed in service in calendar year 2003), meaning there would be no 5% recapture in year 2 (*see* example #4 in Part 3).

Federal depreciation changes other than those contained in JCWAA or JGTRRA

Maine's nonconformity to bonus depreciation claimed in tax years 2002 - 2005 is limited to the changes enacted by section 101 of JCWAA of 2002 and sections 201 and 202 of JGTRRA of 2003. Maine conforms to all other bonus depreciation changes not part of JCWAA or JGTRRA for those years. For property placed in service in 2008 or later, Maine also decouples from federal bonus depreciation law, but the modifications related to those years are calculated differently than for years 2002 – 2005. See Frequently Asked Questions for details.

Maine's nonconformity regarding section 179 expense increases applies to all federal increases, including extensions, applicable to tax years beginning on or after January 1, 2003.

Federal business income limitation

At the federal level, a taxpayer can use section 179 expense only to the extent that the taxpayer has business income. The taxpayer can claim an overall total, however, up to \$100,000 in expense, indexed for inflation (\$125,000 for 2007). If business income is lower than the allowable section 179 claim, the remainder is carried over to future year(s).

Note: Reference to "business income" in this guidance document means, for pass-through entities, taxable income from trade or business activity determined in accordance with Treas. Reg. 1.179-2 (C)(2) & (3).

Maine's addition modifications related to the increased levels of section 179 expensing (36 MRSA §§ 5122(1)(N)(3) and 5200-A(1)(N)(3)) pertain only to the net increase in section 179 expense related to property placed in service that year. As a result, carryover amounts from previous years entered on federal Form 4562 do not enter into the calculation of the addition modification.

Example #1:

Company A purchased a 5-year asset for \$100,000 in 2003 and decided to apply section 179 expense to the whole amount. However, the company has only \$30,000 of business income that year, so \$30,000 of expense is applied to 2003 and the remaining \$70,000 is carried over to 2004.

The Maine add-back is based, not on the total \$100,000 claimed by Company A, but on the \$30,000 actually used in the year the asset was placed in service.

Under prior federal law, which Maine is following, \$25,000 of the asset would be expensed under section 179, while the remaining \$75,000 would be depreciated. The total amount of expense and depreciation allowed would be $\$25,000 + (\$75,000 \times 20\% \text{ 1st year depreciation}) = \$25,000 + \$15,000 = \$40,000$. Since the amount allowable under the old law is higher than the amount actually used in 2003, no addition modification is required.

The allocation of the recapture amounts must be made based on the class-life of the assets. In the example above, since there was no addition modification, there will be no recapture.

Example #2:

In 2003, Company A purchased a 5-year asset for \$50,000 and a 7-year asset for \$50,000. Company A decided to apply section 179 expense to the whole amount. However, the company has only \$60,000 of business income that year, so \$60,000 of expense is applied to 2003 and the remaining \$40,000 is carried over to 2004.

Under prior federal law, which Maine is following, \$25,000 of the assets would be expensed under section 179, while the remaining \$75,000 would be depreciated. The \$75,000 is apportioned between the 5-year asset and the 7-year asset based on the total original basis. In this case, since each asset cost the same, 50% of the disallowed section 179 expense would be associated with the 5-year property and 50% with the 7-year property.

Therefore, the total amount of expense and depreciation allowed would be:

| | |
|--|--------------|
| Section 179 expense | \$25,000 |
| Plus first year depreciation – 5-year property ($\$75,000/2$) x 20% = | 7,500 |
| Plus first year depreciation – 7-year property ($\$75,000/2$) x 14.29% = | <u>5,359</u> |
| | \$37,859 |

The addition modification is the difference between what was actually used and would have been used under prior law: $\$60,000 - \$37,859 = \$22,141$. Remember that, although \$100,000 of section 179 expense is claimed, only \$60,000 is used in the year the assets are placed in service.

The allocation of the recapture amounts must be separated between the asset classes. Company A would, therefore, recapture the \$22,141 add-back as follows:

| | |
|---|-----------------|
| Federal section 179 expense for 5-year property ($60,000 \times 50\%$) | \$30,000 |
| Less Maine section 179 expense for 5-year property ($25,000 \times 50\%$) | 12,500 |
| Less Maine first year allowable depreciation on non-expensed portion ($\$75,000 \times 50\%$) x 0.2 | <u>7,500</u> |
| Equals recapture over years 2 through 5 | <u>\$10,000</u> |

and

| | |
|---|-----------------|
| Federal section 179 expense for 7-year property | \$30,000 |
| Less Maine section 179 expense for 7-year property | 12,500 |
| Less Maine first year allowable depreciation on non-expensed portion ($\$37,500 \times 0.1429$) | <u>5,359</u> |
| Equals recapture over years 2 through 7 | <u>\$12,141</u> |

The addition modification associated with the increase in section 179 expense should apply only to the amount of section 179 expense claimed and deducted in the taxable year. Carryover amounts should be ignored for purposes of the calculation. The modification is calculated based on the difference between the federal amount deducted and the amount allowed by Maine.

In future years, federal carryover amounts are not used in calculating any addition modification for Maine purposes. The addition modification relates to section 179 expense used in the year the asset is placed in service (*see example #5 and example #6 in Part 3*).

Employee business expenses

Bonus depreciation for employee business expenses (including listed automobiles) is normally treated the same as other bonus depreciation. The one exception is for employee business expenses reported on Form 2106 and claimed as an itemized deduction on Form 1040, Schedule A. Do not, in this case, calculate an addition modification for any bonus depreciation claimed on Form 2106.

Allocation of add-back among affected property

For recapture of the add-back modification, taxpayers must allocate the add-back among the class lives of the affected property. If the Maine add-back relates to property falling into various class lives, the taxpayer must prorate the add-back to the various class lives and recover the add-back amount accordingly. For example, if the Maine add-back for 2003 is \$50,000, 25% of which relates to 5-year property and 75% of which relates to 3-year property, the recovery of the add-back would be determined as follows:

Note: For property placed in service in 2003 or later, the recovery period begins the year following the year the property is placed in service. Thus, the 1st year in the recovery period is actually the 2nd year in the class life of the property. For property placed in service in 2002, the recovery period begins the 3rd year of the class life of the asset (2004).

