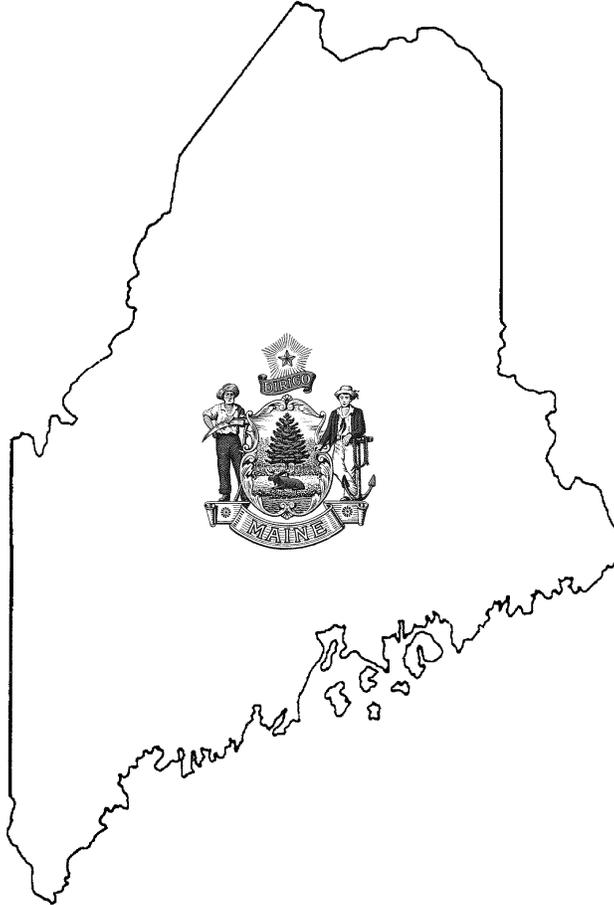


MODIFICATIONS RELATED TO BONUS DEPRECIATION & SECTION 179 EXPENSING



GUIDANCE DOCUMENT

Maine Revenue Services, Income/Estate Tax Division

Rev 2/14

CONTENTS

Introduction	p.	3
Part 1 – General Instructions For property placed in service 2011 - 2013	p.	7
Part 2 – General Instructions For property placed in service 2008 - 2010	p.	16
Part 3 – General Instructions For property placed in service 2002 - 2007	p.	27
Part 4 – Additional Examples	p.	36
Part 5 – Depreciation Schedules	p.	56

Introduction

If a business purchases capital assets in a taxable year, the purchases may be eligible for special (bonus) depreciation under the Internal Revenue Code (“IRC”) § 168(k) or first-year expense under IRC § 179.

Over the years, Maine has been in various stages of conformity with the federal section 179 expense and bonus depreciation laws. For tax year 2013, Maine law is in full conformity with federal section 179 law, but adjustments are necessary on the Maine income tax return related to federal bonus depreciation.

Nonconformity with federal law requires adjustments to federal taxable income through addition and subtraction modifications. This guidance document is intended solely as advice to persons seeking information about income modifications related to federal bonus depreciation and section 179 expense and provides more information than is available in the filing instructions for tax returns. The applicable statutory references are listed below.

<u>Section</u>	<u>Applicable Years</u>
Addition Modifications – Individuals	
36 M.R.S. § 5122(1)(N)	Bonus depreciation – 2002 through 2005
	Section 179 expense – 2003 through 2010
36 M.R.S. § 5122(1)(AA)	Bonus depreciation – 2008 through 2010
36 M.R.S. § 5122(1)(FF)	Bonus depreciation – 2011 through 2012
36 M.R.S. § 5122(1)(HH)	Bonus depreciation – 2013
Corporations	
36 M.R.S. § 5200-A(1)(N)	Bonus depreciation – 2002 through 2005
	Section 179 expense – 2003 through 2010
36 M.R.S. § 5200-A(1)(T)	Bonus depreciation – 2008 through 2010
36 M.R.S. § 5200-A(1)(Y)	Bonus depreciation – 2011 through 2012
36 M.R.S. § 5200-A(1)(AA)	Bonus depreciation – 2013
Subtraction Modifications – Individuals	
36 M.R.S. § 5122(2)(Q)	After 2002 (recapture of sub-§ 1, ¶N)
36 M.R.S. § 5122(2)(X)	After 2002 (recapture of § 5200-A(1)(N))
36 M.R.S. § 5122(2)(AA)	After 2008 (recapture of sub-§ 1, AA)
36 M.R.S. § 5122(2)(II)	After 2011 (recapture of sub-§ 1, ¶FF)
36 M.R.S. § 5122(2)(MM)	After 2013 (recapture of sub-§ 1, ¶HH)
Corporations	
36 M.R.S. § 5200-A(2)(M)	After 2002 (recapture of sub-§ 1, ¶N)
36 M.R.S. § 5200-A(2)(R)	After 2008 (recapture of sub-§ 1, ¶T)
36 M.R.S. § 5200-A(2)(V)	After 2011 (recapture of sub-§ 1, ¶Y)
36 M.R.S. § 5200-A(2)(Y)	After 2013 (recapture of sub-§ 1, ¶AA)

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 increasing certain levels of expense and depreciation. The federal thresholds for 2013 are 50% for bonus depreciation and \$500,000 for section 179 expense with a phase-out beginning at \$2,000,000 for § 179-eligible investments during the year.

