

Cashing out AMT and R&D credits: When, why and how to make the election

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The Housing Assistance Tax Act of 2008 includes a new provision allowing taxpayers to effectively monetize a portion of their alternative minimum tax (AMT) or research and development (R&D) credits as an alternative to bonus depreciation.

Bonus depreciation was created in the Economic Stimulus Act of 2008 and allows half of the cost of eligible property placed in service in 2008 to be recovered immediately, while the other half is depreciated using normal rules.

Congress was concerned that businesses in a loss position would not benefit from the provision and created the new AMT and R&D credit election under IRC Section 168(k)(4). The election allows taxpayers to forgo bonus depreciation for property placed in service during the last three quarters of calendar year 2008, and instead claim a refundable AMT or R&D credit for credits attributable to tax years beginning before 2006.

However, the refundable credit carries significant limits. It is equal to the lesser of:

- 20 percent of the forgone benefit of using bonus depreciation;
- six percent of the total pre-2006 AMT and R&D credit carryforwards; or
- \$30,000,000.

A taxpayer making the election must also use the straight-line depreciation method for property that would otherwise qualify for bonus depreciation.

The restrictions limiting the refundable credit to 20 percent of the amount available under bonus depreciation, and six percent of total pre-2006 AMT and R&D credit carryforwards, can present considerable obstacles for taxpayers hoping to benefit from the Section 168(k)(4) election. For example, a taxpayer would need over \$1.6 million of total pre-2006 AMT and R&D credit carryforwards and need to have placed at least \$1,166,000 of qualified seven-year MACRS property into service to generate a \$100,000 benefit under Section 168(k)(4).

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The recently enacted American Recovery and Reinvestment Tax Act of 2009 extends Section 168(k)(4), providing a second opportunity to apply the provision and a fresh calculation with respect to property placed in service in 2009.

Who may benefit and how much

The following examples highlight how the AMT and R&D credit carryforward limitations apply to a calendar-year taxpayer for 2008.

Example 1

Company A has \$600,000 of R&D credit carryforwards and expects to have a NOL in calendar 2008. Company A purchased \$1,000,000 of eligible qualified seven-year property in the last three quarters of calendar year 2008.

Benefit

- Forgone benefit of bonus depreciation: \$428,500
- Potential refundable credit under Section 168(k)(4) (20 percent of foregone benefit of bonus depreciation): \$85,700
- The \$30,000,000 limit does not apply, but the six percent of pre-2006 R&D carryforward limitation ($\$600,000 \times 6\% = \$36,000$) does. Company A is limited to a \$36,000 refund.

Example 2

Company B has \$1,500,000 of R&D credit carryforwards and expects to have a NOL in calendar 2008. Company B purchased \$800,000 of eligible qualified seven-year property in the last three quarters of calendar-year 2008.

Benefit

- Forgone benefit of bonus depreciation: \$342,800
- Potential refundable credit total (20 percent of foregone benefit of bonus depreciation): \$68,560
- The \$30,000,000 and six percent of pre-2006 R&D carryforward limitations do not apply. Company B is entitled to a \$68,560 refund.

Time and manner of election

In general, the Section 168(k)(4) election for the taxpayer's first taxable year ending after March 31, 2008, must be made by the due date (including extensions) of the federal income tax return for that return. For fiscal-year taxpayers, this election is required even if the taxpayer does not place in service any eligible qualified property during its first taxable year ending after March 31, 2008, if they intend to apply the election to property placed in service during the remainder of calendar-year 2008. The election will also apply to property placed in service in 2009 unless the taxpayer makes a second election for it not to apply. Taxpayers who do not elect the refundable credit for property placed in service in 2008 may elect it for property placed in service in 2009. A separate calculation of the amount of the refundable credit is made for property placed in service in 2008 and 2009.

The IRS has established detailed rules for making the election. For calendar-year taxpayers, the election is generally made by showing the credit on Form 3800 (R&D credits) and/or Form 8827 (AMT credits) and by including Form 4562, "Depreciation and Amortization (Including Information on Listed Property)," on a timely filed return indicating that the taxpayer used the straight-line method and did not claim bonus depreciation for all eligible qualified property. Fiscal-year taxpayers may be required to file an amended return for the first taxable year ending after March 31, 2008, in order to obtain the benefit.

Allocation of benefit

Taxpayers who have both pre-2006 AMT and R&D credit carryforwards can allocate the benefit resulting from the foregone bonus depreciation in any manner they choose and can change the allocation each taxable year. The remaining carryforwards retain their original form and utility.

Items to consider before making a Section 168(k)(4) election

- Electing taxpayers are required to use straight-line depreciation for property that would otherwise qualify for bonus depreciation.
- If a taxpayer elects out of bonus depreciation for a particular class of property, that property is not considered in the election to claim a refundable credit in lieu of bonus depreciation.
- Section 168(k)(4) is limited to C corporations, S corporations and qualifying domestic automotive partnerships.
- All members of a corporate controlled group are treated as a single taxpayer for purposes of the election. This could force non-consolidated filers to forgo bonus depreciation without recognizing the benefit of refundable credit generated by the group.
- A corporation making the Section 168(k)(4) election that is a partner in a partnership must notify the partnership in writing that it is making the election. Any depreciation passed through to an electing partner must be re-determined using the straight-line method.
- Any Section 168(k)(4) business or minimum tax credit limitation increases calculated by an S corporation that result from a Section 168(k)(4) election are applied at the corporate level, not at the shareholder level.
- Taxpayers can allocate the benefit generated by a Section 168(k)(4) election to AMT and R&D carryforwards in any manner they choose

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