5-year property, 1st year in recovery period: $(\$50,000 \times 25\%) \times 5\% = \625

3-year property, 1st year in recovery period: $(\$50,000 \times 75\%) \times 5\% = \$1,875$

Total 1st year (2004) recovery: \$2,500.

5-year property, 2nd year in recovery period (2005): $[(\$50,000 \times 25\%) - \$625] / 3 = \$3,958$.

Note: This is the same amount that the taxpayer would recover in each of the 3rd and 4th years of the recovery period [4th and 5th years in the class life of the property – 2006 and 2007]. The \$625 represents the amount already recovered in the previous tax year and the 3 represents the number of years remaining in the life of the property (1st year is the year in which the property was placed in service and the 2nd year is the year in which \$625 of the add-back was recovered, leaving 3 years in the life of the property).

3-year property, 2nd year in recovery period (2005): $[(\$50,000 \times 75\%) - \$1,875] / 1 = \$35,625$. The \$1,875 represents the amount already recovered in the previous tax year and the 1 represents the number of years remaining in the life of the property (1st year is the year in which the property was placed in service and the 2nd year is the year in which \$1,875 of the add-back was recovered, leaving 1 year in the life of the property).

Total recovery in the 2nd year of the recovery period: \$39,583 (see additional example #7 in Part 3).

Multistate Businesses

Businesses that are taxable by Maine and one or more other states must also calculate a Maine addition modification. The addition modification is based on all of the business' new assets, regardless of where those assets are located. Likewise, the recapture modifications are based on the entire addition modification (see example #11 in Part 3).

Pass-through entities and § 179

The \$25,000 limitation for section 179 expense is applied at both the entity level and the individual taxpayer level. The Maine addition modification for section 179 expense is calculated at the entity level and limitations are also applied at the entity level.

The Maine addition modifications under 36 MRSA §§ 5122(1)(N) and 5200-A(1)(N) apply “with respect to property placed in service during the taxable year” and relate to “the increase in aggregate cost claimed.” Thus, the limitation is based on the property in question, rather than the individual owners of that property.

The limitation applies to the entity level, meaning that the pass-through entity is limited to \$25,000 in section 179 expense. Each member of a pass-through entity would then be limited to his or her share of the total entity limitation and, therefore, his or her share of the addition and subtraction modifications. For examples showing modifications for a member of several pass-through entities, see examples #8 and #9 in Part 3.

Passive activity loss

If a taxpayer is a member of a pass-through entity that claims section 179 expense or bonus depreciation and also has a loss for the year, the taxpayer limits the Maine addition modification by the same ratio that the federal loss is limited due to passive activity loss rules. If, for federal purposes, a taxpayer may not use a loss from a pass-through entity at all, the Maine addition modification for section 179 or bonus depreciation would not apply.

If a portion of the loss can be used in the tax year of the loss, the taxpayer must pro rate the addition modification according to the percentage of the loss that is used (*see* example #10 in Part 3).

Resident member of an out-of-state pass-through entity

For a Maine resident member of a pass-through entity domiciled in another state, 100% of the member’s share of the addition modification for bonus depreciation and section 179 expense is added to income. Consequently, 100% of the recapture of the addition modification is allowed for the resident member.

The addition modification is calculated under Maine law and applies to any member of a pass-through entity claiming bonus depreciation and/or increased section 179 expense.

**Nonresident member of a Maine
pass-through entity**

For a nonresident member of a Maine pass-through entity, the addition modification applies. Therefore, 100% of the net effect of the member's share of bonus depreciation and section 179 expense is added back to income for purposes of determining Maine income tax.

Member of several pass-through entities

Section 179 of the Code allows taxpayers to elect to expense the cost of up to \$100,000 (\$125,000 for tax year 2007) of certain tangible personal property, subject to reduction for each dollar in excess of \$400,000 (\$500,000 for 2007) of such property placed in service during the year and limited to the taxpayer's trade or business income for the year (trade or business income prior to the application of section 179 expense).

For members of pass-through entities, these thresholds are applied at both the entity level and the individual member level. At the member level, these thresholds are applied against that member's aggregate amounts of expense, cost and business income from all pass-through entities.

Amounts disallowed because of the trade or business income limit may be carried forward indefinitely. The carryforward is at the entity level if the entity's trade or business income limits the deduction and is at the individual level if the individual's trade or business income limits the deduction.

At the individual member level, aggregate amounts of section 179 expense in excess of \$100,000 are disallowed at both the federal and state levels. The disallowed amounts are lost and not available for carryover. For Maine purposes, aggregate amounts in excess of \$25,000 (but not more than \$125,000 for 2007) for a member of several pass-through entities must be added

back to income as an addition modification. Maine law allows for the recapture of these Maine income modifications over the class life of each applicable asset. See example #9 in Part 3 for a description of the application of these limitations.

Pass-through entities and change of ownership

Subtraction modifications related to bonus depreciation and section 179 expense add-backs do not transfer to new members of pass-through entities. If, for example a partnership gains a new partner in a year after a required bonus depreciation addition modification, the new partner is not allowed a subtraction modification recapture of the initial add-back.

Mergers

If an entity that has previously claimed an addition modification is subsequently merged with another entity or entities, the recapture schedule from the original entity generally survives the merger and may be claimed as originally scheduled. If, however, a business is not subject to Maine tax prior to a merger, the merged business is not entitled to a recapture, regardless of the merged business' subsequent taxability by Maine. For example, if a Maine company merges with an out-of-state company that had, in previous years, no nexus with Maine, the new merged company may not claim a recapture related to bonus depreciation claimed by the out-of-state company in a year where it had no connection to Maine.