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 Maine capital investment credit. The new credit, available for property placed in service in 2011 and 2012, affects the calculation of the bonus depreciation addition and subtraction modifications. In 2013, the Legislature extended the Maine capital investment credit, with alterations, to property placed in service in 2013. 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 Part 2 and the examples in Part 4 for more information.

Bonus depreciation claimed for property placed in service in 2011 through 2013.

For property placed in service in 2011 and 2012, two separate calculations may be required for bonus depreciation modifications. For bonus depreciation claimed on property placed in service in Maine for which the Maine capital investment credit (“MCIC”) is being claimed, the addition modification is equal to the entire amount of the federal bonus depreciation claimed. Because the MCIC is intended to offset the addition modification for Maine property, there is no related recapture modification for this property. For bonus depreciation claimed on property for which the 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, the examples in Part 4 and 36 M.R.S. § 5219-GG for more information.

For property placed in service in 2013, the addition modification for property subject to the MCIC differs from the modification required for 2011 – 2012 credit property. The addition modification calculation used in 2008 – 2010 applies to *all* property placed in service in Maine in 2013, regardless of whether the MCIC is claimed. The addition modification for property associated with the credit, however, will still be entered on a separate line on the Maine income tax return. For a bonus depreciation addition modification on property related to the MCIC claim, there is no related recapture modification. For bonus depreciation claimed on property for which the Maine capital investment credit is not being claimed, the same subtraction modification approach used for property placed in service in 2008 - 2010 is applied. See Part 1, the examples in Part 4 and 36 M.R.S. § 5219-JJ for more information.

PART 1 – GENERAL INSTRUCTIONS FOR PROPERTY PLACED IN SERVICE 2011 - 2013 FOR FORMS 1040ME AND 1120ME INCOME MODIFICATION LINES

For property placed in service in 2011 and later years, Maine is in full conformity with IRC § 179 expense limitations. Adjustments through addition 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 - 2013, the calculations related to bonus depreciation have changed from prior years. As with modifications for tax years 2008 – 2010, the modifications for 2011 - 2013 are based on tax years 2011 - 2013 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 (and reports its taxes on the same basis), 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 statutory paragraphs relate to bonus depreciation modifications in effect for tax years beginning in 2011 - 2013.

Individuals

§5122. Modifications

1. Additions. Federal adjusted gross income shall be increased by:

FF. For taxable years beginning in 2011 and 2012:

(1) An amount equal to the depreciation deduction claimed by the taxpayer under the Code, Section 168(k) with respect to property placed in service in the State during the taxable year for which a credit is claimed under section 5219-GG; and

(2) An amount equal to the net increase in depreciation attributable to the depreciation deduction claimed by the taxpayer under the Code, Section 168(k) with respect to property for which a credit is not claimed under section 5219-GG; and

HH. For taxable years beginning in 2013:

(1) An amount equal to the net increase in depreciation attributable to the depreciation deduction claimed by the taxpayer under the Code, Section 168(k) with respect to property placed in service in the State during the taxable year for which a credit is claimed under section 5219-JJ for that taxable year; and

(2) An amount equal to the net increase in depreciation attributable to the depreciation deduction claimed by the taxpayer under the Code, Section 168(k) with respect to property for which a credit is not claimed under section 5219-JJ.

2. Subtractions. *Federal adjusted gross income shall be reduced by:*

Q. A fraction of any amount previously added back by the taxpayer to federal adjusted gross income pursuant to subsection 1, paragraph N.

(1) With respect to property first placed in service during taxable years beginning in 2002, the adjustment under this paragraph is available for each year during the recovery period, beginning 2 years after the beginning of the taxable year during which the property was first placed in service. The fraction is equal to the amount added back under subsection 1, paragraph N with respect to the property, divided by the number of years in the recovery period minus 2.

(2) With respect to all other property, for the taxable year immediately following the taxable year during which the property was first placed in service, the fraction allowed by this paragraph is equal to 5% of the amount added back under subsection 1, paragraph N with respect to the property. For each subsequent taxable year during the recovery period, the fraction is equal to 95% of the amount added back under subsection 1, paragraph N with respect to the property, divided by the number of years in the recovery period minus 2.

In the case of property expensed pursuant to Section 179 of the Code, the term "recovery period" means the recovery period that would have been applicable to the property had Section 179 not been applied;

X. The taxpayer's pro rata share of an amount that was previously added back to federal taxable income pursuant to section 5200-A, subsection 1, paragraph N by an S corporation of which the taxpayer is a shareholder and by which, absent the S corporation election, the corporation could have reduced its federal taxable income for the taxable year pursuant to section 5200-A, subsection 2, paragraph M;

AA. For taxable years beginning on or after January 1, 2009, an amount equal to the net increase in the depreciation deductions allowable under Sections 167 and 168 of the Code that would have been applicable to that property had the depreciation deduction under the Code, Section 168(k) not been claimed with respect to such property placed in service on or after January 1, 2008 for which an addition was required under subsection 1, paragraph AA in a prior year.

