

COMMISSIONER'S DIRECTIVE #19

AUGUST 2003

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SUBJECT: FEDERAL BONUS DEPRECIATION DEDUCTION AS APPLIED TO INDIANA ADJUSTED GROSS INCOME

INTRODUCTION

This Directive is intended to explain the proper method for removing federal bonus depreciation from federal adjusted gross income in arriving at Indiana taxable income.

House Enrolled Act 1728, (2003), effective retroactive to January 1, 2003, is the legislation that is traditionally passed which updates the Indiana definition of federal adjusted gross income to the definition that is currently applicable in the Internal Revenue Code. Federal changes to adjusted gross income that were passed in March of 2002 included retroactive provisions that were effective as early as September 11, 2001. None of these provisions were incorporated by reference as of January 1, 2002. HEA 1728 incorporated all of these changes into the calculation of Indiana taxable income except for federal bonus depreciation.

I. DEFINITION OF BONUS DEPRECIATION

Bonus depreciation is defined in IC 6-3-1-33 to be an amount equal to that part of any depreciation allowance allowed in computing the taxpayer's federal adjusted gross income or federal taxable income that is attributable to the additional first year special depreciation allowance (bonus depreciation) for qualified property allowed under Section 168(k) of the Internal Revenue Code.

II. MODIFICATION TO ADJUSTED GROSS AND TAXABLE INCOME

IC 6-3-1-3.5 is the section of the Indiana Code that defines adjusted gross income and taxable income. Both terms start with the federal definition and then are modified for Indiana purposes. The modification that has occurred for 2003 and thereafter provides an adjustment for any taxpayer that owns property for which bonus depreciation was allowed in the current or an earlier taxable year. The adjustment is equal to the amount that would have been computed if an election had not been made to apply the bonus depreciation to the property in the year that it was placed in service.

This provision along with language in HEA 1728 SECTION 6, also prohibits a taxpayer from deducting any part of a depreciation allowance used to compute the additional first-year special depreciation allowance for any taxable year that began before January 1, 2003.

The depreciation allowance that is permitted will be the same calculation and schedule that was in effect for taxable years beginning before 2001. This is done through a three step process.

1. Add-back the thirty percent (30%) bonus depreciation in the first year so that Indiana depreciable values are one hundred percent (100%) of acquisition cost.
2. An adjustment must be made to all additional years of the life of the asset. The federal depreciation basis is seventy percent (70%) of cost for those years. The adjustment is necessary to bring the original basis for Indiana depreciation to one hundred percent (100%) of cost.
3. When the asset is sold, bonus depreciation is added back to the value when calculating a capital gain or depreciation recapture. An Indiana adjustment is necessary to reflect the correct amount of Indiana depreciation.

(Note: The federal Jobs and Growth Tax Relief Reconciliation Act of 2003 has increased bonus depreciation from thirty percent (30%) to fifty percent (50%) for property acquired after May 5, 2003.)

III. OTHER FEDERAL CHANGES INCORPORATED INTO INDIANA ADJUSTED GROSS INCOME

HEA 1728 incorporates all other federal changes by updating the Indiana Code to coincide with the federal changes. The incorporated changes include all of those changes that had retroactive application including extending the carryback of net operating losses for 2001 and 2002. Non-code language in HEA 1728 SECTION 7 that states that the definitional changes apply only to years beginning after January 1, 2003 only prevents the application of those updated, but non-retroactive provisions, to fiscal years in progress as of January 1, 2003.

A handwritten signature in black ink, reading "Kenneth L. Miller", written over a horizontal line.

Kenneth L. Miller
Commissioner