At-risk loss limitations

Owners of pass-through entities who are subject to the at-risk limitations will have limited modifications for bonus depreciation. The total bonus depreciation modification, calculated without regard to the loss limitation is multiplied by a percentage. This percentage is calculated by dividing the pass-through entity loss used by the taxpayer by the total loss passed through to the taxpayer by the pass-through entity. For example, if the pass-through entity reports a loss of \$100 allocated to the taxpayer and the taxpayer can use, due to the at-risk limitation, only \$50 of that loss, the percentage applied against the bonus depreciation modification is $\$50/\100 , or 50%. Losses carried over to subsequent years do not carry with them additional add-backs.

Related subtraction modifications in subsequent years are also limited by the same percentage and the total subtraction modifications may not exceed the original addition modification. For more information, see “Passive activity loss” above.

PART 4 – ADDITIONAL EXAMPLES

For the following example, assume that the 30% bonus depreciation option is selected and that no additional section 179 expensing is involved.

EXAMPLE #1 – property placed in service in 2003:

Federal return:

Asset purchase price = \$10,000 5-year life

Bonus depreciation = $10,000 \times 30\% = \$3,000$

MACRS depreciation = $(10,000 - 3,000) \times 20\% = \$1,400$

Depreciation with bonus = $3,000 + 1,400 = \$4,400$

Maine return:

MACRS depreciation = $10,000 \times 20\% = \$2,000$

Addition modification: Year 1 = $4,400 - 2,000 = \$2,400$

Recovery: Year 2 = $2,400 \times 5\% = (\$ 120)$

Year 3 = $(2,400 - 120)/3 = (\$ 760)$

Year 4 = “ $(\$ 760)$

Year 5 = “ $(\$ 760)$

For the following example, assume that the taxpayer selected section 179 expense, but no bonus depreciation.

EXAMPLE #2 – property placed in service in 2003:

Federal return:

Asset purchase price = \$110,000 5-year life

Section 179 expense claimed = \$100,000

MACRS depreciation = $(110,000 - 100,000) \times 20\% = \$2,000$

Depreciation with § 179 = $100,000 + 2,000 = \$102,000$

Maine return:

Allowable § 179 = \$25,000

MACRS depreciation = $(110,000 - 25,000) \times 20\% = \$17,000$

Depreciation with § 179 = $25,000 + 17,000 = \$42,000$

Addition modification: Year 1 = $102,000 - 42,000 = \$60,000$

Recovery: Year 2 = $60,000 \times 5\% = (\$ 3,000)$

Year 3 = $(60,000 - 3,000)/3 = (\$19,000)$

Year 4 = “ $(\$19,000)$

Year 5 = “ $(\$19,000)$

For the following example, the taxpayer elected to use both section 179 expense and 50% bonus depreciation.

EXAMPLE #3 – property placed in service in 2003:

Federal return:

Asset purchase price = \$110,000 5-year life

Section 179 expense claimed = \$100,000

Bonus depreciation = $(110,000 - 100,000) \times 50\% = \$5,000$

MACRS depreciation = $(110,000 - 100,000 - 5,000) \times 20\% = \$1,000$

Depreciation with § 179 = $100,000 + 5,000 + 1,000 = \$106,000$

Maine return:

Allowable § 179 = \$25,000

MACRS depreciation = $(110,000 - 25,000) \times 20\% = \$17,000$

Depreciation with § 179 = $25,000 + 17,000 = \$42,000$

Addition modification: Year 1 = $106,000 - 42,000 = \$64,000$

Recovery: Year 2 = $64,000 \times 5\% = (\$ 3,200)$

Year 3 = $(64,000 - 3,200)/3 =$ (\$20,267)
 Year 4 = “ (\$20,267)
 Year 5 = “ (\$20,266)

EXAMPLE #4 – FISCAL-YEAR FILER (Tax year 7/1/02 - 6/30/03):

Federal return:

Asset #1 purchase price = \$20,000 5-year life, purchased/placed in service 10/02

30% bonus depreciation = $20,000 \times 30\% =$ \$6,000

MACRS depreciation = $(20,000 - 6,000) \times 20\% =$ \$2,800

Asset # 2 purchase price = \$20,000 5-year life, purchased/placed in service 5/03

Section 179 expense = \$20,000

Total depreciation/expense = $6,000 + 2,800 + 20,000 =$ \$28,800

Maine return:

Allowable MACRS, Asset #1 = $20,000 \times 20\% =$ \$4,000

Allowable § 179, Asset #2 = \$20,000

Depreciation with § 179 = $4,000 + 20,000 =$ \$24,000

Addition modification: Year 1 = $28,800 - 24,000 =$ \$4,800

Recovery: Year 2 = \$0 (for property placed in service during tax years beginning in 2002, there is no recapture amount in Year 2)

Year 3 = $4,800/3 =$ (\$1,600)

Year 4 = “ (\$1,600)

Year 5 = “ (\$1,600)

EXAMPLE #5 – BUSINESS INCOME LIMITATION:

Note: This limitation applies to section 179 expense, and not to bonus depreciation.

Example using section 179 expense only

Federal return:

Asset purchase price = \$100,000 5-year life

Section 179 expense = \$100,000

Business income = \$30,000

The amount of section 179 expense that the taxpayer can use this year is limited to \$30,000.

The additional \$70,000 of section 179 expense is carried over to the following year.

Maine return:

Allowable § 179 = \$25,000

MACRS depreciation = $(100,000 - 25,000) \times 20\% = \$15,000$

Depreciation with § 179 = $25,000 + 15,000 = \$40,000$

Addition modification: Year 1 = $30,000 - 40,000 = (\$10,000)^*$

*Since the expense deduction and allowable depreciation under prior law are greater than the amount actually used for this tax year, the taxpayer would have no addition modification and, therefore, no subtraction modifications in subsequent years. The addition modification is based on the increase in depreciation and/or expense used in the taxable year for federal purposes over the Maine pro forma depreciation/expense under prior federal law. Since, in this case, there is no increase, there is also no modification for Maine purposes.