Upon the taxable disposition of property to which this paragraph applies, the amount of any gain or loss includable in federal adjusted gross income must be adjusted for Maine income tax purposes by an amount equal to the difference between the addition modification for such property under subsection 1, paragraph AA and the subtraction modifications allowed pursuant to this paragraph.

The total amount of subtraction claimed for property under this paragraph for all tax years may not exceed the addition modification under subsection 1, paragraph AA for the same property;

II. For taxable years beginning on or after January 1, 2012, an amount equal to the net increase in the depreciation deduction allowable under the Code, Sections 167 and 168 that would have been applicable to that property had the depreciation deduction under the Code, Section 168(k) not been claimed with respect to such property placed in service during the taxable year beginning in 2011 or 2012 for which an addition was required under subsection 1, paragraph FF, subparagraph (2) for the taxable year beginning in 2011 or 2012.

Upon the taxable disposition of property to which this paragraph applies, the amount of any gain or loss includable in federal adjusted gross income must be adjusted for Maine income tax purposes by an amount equal to the difference between the addition modification for such property under subsection 1, paragraph FF, subparagraph (2) related to property placed in service outside the State and the subtraction modifications allowed pursuant to this paragraph.

The total amount of the subtraction modification claimed under this paragraph for all tax years may not exceed the addition modification under subsection 1, paragraph FF, subparagraph (2) for the same property;

MM. For taxable years beginning on or after January 1, 2014, an amount equal to the net increase in the depreciation deduction allowable under the Code, Sections 167 and 168 that would have been applicable to that property had the depreciation deduction under the Code, Section 168(k) not been claimed with respect to such property placed in service during the taxable year beginning in 2013 for which an addition was required under subsection 1, paragraph HH, subparagraph (2) for the taxable year beginning in 2013.

Upon the taxable disposition of property to which this paragraph applies, the amount of any gain or loss includable in federal adjusted gross income must be adjusted for Maine income tax purposes by an amount equal to the difference between the addition modification for such property under subsection 1, paragraph HH, subparagraph (2) and the subtraction modifications allowed pursuant to this paragraph.

The total amount of subtraction claimed under this paragraph for all tax years may not exceed the addition modification under subsection 1, paragraph HH, subparagraph (2) for the same property.

Corporations

§5200-A. Modifications

1. Additions. *The taxable income of the taxpayer under the laws of the United States shall be increased by:*

Y. For taxable years beginning in 2011 and 2012:

(1) An amount equal to the depreciation deduction claimed by the taxpayer under the Code, Section 168(k) with respect to property placed in service in the State during the taxable year for which a credit is claimed under section 5219-GG; and

(2) An amount equal to the net increase in depreciation attributable to the depreciation deduction claimed by the taxpayer under the Code, Section 168(k) with respect to property for which a credit is not claimed under section 5219-GG; and

AA. For taxable years beginning in 2013:

(1) An amount equal to the net increase in depreciation attributable to the depreciation deduction claimed by the taxpayer under the Code, Section 168(k) with respect to property placed in service in the State during the taxable year for which a credit is claimed under section 5219-JJ for that taxable year; and

(2) An amount equal to the net increase in depreciation attributable to the depreciation deduction claimed by the taxpayer under the Code, Section 168(k) with respect to property for which a credit is not claimed under section 5219-JJ.

2. Subtractions. *The taxable income of the taxpayer under the laws of the United States shall be decreased by:*

M. A fraction of any amount previously added back by the taxpayer to federal taxable income pursuant to subsection 1, paragraph N.

(1) With respect to property first placed in service during taxable years beginning in 2002, the adjustment under this paragraph is available for each year during the recovery period, beginning 2 years after the beginning of the taxable year during which the property was first placed in service. The fraction is equal to the amount added back under subsection 1, paragraph N with respect to the property, divided by the number of years in the recovery period minus 2.

(2) With respect to all other property, for the taxable year immediately following the taxable year during which the property was first placed in service, the fraction allowed by this paragraph is equal to 5% of the amount added back under subsection 1, paragraph N with respect to the property. For each subsequent taxable year during the recovery period, the fraction is equal to 95% of the amount added back under subsection 1, paragraph N with respect to the property, divided by the number of years in the recovery period minus 2.

In the case of property expensed pursuant to Section 179 of the Code, the term "recovery period" means the recovery period that would have been applicable to the property had Section 179 not been applied;

R. For taxable years beginning on or after January 1, 2009, an amount equal to the net increase in the depreciation deductions allowable under Sections 167 and 168 of the Code that would have been applicable to that property had the depreciation deduction under the Code, Section 168(k) not been claimed with respect to such property placed in service on or after January 1, 2008 for which an addition was required under subsection 1, paragraph T in a prior year.

Upon the taxable disposition of property to which this paragraph applies, the amount of any gain or loss includable in federal taxable income must be adjusted for Maine income tax purposes by an amount equal to the difference between the addition modification for such property under subsection 1, paragraph T and the subtraction modifications allowed pursuant to this paragraph.