What happens in the following year, when the taxpayer uses the \$70,000 carryforward? There will be no modification based on the carryforward amount in that year. The amount of section 179 expense subject to the Maine addition modification is only the amount used for federal purposes in the same year that the asset is placed in service.

EXAMPLE #6 – BUSINESS INCOME LIMITATION continued – property placed in service in 2003:

Example using section 179 expense and bonus depreciation

Federal return:

Asset purchase price = \$120,000 5-year life

Section 179 expense = \$100,000

50% bonus depreciation = $(120,000 - 100,000) \times 50\% = \$10,000$

MACRS depreciation = $(120,000 - 100,000 - 10,000) \times 20\% = \$2,000$

Total federal deduction/expense = $100,000 + 10,000 + 2,000 = \$112,000$

Business income = \$50,000

Federal depreciation/expense is limited to: $50,000 + 10,000 + 2,000 = \$62,000$

Carryforward to next year = $100,000 - 50,000 = \$50,000$

Maine return:

Allowable § 179 = \$25,000

MACRS depreciation = $(120,000 - 25,000) \times 20\% = \$19,000$

Depreciation with § 179 = $25,000 + 19,000 = \$44,000$

Addition modification: Year 1 = $62,000 - 44,000 =$ \$18,000

Recovery: Year 2 = $18,000 \times 5\% =$ (\$ 900)

Year 3 = $(18,000 - 900)/3 =$ (\$ 5,700)

Year 4 = (\$ 5,700)

Year 5 = (\$ 5,700)

EXAMPLE #7 – APPLICATION OF SECTION 179 RECAPTURE – property placed in service in 2003:

Federal return:

Asset #1 purchase price = \$70,000 3-year life

Section 179 expense = \$70,000

Asset # 2 purchase price = \$30,000 5-year life

Section 179 expense = \$30,000

Total section 179 expense = $70,000 + 30,000 = \$100,000$ (70% related to 3-year property, 30% related to 5-year property)

Maine return:

Allowable § 179 = \$25,000

-related to 3-year asset = $25,000 \times 70\% = \$17,500$

-related to 5-year asset = $25,000 \times 30\% = \$ 7,500$

Allowable MACRS, Asset #1 = $(70,000 - 17,500) \times 33.33\% = \$17,498$

Allowable MACRS, Asset #2 = $(30,000 - 7,500) \times 20\% = \$4,500$

Depreciation with § 179 = $25,000 + 17,498 + 4,500 = \$46,998$

Add-back related to 3-year property = $70,000 - 17,500 - 17,498 = \$35,002$

Add-back related to 5-year property = $30,000 - 7,500 - 4,500 = \$18,000$

Total add-back = $35,002 + 18,000 = \$53,002$

Recovery:

Year 2 = $(35,002 \times 5\%) + (18,000 \times 5\%) = 1,750 + 900 =$ (\$ 2,650)

Year 3 = $(35,002 - 1,750) + (18,000 - 900)/3 = 33,252 + 5,700 =$ (\$38,952)

Year 4 = $(18,000 - 900)/3 =$ (\$ 5,700)

Year 5 = “ (\$ 5,700)

EXAMPLE #8 – MEMBER OF SEVERAL PASS-THROUGH ENTITIES – property placed in service in 2003:

Member A is a part owner of three partnerships. Member A owns 50% of Partnership #1, 20% of Partnership #2 and 75% of Partnership #3

Partnership #1

Federal return:

Asset purchase price = \$10,000 5-year life

No section 179 expense

50% bonus depreciation = $10,000 \times 50\% = \$5,000$

MACRS depreciation = $(10,000 - 5,000) \times 20\% = \$1,000$

Total depreciation = $5,000 + 1,000 = \$6,000$

Maine return:

MACRS depreciation = $10,000 \times 20\% = \$2,000$

Addition modification = $6,000 - 2,000 = \$4,000$

Member A portion of Year 1 addition = $4,000 \times 50\% =$ \$2,000

Recovery: Year 2 = $2,000 \times 5\% =$ (\$ 100)

Year 3 = $(2,000 - 100)/3 =$ (\$ 634)

Year 4 = “ (\$ 633)
 Year 5 = “ (\$ 633)

Partnership #2

Federal return:

Asset purchase price = \$50,000 7-year life

Section 179 expense = \$50,000

Maine return:

Allowable § 179 = \$25,000

MACRS depreciation = (50,000 - 25,000) x 14.29% = \$3,573

Total expense/depreciation = 25,000 + 3,573 = \$28,573

Addition modification = 50,000 - 28,573 = \$21,427

Member A portion of Year 1 addition = 21,427 x 20% = \$4,285

Recovery: Year 2 = 4,285 x 5% = (\$ 214)

Year 3 = (4,285 - 214)/5 = (\$ 815)

Year 4 = “ (\$ 814)

Year 5 = “ (\$ 814)

Year 6 = “ (\$ 814)

Year 7 = “ (\$ 814)

Partnership #3

Federal return:

Asset purchase price = \$30,000 3-year life

No section 179 expense

50% bonus depreciation = 30,000 x 50% = \$15,000

MACRS depreciation = (30,000 - 15,000) x 33.33% = \$5,000

Total depreciation = 15,000 + 5,000 = \$20,000

Maine return:

MACRS depreciation = 30,000 x 33.33% = \$9,999

Addition modification = 20,000 - 9,999 = \$10,001

Member A portion of Year 1 addition = 10,001 x 75% = \$7,501

Recovery: Year 2 = 7,501 x 5% = (\$ 375)

$$\text{Year 3} = 7,501 - 375 = (\$7,126)$$

Member A

Federal return (passed through from partnerships):

Asset purchase price = 10,000 + 50,000 + 30,000 = \$90,000

Related to 3-year property = 30,000/90,000 = 33.33%

Related to 5-year property = 10,000/90,000 = 11.11%

Related to 7-year property = 50,000/90,000 = 55.56%

Section 179 expense = \$50,000

Maine return:

Section 179 expense = \$25,000

Year 1 addition modifications = 2,000 + 4,285 + 7,501 = \$13,786

Recovery: Year 2 = 100 + 214 + 375 = (\$ 689)

Year 3 = 634 + 815 + 7,126 = (\$ 8,575)

Year 4 = 633 + 814 = (\$ 1,447)

Year 5 = 633 + 814 = (\$ 1,447)

Year 6 = (\$ 814)

Year 7 = (\$ 814)

EXAMPLE #9 – SECTION 179 EXPENSE AND A MEMBER OF SEVERAL PASS-THROUGH ENTITIES – PROPERTY PLACED IN SERVICE IN 2003:

Federal return

Partnership #1:

Business income \$100,000 x 50%

Section 179 expense \$ 80,000

Distributable income \$ 20,000

Member A's share:

\$50,000

\$40,000

\$10,000

Member A is a 50% owner of this partnership

Section 179 expense breakdown:

\$20,000 3-year property (25%)

\$60,000 5-year property (75%)

Dollar Limitation:

The aggregate cost of section 179 property that a taxpayer can elect to expense is \$100,000.

Business Income Limitation:

Because the partnership's business income is \$100,000 and the aggregate cost of the section 179 property is \$80,000, there is no business income limitation.

Carryforward:

There is no carryforward amount because there has been no limitation based on taxable income.

Partnership #2:

Business income \$100,000 x 90%

Section 179 expense \$ 80,000

Distributable income \$ 20,000

Member A's share:

\$90,000

\$72,000

\$18,000

Member A is a 90% owner of this partnership

Section 179 expense breakdown:

\$50,000 5-year property (62.5%)

\$30,000 7-year property (37.5%)

Limitations: same as for Partnership #1.

Member A:

Business income 50,000 + 90,000 \$140,000

Section 179 expense

40,000 + 72,000 = 112,000 (limited to 100,000) \$100,000

Federal Adjusted Gross Income ("FAGI") \$ 40,000

Dollar Limitation:

The aggregate cost of section 179 property that a taxpayer can elect to expense is \$100,000. Since Member A's aggregate expense passed through from the partnerships exceeds \$100,000, the excess is disallowed for both federal and state purposes.

Maine return

Maine Limitation:

Dollar limitation:

The aggregate cost of section 179 property that a taxpayer can elect to expense is \$25,000. The partnership may not allocate to its partners as a section 179 expense deduction for any taxable year more than the partnership's business income limitation for that taxable year. (Treas. Reg. 1.179-2(c)(2)).

Business Income Limitation:

For each partnership, the partnership's business income is \$100,000; therefore, there is no limitation in the \$25,000 allowed in the section 179 expense deduction for Maine purposes.

Carryforward:

There is no carryforward amount because there has been no limitation based on business income.

Since section 179 expense is limited to \$25,000, each partnership must calculate a total addition modification and then allocate it among its members. The addition modification is equal to the difference in the section 179 expense taken at the federal level and the allowable pro forma amount for Maine purposes, net of allowable pro forma first year depreciation.

Partnership #1:

Difference between amount taken for federal purposes and allowable pro forma amount for

Maine purposes: $80,000 - 25,000 = \$55,000$

Breakdown: 25% applies to 3-year property; 75% applies to 5-year property

First year depreciation: 33.33% for 3-year property; 20% for 5-year property

Allowable depreciation = $(\$55,000 \times 25\% \times 33.33\%) + (\$55,000 \times 75\% \times 20\%)$
 $= 4,583 + 8,250 = \$12,833$

Total addition modification = $55,000 - 12,833 = \$42,167$

Addition allocated to Member A = $42,167 \times 50\%$ ownership = \$21,084

Partnership #2:

Difference between amount taken for federal purposes and allowable pro forma amount for

Maine purposes: $80,000 - 25,000 = \$55,000$

Breakdown: 62.5% applies to 5-year property; 37.5% applies to 7-year property

First year depreciation: 20% for 5-year property; 14.29% for 7-year property

Allowable depreciation = $(\$55,000 \times 62.5\% \times 20\%) + (\$55,000 \times 37.5\% \times 14.29\%)$
 $= 6,875 + 2,947 = \$9,822$

Total addition modification = $55,000 - 9,822 = \$45,178$

Addition allocated to Member A = $45,178 \times 90\%$ ownership = \$40,660

Member A:

FAGI = \$ 40,000

Modification from Partnership #1 = \$ 21,084

Modification from Partnership #2 = \$ 40,660

\$101,744

However, this amount needs to be adjusted further, due to the \$25,000 section 179 expense limitation application at the member level. The addition modification that the partnerships calculated effectively reduced the section 179 expense claimed by each to \$25,000. After

application of Member A's ownership percentage to each partnership's total section 179 expense allowed by Maine, the result is:

| | |
|---|-----------------|
| Partnership #1: \$25,000 expense x 50% Member A ownership = | \$12,500 |
| Partnership #2: \$25,000 x 90% ownership = | <u>\$22,500</u> |
| Effective section 179 expense passed through to Member A = | <u>\$35,000</u> |

This total exceeds the \$25,000 allowable aggregate by \$10,000. Therefore, an additional modification of \$10,000 is required. Since, under prior law, this excess aggregate would have simply been disallowed, a regular first year depreciation amount is not allowed on the \$10,000 for purposes of calculating the Maine addition modification.

Finally, the calculation for Maine adjusted gross income ("MAGI") looks like this:

| | |
|---------------------------------|------------------|
| FAGI = | \$ 40,000 |
| Partnership #1 modification = | \$ 21,084 |
| Partnership #2 modification = | \$ 40,660 |
| Excess aggregate modification = | <u>\$ 10,000</u> |
| MAGI = | <u>\$111,744</u> |

Recapture:

For purposes of recapture the following percentages apply:

From Partnership #1: \$20,000 3-year property
 \$60,000 5-year property

Member A is a 50% owner of this entity, so his allocated expense breakdown is:

20,000 x 50% = \$10,000 3-year property
60,000 x 50% = \$30,000 5-year property

From Partnership #2: \$50,000 5-year property
 \$30,000 7-year property

Member A is a 90% owner of this entity, so his allocated expense breakdown is:

$$50,000 \times 90\% = \$45,000 \text{ 5-year property}$$

$$30,000 \times 90\% = \$27,000 \text{ 7-year property}$$

Combining the two entities,

$$\$ 10,000 \text{ 3-year property}$$

$$30,000 + 45,000 = \$ 75,000 \text{ 5-year property}$$

$$\underline{\$ 27,000} \text{ 7-year property}$$

$$\$112,000$$

Percentage allocation: $10,000/112,000 = 8.9\%$ 3-year property

$$75,000/112,000 = 67.0\% \text{ 5-year property}$$

$$27,000/112,000 = 24.1\% \text{ 7-year property}$$

The recapture schedule is as follows:

$$\text{Subtraction modification in Year 2} = 10,000 \times 5\% = \underline{\$500}$$

$$\text{Remainder to be recaptured} = 10,000 - 500 = \$9,500$$

$$\text{Subtraction modification in Year 3} = (9,500 \times 8.9\%) + [(9,500 \times 67.0\%)/3] + [(9,500 \times 24.1\%)/5] = 846 + (6,365/3) + (2,290/5) = 846 + 2,122 + 458 = \underline{\$3,426}$$

$$\text{Subtraction modification in Year 4} = (6,365/3) + (2,290/5) = 2,121 + 458 = \underline{\$2,579}$$

$$\text{Subtraction modification in Year 5} = (6,365/3) + (2,290/5) = 2,121 + 458 = \underline{\$2,579}$$

$$\text{Subtraction modification in Year 6} = (2,290/5) = \underline{\$458}$$

$$\text{Subtraction modification in Year 7} = (2,290/5) = \underline{\$458}$$

These recapture amounts, as calculated by Member A, are in addition to the recapture amounts that each partnership will calculate and pass through to Member A on an annual basis.

EXAMPLE #10 – PASSIVE ACTIVITY LOSS – property placed in service in 2003:

Member A is 50% owner of Partnership #1. Income from Partnership #1 is considered passive activity income for Member A. Member A has no business income other than from Partnership #1.

Partnership #1

Federal return:

Asset purchase price = \$50,000 5-year life

No section 179 expense

50% bonus depreciation = $50,000 \times 50\% = \$25,000$

MACRS depreciation = $25,000 \times 20\% = \$5,000$

Total depreciation = \$30,000; Member A's share = $30,000 \times 50\% = \$15,000$

2003 passive activity loss = (\$20,000); Member A's share = $(20,000) \times 50\% = (\$10,000)$

Maine return:

MACRS depreciation = $50,000 \times 20\% = \$10,000$

Addition modification = $30,000 - 10,000 = \$20,000$; Member A's share = $20,000 \times 50\% = \$10,000$

Recovery:

Year 2 = $20,000 \times 5\% = (\$1,000)$; Member A's share = $1,000 \times 50\% = (\$ 500)$

Year 3 = $(20,000 - 1,000)/3 = (\$6,334)$; Member A's share = $(\$ 3,167)$

Year 4 = " $(\$6,333)$; Member A's share = $(\$ 3,167)$

Year 5 = " $(\$6,333)$; Member A's share = $(\$ 3,166)$

Member A

Share of loss from Partnership #1 = (\$10,000)

Share of passive activity income from other sources = \$3,000

Member A can use only \$3,000, or 30% of the loss from Partnership #1 in the taxable year; therefore, only 30% of the addition modification is required for Maine tax purposes.

Addition: Year 1 = $10,000 \times 30\% = \$3,000$

Recovery: Year 2 = $500 \times 30\% = (\$ 150)$

Year 3 = $3,167 \times 30\% = (\$ 950)$

Year 4 = $3,167 \times 30\% = (\$ 950)$

Year 5 = $3,166 \times 30\% = (\$ 950)$

The amount of passive activity loss from Partnership #1 used by Member A in future years will not generate an addition modification in those years.

EXAMPLE #11 – MULTISTATE BUSINESS – property placed in service in 2005:

Corporation A is located in several different states. Corporation A places \$105,000 of 5-year property in service in 2005, some in Maine, some elsewhere. Corporation A claims the total amount of the property, \$105,000 as a section 179 expense. Corporation A calculates its Maine corporate income tax apportionment factor to be 0.15 (15% of income attributable to Maine). The Maine addition modification for the federal section 179 expense claimed is calculated as follows:

Section 179 expense claimed = \$105,000

Expense allowed under prior law = \$25,000

MACRS depreciation allowed under prior law = $(105,000 - 25,000) \times 20\% = \$16,000$

Maine addition modification = $105,000 - 25,000 - 16,000 = \$64,000$

The Maine addition modification is based on the corporation's entire section 179 expense claimed. The Maine apportionment factor is then applied to the corporation's gross Maine income tax. Similarly, the corporation's recapture amounts are based on the entire \$64,000 add-back and gross Maine income tax is calculated and apportioned after the application of the full recapture amount for that year.