The total amount of subtraction claimed for property under this paragraph for all tax years may not exceed the addition modification under subsection 1, paragraph T for the same property;

V. For taxable years beginning on or after January 1, 2012, an amount equal to the net increase in the depreciation deduction allowable under the Code, Sections 167 and 168 that would have been applicable to that property had the depreciation deduction under the Code, Section 168(k) not been claimed with respect to such property placed in service during the taxable year beginning in 2011 or 2012 for which an addition was required under subsection 1, paragraph Y, subparagraph (2) for the taxable year beginning in 2011 or 2012.

Upon the taxable disposition of property to which this paragraph applies, the amount of any gain or loss includable in federal taxable income must be adjusted for Maine income tax purposes by an amount equal to the difference between the addition modification for such property under subsection 1, paragraph Y, subparagraph (2) related to property placed in service outside the State and the subtraction modifications allowed pursuant to this paragraph.

The total amount of the subtraction modification claimed under this paragraph for all tax years may not exceed the addition modification under subsection 1, paragraph Y, subparagraph (2) for the same property;

Y. For taxable years beginning on or after January 1, 2014, an amount equal to the net increase in the depreciation deduction allowable under the Code, Sections 167 and 168 that would have been applicable to that property had the depreciation deduction under the Code, Section 168(k) not been claimed with respect to such property placed in service during the taxable year beginning in 2013 for which an addition was required under subsection 1, paragraph AA, subparagraph (2) for the taxable year beginning in 2013.

Upon the taxable disposition of property to which this paragraph applies, the amount of any gain or loss includable in federal taxable income must be adjusted for Maine income tax purposes by an amount equal to the difference between the addition modification for such property under subsection 1, paragraph AA, subparagraph (2) and the subtraction modifications allowed pursuant to this paragraph.

The total amount of subtraction claimed under this paragraph for all tax years may not exceed the addition modification under subsection 1, paragraph AA, subparagraph (2) for the same property.

The following instructions explain the modification calculations for property placed in service for taxable years beginning in 2011 - 2013. See the examples in Part 4 for more information.

Addition modification (add-back)

The addition modification may or may not change with the new decoupling method. The addition modification calculation is based on whether the Maine capital investment credit ("MCIC") is claimed and when it is claimed.

The credit, as first enacted, applies to tax years beginning in 2011 and 2012 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 MCIC 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 MCIC 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.

The credit was extended for property placed in service in Maine in tax year 2013, with certain changes. The credit for 2013 property is equal to 9% of the addition modification claimed for that property. The addition modification for credit property and non-credit property is equal to 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 *all* property placed in service in 2013 is the same bonus depreciation calculation used in 2008 – 2010.

Subtraction modification (recapture)

If a taxpayer claims the MCIC 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 total federal claim (\$100,000) and the regular MACRS depreciation applied without any bonus depreciation, or \$20,000 ($\$100,000 * 20\%$). The 2011 addition modification, therefore, is \$80,000 ($\$100,000 - \$20,000$). In 2012, 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 2012 subtraction modification would be the Maine depreciation of \$32,000 ($\$100,000 * 32\%$) less the federal depreciation of \$0 (asset was fully depreciated in 2011), 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 MCIC 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 six 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 – 2013, however, any remaining recapture related to bonus depreciation on non-credit property is allowed in the year of an asset's disposal. This 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 – 2013. 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

Corporations and other entities realizing Maine-source income 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 #4.10*). 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 claim a loss of \$10,000 (50% share of partnership loss) and be required to apply the full share of add-back, \$20,000. 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. A subtraction modification is not allowed in this case because that partner was not required to apply an add-back in the previous year.

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, an entity is not subject to Maine tax prior to a merger, the merged entity is not entitled to a recapture, regardless of the merged entity's 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 (and reports its taxes on the same basis), 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 statutory paragraphs relate to bonus depreciation/§ 179 modifications in effect for tax years beginning in 2008, 2009 and 2010.

Individuals

§5122. Modifications

1. Additions. Federal adjusted gross income shall be increased by:

N. With respect to property placed in service during the taxable year, an amount equal to the net increase in depreciation or expensing attributable to:

(1) For taxable years beginning on or after January 1, 2002 but prior to January 1, 2006, a 30% bonus depreciation deduction claimed by the taxpayer pursuant to Section 101 of the federal Job Creation and Worker Assistance Act of 2002, Public Law 107-147 with respect to property placed in service during the taxable year;

(2) For taxable years beginning on or after January 1, 2002 but prior to January 1, 2006, a 50% bonus depreciation deduction claimed by the taxpayer pursuant to Section 201 of the federal Jobs and Growth Tax Relief Reconciliation Act of 2003, Public Law 108-27 with respect to property placed in service during the taxable year; and

(3) For taxable years beginning on or after January 1, 2003 but prior to January 1, 2011, the increase in aggregate cost under Section 179 of the Code arising from amendments to the Code applicable to tax years beginning on or after January 1, 2003;

AA. For taxable years beginning on or after January 1, 2008 but before January 1, 2011, an amount equal to the net increase in depreciation attributable to the depreciation deduction claimed by the taxpayer under the Code, Section 168(k) arising from amendments to the Code applicable to taxable years beginning on or after January 1, 2008;

2. Subtractions. Federal adjusted gross income shall be reduced by:

Q. A fraction of any amount previously added back by the taxpayer to federal adjusted gross income pursuant to subsection 1, paragraph N.

(1) With respect to property first placed in service during taxable years beginning in 2002, the adjustment under this paragraph is available for each year during the recovery period, beginning 2 years after the beginning of the taxable year during which the property was first placed in service. The fraction is equal to the amount added back under subsection 1, paragraph N with respect to the property, divided by the number of years in the recovery period minus 2.

(2) With respect to all other property, for the taxable year immediately following the taxable year during which the property was first placed in service, the fraction allowed by this paragraph is equal to 5% of the amount added back under subsection 1, paragraph N with respect to the property. For each subsequent taxable year during the recovery period, the fraction is equal to 95% of the amount added back under subsection 1, paragraph N with respect to the property, divided by the number of years in the recovery period minus 2.

In the case of property expensed pursuant to Section 179 of the Code, the term "recovery period" means the recovery period that would have been applicable to the property had Section 179 not been applied;

X. The taxpayer's pro rata share of an amount that was previously added back to federal taxable income pursuant to section 5200-A, subsection 1, paragraph N by an S corporation of which the taxpayer is a shareholder and by which, absent the S corporation election, the corporation could have reduced its federal taxable income for the taxable year pursuant to section 5200-A, subsection 2, paragraph M;

AA. For taxable years beginning on or after January 1, 2009, an amount equal to the net increase in the depreciation deductions allowable under Sections 167 and 168 of the Code that would have been applicable to that property had the depreciation deduction under the Code, Section 168(k) not been claimed with respect to such property placed in service on or after January 1, 2008 for which an addition was required under subsection 1, paragraph AA in a prior year.

Upon the taxable disposition of property to which this paragraph applies, the amount of any gain or loss includable in federal adjusted gross income must be adjusted for Maine income tax purposes by an amount equal to the difference between the addition modification for such property under subsection 1, paragraph AA and the subtraction modifications allowed pursuant to this paragraph.

The total amount of subtraction claimed for property under this paragraph for all tax years may not exceed the addition modification under subsection 1, paragraph AA for the same property;

Corporations

§5200-A. Modifications

1. Additions. *The taxable income of the taxpayer under the laws of the United States shall be increased by:*

N. With respect to property placed in service during the taxable year, an amount equal to the net increase in depreciation or expensing attributable to:

(1) For taxable years beginning on or after January 1, 2002 but prior to January 1, 2006, a 30% bonus depreciation deduction claimed by the taxpayer pursuant to Section 101 of the federal Job Creation and Worker Assistance Act of 2002, Public Law 107-147 with respect to property placed in service during the taxable year;

(2) For taxable years beginning on or after January 1, 2002 but prior to January 1, 2006, a 50% bonus depreciation deduction claimed by the taxpayer pursuant to Section 201 of the federal Jobs and Growth Tax Relief Reconciliation Act of 2003, Public Law 108-27 with respect to property placed in service during the taxable year; and

(3) For taxable years beginning on or after January 1, 2003 but prior to January 1, 2011, the increase in aggregate cost under Section 179 of the Code arising from amendments to the Code applicable to tax years beginning on or after January 1, 2003;

T. For taxable years beginning on or after January 1, 2008 but before January 1, 2011, an amount equal to the net increase in depreciation attributable to the depreciation deduction claimed by the taxpayer under the Code, Section 168(k) arising from amendments to the Code applicable to taxable years beginning on or after January 1, 2008;

2. Subtractions. *The taxable income of the taxpayer under the laws of the United States shall be decreased by:*

M. A fraction of any amount previously added back by the taxpayer to federal taxable income pursuant to subsection 1, paragraph N.

(1) With respect to property first placed in service during taxable years beginning in 2002, the adjustment under this paragraph is available for each year during the recovery period, beginning 2 years after the beginning of the taxable year during which the property was first placed in service. The fraction is equal to the amount added back under subsection 1, paragraph N with respect to the property, divided by the number of years in the recovery period minus 2.

(2) With respect to all other property, for the taxable year immediately following the taxable year during which the property was first placed in service, the fraction allowed by this paragraph is equal to 5% of the amount added back under subsection 1, paragraph N with respect to the property. For each subsequent taxable year during the recovery period, the fraction is equal to 95% of the amount added back under subsection 1, paragraph N with respect to the property, divided by the number of years in the recovery period minus 2.

In the case of property expensed pursuant to Section 179 of the Code, the term "recovery period" means the recovery period that would have been applicable to the property had Section 179 not been applied;

R. For taxable years beginning on or after January 1, 2009, an amount equal to the net increase in the depreciation deductions allowable under Sections 167 and 168 of the Code that would have been applicable to that property had the depreciation deduction under the Code, Section 168(k) not been claimed with respect to such property placed in service on or after January 1, 2008 for which an addition was required under subsection 1, paragraph T in a prior year.

Upon the taxable disposition of property to which this paragraph applies, the amount of any gain or loss includable in federal taxable income must be adjusted for Maine income tax purposes by an amount equal to the difference between the addition modification for such property under subsection 1, paragraph T and the subtraction modifications allowed pursuant to this paragraph.