EXAMPLE #12 – property placed in service in 2008 and only bonus depreciation claimed:

Year 1

Federal return:

Asset purchase price = \$100,000 5-year life

Bonus depreciation = $100,000 \times 50\% = \$50,000$

MACRS depreciation = $(100,000 - 50,000) \times 20\% = \$10,000$

Total depreciation = $50,000 + 10,000 = \$60,000$

Maine return:

MACRS depreciation = $100,000 \times 20\% = \$20,000$

Addition modification: Year 1 = $60,000 - 20,000 = \$40,000$

Year 2

Federal return:

MACRS depreciation = $50,000 \times 32\% = \$16,000$

Maine return:

MACRS depreciation = $100,000 \times 32\% = \$32,000$

Subtraction modification = $32,000 - 16,000 = \$16,000$

Year 3

Federal return:

MACRS depreciation = $50,000 \times 19.2\% = \$9,600$

Maine return:

MACRS depreciation = $100,000 \times 19.2\% = \$19,200$

Subtraction modification = $19,200 - 9,600 = \$9,600$

Year 4

Federal return:

MACRS depreciation = $50,000 \times 11.52\% = \$5,760$

Maine return:

MACRS depreciation = $100,000 \times 11.52\% = \$11,520$

Subtraction modification = $11,520 - 5,760 = \$5,760$

Year 5

Federal return:

MACRS depreciation = $50,000 \times 11.52\% = \$5,760$

Maine return:

MACRS depreciation = $100,000 \times 11.52\% = \$11,520$

Subtraction modification = $11,520 - 5,760 = \$5,760$

Year 6

Federal return:

MACRS depreciation = $50,000 \times 5.76\% = \$2,880$

Maine return:

MACRS depreciation = $100,000 \times 5.76\% = \$5,760$

Subtraction modification = $5,760 - 2,880 = \$2,880$

EXAMPLE #13 – property placed in service in 2008 and both bonus depreciation and section 179 expense claimed:

Year 1

Federal return:

Asset purchase price = \$100,000 5-year life

Section 179 expense claimed = \$50,000

Bonus depreciation = $(100,000 - 50,000) \times 50\% = \$25,000$

Depreciable basis = $100,000 - 50,000 - 25,000 = \$25,000$

MACRS depreciation = $25,000 \times 20\% = \$5,000$

Total § 179 expense and depreciation = $50,000 + 25,000 + 5,000 = \$80,000$

In order to correctly calculate the recapture for bonus depreciation and for section 179 expense, assume there are two separate assets, each worth \$50,000. One asset is completely expensed under section 179 and the other asset is only subject to depreciation.

Asset 1

Federal return:

Asset purchase price = \$50,000 5-year life

Section 179 expense claimed = \$50,000

Maine return:

Section 179 expense allowed = \$25,000

MACRS depreciation = $(50,000 - 25,000) \times 20\% = \$5,000$

Total § 179 expense and depreciation = $25,000 + 5,000 = \$30,000$

Addition modification: Asset 1 = $50,000 - 30,000 = \$20,000$

Asset 2

Federal return:

Asset purchase price = \$50,000 5-year life

Bonus depreciation = $50,000 \times 50\% = \$25,000$

MACRS depreciation = $(50,000 - 25,000) \times 20\% = \$5,000$

Total depreciation = $25,000 + 5,000 = \$30,000$

Maine return:

MACRS depreciation = $50,000 \times 20\% = \$10,000$

Addition modification: Asset 2 = $30,000 - 10,000 = \$20,000$

Total addition modification, Year 1 = $20,000 + 20,000 = \$40,000$

Year 2

Asset 1

Subtraction modification = $20,000 \times 5\% = \$1,000$

Asset 2

Federal return:

MACRS depreciation = $25,000 \times 32\% = \$8,000$

Maine return:

MACRS depreciation = $50,000 \times 32\% = \$16,000$

Subtraction modification = $16,000 - 8,000 = \$8,000$

Total Year 2 subtraction modification: \$9,000

Year 3

Asset 1

Subtraction modification = $(20,000 - 1,000)/3 = \$6,334$

Asset 2

Federal return:

MACRS depreciation = $25,000 \times 19.2\% = \$4,800$

Maine return:

MACRS depreciation = $50,000 \times 19.2\% = \$9,600$

Subtraction modification = $9,600 - 4,800 = \$4,800$

Total Year 3 subtraction modification: \$11,134

Year 4

Asset 1

Subtraction modification = $(20,000 - 1,000)/3 = \$6,333$

Asset 2

Federal return:

MACRS depreciation = $25,000 \times 11.52\% = \$2,880$

Maine return:

MACRS depreciation = $50,000 \times 11.52\% = \$5,760$

Subtraction modification = $5,760 - 2,880 = \$2,880$

Total Year 4 subtraction modification: \$9,213

Year 5

Asset 1

Subtraction modification = $(20,000 - 1,000)/3 = \$6,333$

Asset 2

Federal return:

MACRS depreciation = $25,000 \times 11.52\% = \$2,880$

Maine return:

MACRS depreciation = $50,000 \times 11.52\% = \$5,760$

Subtraction modification = $5,760 - 2,880 = \$2,880$

Total Year 5 subtraction modification: \$9,213

Year 6

Asset 2

Federal return:

MACRS depreciation = $25,000 \times 5.76\% = \$1,440$

Maine return:

MACRS depreciation = $50,000 \times 5.76\% = \$2,880$

Subtraction modification = $2,880 - 1,440 = \$1,440$

Total Year 6 subtraction modification: \$1,440

Total modifications

Addition, Year 1 = \$40,000

Subtraction, Year 2 = $1,000 + 8,000 = (9,000)$
 Subtraction, Year 3 = $6,334 + 4,800 = (11,134)$
 Subtraction, Year 4 = $6,333 + 2,880 = (9,213)$
 Subtraction, Year 5 = $6,333 + 2,880 = (9,213)$
 Subtraction, Year 6 = $1,440 = (1,440)$

Total 0

EXAMPLE #14 – property placed in service in 2011 and bonus depreciation claimed:

Year 1

Federal return:

Asset purchase price = \$100,000 5-year life
 Bonus depreciation = $100,000 \times 100\% = \$100,000$
 MACRS depreciation = $(100,000 - 100,000) \times 20\% = \0
 Total depreciation = $100,000 + 0 = \$100,000$

Maine return:

MACRS depreciation = $100,000 \times 20\% = \$20,000$
 Addition modification: Year 1 = $100,000 - 20,000 = \$80,000$

Year 2

Federal return:

MACRS depreciation = \$0, asset fully depreciated in Year 1

Maine return:

MACRS depreciation = $100,000 \times 32\% = \$32,000$
 Subtraction modification = $32,000 - 0 = \$32,000$

Year 3

Federal return:

MACRS depreciation = \$0

Maine return:

MACRS depreciation = $100,000 \times 19.2\% = \$19,200$

Subtraction modification = $19,200 - 0 = \$19,200$

Year 4

Federal return:

MACRS depreciation = \$0

Maine return:

MACRS depreciation = $100,000 \times 11.52\% = \$11,520$

Subtraction modification = $11,520 - 0 = \$11,520$

Year 5

Federal return:

MACRS depreciation = \$0

Maine return:

MACRS depreciation = $100,000 \times 11.52\% = \$11,520$

Subtraction modification = $11,520 - 0 = \$11,520$

Year 6

Federal return:

MACRS depreciation = \$0

Maine return:

MACRS depreciation = $100,000 \times 5.76\% = \$5,760$

Subtraction modification = $5,760 - 0 = \$5,760$

EXAMPLE #15 – property placed in service in 2011 and both bonus depreciation and Maine Capital Investment Credit claimed:

Year 1

Federal return:

Asset purchase price = \$100,000 5-year life

Bonus depreciation = $100,000 \times 100\% = \$100,000$

MACRS depreciation = $(100,000 - 100,000) \times 20\% = \0

Total depreciation = $100,000 + 0 = \$100,000$

Maine return:

Addition modification: Year 1 = \$100,000 Since the taxpayer is claiming the Maine Capital Investment Credit , all federal bonus depreciation must be added back to Maine income.

Year 2

Federal return:

MACRS depreciation = \$0, asset fully depreciated in Year 1

Maine return:

Subtraction modification = \$0 The credit claimed in Year 1 replaces all recapture modifications for those assets

EXAMPLE #16 – property placed in service in 2011, bonus depreciation claimed and Maine Capital Investment Credit claimed for some of the bonus depreciation property:

Year 1

Federal return:

Asset purchase price = \$100,000 5-year life, \$75,000 located in Maine, \$25,000 in
Massachusetts

Bonus depreciation = $100,000 \times 100\% = \$100,000$

MACRS depreciation = $(100,000 - 100,000) \times 20\% = \0

Total depreciation = $100,000 + 0 = \$100,000$

Maine return:

Maine Capital Investment Credit is claimed for \$75,000 of eligible property

Credit property addition modification: Year 1 = \$75,000 Since the taxpayer is claiming the
Maine Capital Investment Credit, all
federal bonus depreciation for this
property must be added back to Maine
income

Non-credit property MACRS depreciation = $\$25,000 \times 20\% = \$5,000$

Addition modification: Year 1 = $25,000 - 5,000 = \$20,000$

Year 2

Federal return:

MACRS depreciation = \$0, assets fully depreciated in Year 1

Maine return:

Credit property addition modification in Year 1 is not eligible for recapture

Non-credit property MACRS depreciation = $25,000 \times 32\% = \$8,000$

Subtraction modification = $8,000 - 0 = \$8,000$

Year 3

Federal return:

MACRS depreciation = \$0

Maine return:

Non-credit property MACRS depreciation = $25,000 \times 19.2\% = \$4,800$

Subtraction modification = $4,800 - 0 = \$4,800$

Year 4

Federal return:

MACRS depreciation = \$0

Maine return:

Non-credit property MACRS depreciation = $25,000 \times 11.52\% = \$2,880$

Subtraction modification = $2,800 - 0 = \$2,800$

Year 5

Federal return:

MACRS depreciation = \$0

Maine return:

Non-credit property MACRS depreciation = $25,000 \times 11.52\% = \$2,880$

Subtraction modification = $2,800 - 0 = \$2,800$

Year 6

Federal return:

MACRS depreciation = \$0

Maine return:

Non-credit property MACRS depreciation = $25,000 \times 5.76\% = \$1,440$

Subtraction modification = $1,440 - 0 = \$1,440$

PART 5 – DEPRECIATION SCHEDULES

MACRS 1/2-year convention depreciation schedules

| Recovery Year | Recovery Period | | | | | |
|------------------|-----------------|---------|---------|---------|---------|---------|
| | 3-year | 5-year | 7-year | 10-year | 15-year | 20-year |
| 1 | 0.33330 | 0.20000 | 0.14290 | 0.10000 | 0.05000 | 0.03750 |
| 2 | 0.44450 | 0.32000 | 0.24490 | 0.18000 | 0.09500 | 0.07219 |
| 3 | 0.14810 | 0.19200 | 0.17490 | 0.14400 | 0.08550 | 0.06677 |
| 4 | 0.07410 | 0.11520 | 0.12490 | 0.11520 | 0.07700 | 0.06177 |
| 5 | | 0.11520 | 0.08930 | 0.09220 | 0.06930 | 0.05713 |
| 6 | | 0.05760 | 0.08920 | 0.07370 | 0.06230 | 0.05285 |
| 7 | | | 0.08930 | 0.06550 | 0.05900 | 0.04888 |
| 8 | | | 0.04460 | 0.06550 | 0.05900 | 0.04522 |
| 9 | | | | 0.06560 | 0.05910 | 0.04462 |
| 10 | | | | 0.06550 | 0.05900 | 0.04461 |
| 11 | | | | 0.03280 | 0.05910 | 0.04462 |
| 12 | | | | | 0.05900 | 0.04461 |
| 13 | | | | | 0.05910 | 0.04462 |
| 14 | | | | | 0.05900 | 0.04461 |
| 15 | | | | | 0.05910 | 0.04462 |
| 16 | | | | | 0.02950 | 0.04461 |
| 17 | | | | | | 0.04462 |
| 18 | | | | | | 0.04461 |
| 19 | | | | | | 0.04462 |
| 20 | | | | | | 0.04461 |
| 21 | | | | | | 0.02231 |