The total amount of subtraction claimed for property under this paragraph for all tax years may not exceed the addition modification under subsection 1, paragraph T for the same property;

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 (add-back)

The Maine addition modification 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 2008 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 2008 addition modification, therefore, is \$40,000 ($\$60,000 - \$20,000$). In 2009, 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 2009 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 M.R.S. § 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 M.R.S. §§ 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 #2.1:

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 (\$40,000) is higher than the amount actually used in 2008 (\$30,000), 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 #2.2:

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 #4.5 and example #4.6*).

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 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 #4.7*).

Multistate Businesses

Corporations and other entities realizing Maine-source income 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 #4.11).

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 M.R.S. §§ 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 #4.8 and #4.9.

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 #4.10). 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 claim a loss of \$10,000 (50% share of partnership loss) and be required to apply the full share of add-back, \$20,000. 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. A subtraction modification is not allowed in this case because that partner was not required to apply an add-back in the previous year.

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, an entity is not subject to Maine tax prior to a merger, the merged entity is not entitled to a recapture, regardless of the merged entity's 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

The following statutory paragraphs relate to bonus depreciation/§ 179 modifications in effect for tax years beginning in 2002-2007.

Individuals

§5122. Modifications

1. Additions. Federal adjusted gross income shall be increased by:

N. With respect to property placed in service during the taxable year, an amount equal to the net increase in depreciation or expensing attributable to:

(1) For taxable years beginning on or after January 1, 2002 but prior to January 1, 2006, a 30% bonus depreciation deduction claimed by the taxpayer pursuant to Section 101 of the federal Job Creation and Worker Assistance Act of 2002, Public Law 107-147 with respect to property placed in service during the taxable year;

(2) For taxable years beginning on or after January 1, 2002 but prior to January 1, 2006, a 50% bonus depreciation deduction claimed by the taxpayer pursuant to Section 201 of the federal Jobs and Growth Tax Relief Reconciliation Act of 2003, Public Law 108-27 with respect to property placed in service during the taxable year; and

(3) For taxable years beginning on or after January 1, 2003 but prior to January 1, 2011, the increase in aggregate cost under Section 179 of the Code arising from amendments to the Code applicable to tax years beginning on or after January 1, 2003;

2. Subtractions. Federal adjusted gross income shall be reduced by:

Q. A fraction of any amount previously added back by the taxpayer to federal adjusted gross income pursuant to subsection 1, paragraph N.

(1) With respect to property first placed in service during taxable years beginning in 2002, the adjustment under this paragraph is available for each year during the recovery period, beginning 2 years after the beginning of the taxable year during which the property was first placed in service. The fraction is equal to the amount added back under subsection 1, paragraph N with respect to the property, divided by the number of years in the recovery period minus 2.

(2) With respect to all other property, for the taxable year immediately following the taxable year during which the property was first placed in service, the fraction allowed by this paragraph is equal to 5% of the amount added back under subsection 1, paragraph N with respect to the property. For each subsequent taxable year during the

recovery period, the fraction is equal to 95% of the amount added back under subsection 1, paragraph N with respect to the property, divided by the number of years in the recovery period minus 2.

In the case of property expensed pursuant to Section 179 of the Code, the term "recovery period" means the recovery period that would have been applicable to the property had Section 179 not been applied;

X. The taxpayer's pro rata share of an amount that was previously added back to federal taxable income pursuant to section 5200-A, subsection 1, paragraph N by an S corporation of which the taxpayer is a shareholder and by which, absent the S corporation election, the corporation could have reduced its federal taxable income for the taxable year pursuant to section 5200-A, subsection 2, paragraph M;

Corporations

§5200-A. Modifications

1. Additions. *The taxable income of the taxpayer under the laws of the United States shall be increased by:*

N. With respect to property placed in service during the taxable year, an amount equal to the net increase in depreciation or expensing attributable to:

(1) For taxable years beginning on or after January 1, 2002 but prior to January 1, 2006, a 30% bonus depreciation deduction claimed by the taxpayer pursuant to Section 101 of the federal Job Creation and Worker Assistance Act of 2002, Public Law 107-147 with respect to property placed in service during the taxable year;

(2) For taxable years beginning on or after January 1, 2002 but prior to January 1, 2006, a 50% bonus depreciation deduction claimed by the taxpayer pursuant to Section 201 of the federal Jobs and Growth Tax Relief Reconciliation Act of 2003, Public Law 108-27 with respect to property placed in service during the taxable year; and

(3) For taxable years beginning on or after January 1, 2003 but prior to January 1, 2011, the increase in aggregate cost under Section 179 of the Code arising from amendments to the Code applicable to tax years beginning on or after January 1, 2003;

2. Subtractions. *The taxable income of the taxpayer under the laws of the United States shall be decreased by:*

M. A fraction of any amount previously added back by the taxpayer to federal taxable income pursuant to subsection 1, paragraph N.

(1) With respect to property first placed in service during taxable years beginning in 2002, the adjustment under this paragraph is available for each year during the recovery period, beginning 2 years after the beginning of the taxable year during which the property was first placed in service. The fraction is equal to the amount added back

under subsection 1, paragraph N with respect to the property, divided by the number of years in the recovery period minus 2.

(2) With respect to all other property, for the taxable year immediately following the taxable year during which the property was first placed in service, the fraction allowed by this paragraph is equal to 5% of the amount added back under subsection 1, paragraph N with respect to the property. For each subsequent taxable year during the recovery period, the fraction is equal to 95% of the amount added back under subsection 1, paragraph N with respect to the property, divided by the number of years in the recovery period minus 2.

In the case of property expensed pursuant to Section 179 of the Code, the term "recovery period" means the recovery period that would have been applicable to the property had Section 179 not been applied;

Addition modification (add-back)

The Maine addition modification 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 2004, and \$3,800 is recaptured in each of years 2005, 2006 and 2007. The same rules apply to assets placed in service in 2002, except that recapture begins in 2004 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 2004, 2005 and 2006.

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 M.R.S. § 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 expense 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 #4.4).

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.

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 years.

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 expense (36 M.R.S. §§ 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 #3.1:

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 (\$40,000) is higher than the amount actually used in 2003 (\$30,000), 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 #3.2:

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 $(\$75,000/2) \times 20\% =$	7,500
Plus first year depreciation – 7-year property $(\$75,000/2) \times 14.29\% =$	<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 x 50%)	\$30,000
Less Maine section 179 expense for 5-year property (25,000 x 50%)	12,500
Less Maine first year allowable depreciation on non-expensed portion (\$75,000 x 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 x 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 #4.5 and example #4.6).

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 first year in the recovery period is actually the second year in the class life of the property. For property placed in service in 2002, the recovery period begins the third year of the class life of the asset (2004).

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

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

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

5-year property, second 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 third and fourth years of the recovery period [fourth and fifth 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, second 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 (first year is the year in which the property was placed in service and the second year is the year in which \$1,875 of the add-back was recovered, leaving one year in the life of the property).

Total recovery in the 2nd year of the recovery period: \$39,583 (see additional example #4.7).

Multistate Businesses

Corporations and other entities realizing Maine-source income 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 #4.11).

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 M.R.S. §§ 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 #4.8 and #4.9.

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 #4.10*).

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 #4.9 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. A subtraction modification is not allowed in this case because that partner was not required to apply an add-back in the previous year.

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, an entity is not subject to Maine tax prior to a merger, the merged entity is not entitled to a recapture, regardless of the merged entity's 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

EXAMPLE #4.1 – property placed in service in 2003:

Assume that the 30% bonus depreciation option is selected and that no additional section 179 expensing is involved.

Federal return:

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

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

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

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

Maine return:

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

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

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

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

Year 4 = “ (\$ 760)

Year 5 = “ (\$ 760)

EXAMPLE #4.2 – property placed in service in 2003:

Assume that the taxpayer selected section 179 expense, but no bonus depreciation.

Federal return:

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

Section 179 expense claimed = \$100,000

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

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

Maine return:

Allowable § 179 = \$25,000

MACRS depreciation = (\$110,000 - \$25,000) x 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 x 5% = (\$ 3,000)

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

Year 4 = “ (\$19,000)

Year 5 = “ (\$19,000)

EXAMPLE #4.3 – property placed in service in 2003:

The taxpayer elected to use both section 179 expense and 50% bonus depreciation.

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 #4.4 – 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 #4.5 – 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 #4.6 – 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 #4.7 – 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 #4.8 – 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 = $(\$50,000 - \$25,000) \times 14.29\% = \$3,573$

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

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

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

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

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 = $\$30,000 \times 50\% = \$15,000$

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

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

Maine return:

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

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

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

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

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 #4.9 – 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%	\$50,000
Section 179 expense	<u>\$ 80,000</u>		<u>\$40,000</u>
Distributable income	\$ 20,000		<u>\$10,000</u>

Member A's share:

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%	\$90,000
Section 179 expense	<u>\$ 80,000</u>		<u>\$72,000</u>
Distributable income	\$ 20,000		<u>\$18,000</u>

Member A's share:

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)	<u>\$100,000</u>
Federal Adjusted Gross Income ("FAGI")		<u>\$ 40,000</u>

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

$$\begin{aligned}\text{Allowable depreciation} &= (\$55,000 \times 25\% \times 33.33\%) + (\$55,000 \times 75\% \times 20\%) \\ &= \$4,583 + \$8,250 = \$12,833\end{aligned}$$

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

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

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

$$\begin{aligned}\text{Allowable depreciation} &= (\$55,000 \times 62.5\% \times 20\%) + (\$55,000 \times 37.5\% \times 14.29\%) \\ &= \$6,875 + \$2,947 = \$9,822\end{aligned}$$

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

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

Member A:

FAGI =	\$ 40,000
Modification from Partnership #1 =	\$ 21,084
Modification from Partnership #2 =	<u>\$ 40,660</u>
Modified FAGI =	<u>\$101,744</u>

While this amount looks like MAGI, it 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 x 90% = \$45,000 5-year property
\$30,000 x 90% = \$27,000 7-year property

Combining the two entities,

\$30,000 + \$45,000 = \$ 10,000 3-year property
 \$ 75,000 5-year property
 \$ 27,000 7-year property
 \$112,000

Percentage allocation: \$10,000/\$112,000 = 8.9% 3-year property
 \$75,000/\$112,000 = 67.0% 5-year property
 \$27,000/\$112,000 = 24.1% 7-year property

The recapture schedule is as follows:

Subtraction modification in Year 2 = \$10,000 x 5% = \$500

Remainder to be recaptured = \$10,000 – \$500 = \$9,500

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

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

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

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

Subtraction modification in Year 7 = (\$2,290/5) = \$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 #4.10 – 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 #4.11 – 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 #4.12 – 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 #4.13 – 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 x 11.52% = \$2,880

Maine return:

MACRS depreciation = \$50,000 x 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 x 11.52% = \$2,880

Maine return:

MACRS depreciation = \$50,000 x 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 x 5.76% = \$1,440

Maine return:

MACRS depreciation = \$50,000 x 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 =	<u>(\$ 1,440)</u>

Total \$ 0

EXAMPLE #4.14 – 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 #4.15 – 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 #4.16 – 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 = $\$1,440 - \$0 = \$1,440$

EXAMPLE #4.17 – property placed in service in 2013, 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 (credit property),
\$25,000 in Massachusetts (non-credit property)

Bonus depreciation, credit property = $\$75,000 \times 50\% = \$37,500$

Bonus depreciation, non-credit property = $\$25,000 \times 50\% = \$12,500$

MACRS depreciation, credit property = $(\$75,000 - \$37,500) \times 20\% = \$7,500$

MACRS depreciation, non-credit property = $(\$25,000 - \$12,500) \times 20\% = \$2,500$

Total depreciation = $\$37,500 + \$12,500 + \$7,500 + \$2,500 = \$60,000$

Maine return:

Maine capital investment credit is claimed for \$75,000 of credit property.

Credit property addition modification = fed depreciation, credit property – MACRS
depreciation, credit property before bonus
= $(\$37,500 + \$7,500) - (\$75,000 \times 20\%)$
= $\$45,000 - \$15,000 = \$30,000$

This amount forms the basis for the Maine capital investment credit.

Non-credit property addition modification = fed depreciation, non-credit property – MACRS
depreciation, non-credit property before bonus
= $(\$12,500 + \$2,500) - (\$25,000 \times 20\%)$
= $\$15,000 - \$5,000 = \$10,000$

This amount is recaptured in future years.

Year 2

Federal return:

MACRS depreciation, non-credit property = $\$12,500 \times 32\% = \$4,000$

Maine return:

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

$$\begin{aligned} \text{Non-credit property subtraction modification} &= \text{MACRS depreciation, non-credit property} \\ &\quad \text{before bonus} - \text{fed MACRS depreciation, non-} \\ &\quad \text{credit property} \\ &= (\$25,000 \times 32\%) - \$4,000 \\ &= \$8,000 - \$4,000 = \$4,000 \end{aligned}$$

Year 3

Federal return:

$$\text{MACRS depreciation, non-credit property} = \$12,500 \times 19.2\% = \$2,400$$

Maine return:

$$\begin{aligned} \text{Non-credit property subtraction modification} &= \text{MACRS depreciation before bonus} - \text{fed} \\ &\quad \text{MACRS depreciation} \\ &= (\$25,000 \times 19.2\%) - \$2,400 \\ &= \$4,800 - \$2,400 = \$2,400 \end{aligned}$$

Year 4

Federal return:

$$\text{MACRS depreciation, non-credit property} = \$12,500 \times 11.52\% = \$1,440$$

Maine return:

$$\begin{aligned} \text{Non-credit property subtraction modification} &= \text{MACRS depreciation before bonus} - \text{fed} \\ &\quad \text{MACRS depreciation} \\ &= (\$25,000 \times 11.52\%) - \$1,440 \\ &= \$2,880 - \$1,440 = \$1,440 \end{aligned}$$

Year 5

Federal return:

$$\text{MACRS depreciation, non-credit property} = \$12,500 \times 11.52\% = \$1,440$$

Maine return:

$$\begin{aligned} \text{Non-credit property subtraction modification} &= \text{MACRS depreciation before bonus} - \text{fed} \\ &\quad \text{MACRS depreciation} \\ &= (\$25,000 \times 11.52\%) - \$1,440 \\ &= \$2,880 - \$1,440 = \$1,440 \end{aligned}$$

Year 6

Federal return:

$$\text{MACRS depreciation, non-credit property} = \$12,500 \times 5.76\% = \$720$$

Maine return:

$$\begin{aligned}\text{Non-credit property subtraction modification} &= \text{MACRS depreciation before bonus} - \text{fed} \\ &\quad \text{MACRS depreciation} \\ &= (\$25,000 \times 5.76\%) - \$720 \\ &= \$1,440 - \$720 = \$720\end{aligned}$$

As a check, you will see that the total amount of subtractions equals the original addition for the non-credit property.

$$\begin{aligned}\$4,000 \text{ (Year 2)} + \$2,400 \text{ (Year 3)} + \$1,440 \text{ (Year 4)} + \$1,440 \text{ (Year 5)} + \$720 \text{ (Year 6)} = \\ \$10,000 \text{ (Year 1 addition)}\end{aligned}$$

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