

# Accelerated Credits Election: Intended and Unintended Consequences

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February 2009

# The Election

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- ❑ §168(k)(4) allows a corporation to monetize historic [pre-2006] research and AMT credits
  - ❑ Credits are fully refundable, against regular tax and AMT
  - ❑ Especially useful for always-loss and always-AMT taxpayers
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# Assessing the Election

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- Trade-off – SL cost recovery only, no bonus or accelerated, over MACRS life
  - Limitations
    - Shared by controlled group
    - Assets placed in service after 3/31/2008
    - Bonus Depr. Amount (BDA) = Least of:
      - 20% x Depreciation [With – Without Bonus]
      - \$30 million
      - 6 percent x Credit carryforwards
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# Computational Example

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- Corporation A has \$2M unused pre-2006 research credits and \$8M unused pre-2006 AMT credits
  - \$10M of eligible 5-year MACRS bonus depreciation property placed in service during the 9-month window
  - “Bonus Depreciation Amount” is least of:
    - $.20 \times (\$6,000,000 - \$2,000,000) = \$800,000$
    - \$30,000,000
    - $\$10,000,000 \times .06 = \mathbf{\$600,000}$
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# Other Aspects

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- Taxpayer allocates the refund between the two credits
  - SL required even if no credit claimed on property placed in service
  - Election, allocation revoked only with IRS consent
  - FAS 109 → Release of valuation allowance
  - State and local conformity
  - Adequate documentation
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# Other Aspects

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- Query – When is the election attractive? How best to use it?
    - How to allocate between carryforwards
    - What about profitable corps?
    - What if credits available *without* the election?
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# Model of the Analysis

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- Any analysis for profitable companies must incorporate the following elements:
    - Possible loss of bonus depreciation not compensated by with additional credits due to the 6% or \$30M limitations
    - Time value of money concepts for differing cost recoveries and credits usage
    - Possible alternative usage of credits against tax liability without the acceleration election
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# Excel Spreadsheet Analysis – 1

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## □ Facts for Analysis

- Corporation A has \$8M unused pre-2006 research credits and \$2M unused AMT credits
  - \$3M of eligible 5-year property and \$5M of eligible 7-year property placed in service during the 9-month window
  - Without an election, Corporation A expects to utilize \$10,000 of the pre-2006 credits in each of the next 15 years
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# Excel Spreadsheet Analysis - 2

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## □ Inputs

- Unused Pre-2006 Research & AMT Credits
- Eligible Personalty Placed in Service by MACRS Categories
- Expected alternative usage of credits with no election

□ Note – Simple algebra may be used to reduce computation of “bonus depreciation amount” (BNA) to a percentage of total cost of property (see below)

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# Equivalent “Bonus Depreciation Amounts” as a Pct. of Asset Cost

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- ❑ 3-year property . . . . . 6.67% of total cost
  - ❑ 5-year property . . . . . 8.00% of total cost
  - ❑ 7-year property . . . . . 8.57% of total cost
  - ❑ 10-year property . . . . . 9.00% of total cost
  - ❑ 15-year property . . . . . 9.50% of total cost
  - ❑ 20-year property . . . . . 9.63% of total cost
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# Excel Spreadsheet Analysis - 3

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- Output Sections of Spreadsheet
    - Computation of maximum bonus depreciation amount (BDA)
    - Present Value of Tax Savings Without the §168(k)(4) Election
    - Present Value of Tax Savings With the §168(k)(4) Election
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# Excel Spreadsheet Analysis - 3

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## Projected Results for Assumed Facts:

NPV tax savings w/o election . . .	\$2,764,928
NPV tax savings with election. . .	( <u>2,985,268</u> )
NPV taxes saved. . . . .	(\$ 220,340)

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# Sensitivity Analysis - 1

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<b><i>5-Year MACRS</i></b>	<b><i>7-Year MACRS</i></b>	<b><i>Tax Cost (Savings)</i></b>
\$ 3,000,000	\$ 5,000,000	( \$220,340 )
\$ 2,000,000	\$ 4,000,000	( \$182,602 )
\$ 2,000,000	\$ 5,134,189	( \$227,468 )
\$ 6,000,000	\$10,000,000	\$ 50,334

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# Sensitivity Analysis - 2

<b>\$5,000,000 Investment – Expected Tax Savings by MACRS Class</b>	
<b>Asset Class</b>	<b>Projected Tax Cost (Savings) of Election</b>
3-year MACRS	(\$186,691)
5-year MACRS	(\$333,400)
7-year MACRS	(\$197,786)
10-year MACRS	(\$165,624)
15-year MACRS	(\$143,202)
20-year MACRS	(\$ 89,756)

# Planning Current Acquisitions

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- ❑ *Question* – Camden Corporation has \$8M pre-2006 research credit and \$2M pre-2006 AMT C/Os; what is the dollar amount of 7-year property that will optimize the use of the §168(k)(4) election?
  - ❑ *Answer* – Since maximum bonus depr. amount is limited to \$600,000 (6% rule), total acquisitions should be approximately \$7,001,167 ( $\$600,000 / .0857$ )
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# Planning Current-Year Acquisitions

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- ❑ *Question* – Same facts, except Camden has already placed in service \$2M of 5-year property during the year; what is the dollar amount of 7-year property that will optimize the bonus depreciation amount?
  - ❑ *Answer* – Since \$2M of 5-year property generates a BDA of \$160,000 ( $\$2,000,000 \times .08$ ), the 7-year acquisitions should be approximately \$5,134,189 ( $\$440,000 / .0857$ )
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# Summary

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- ❑ A rare opportunity to produce immediate cash
  - ❑ Extension by ARIA through 2009
  - ❑ Analysis of the election requires review of many factors, e.g., with software
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		<b>Corporate Taxpayers</b>			
		<b>Accelerated Credits Election Analysis</b>			
<b>Initial Inputs:</b>					
Cost of qualifying bonus depreciation property:					
3-Year property				0	
5-Year property				3,000,000	
7-Year property				5,000,000	
10-Year property				0	
15-Year property				0	
20-Year property				0	
Unused Pre-2006 Credit Amounts:					
Research credits				8,000,000	
AMT credits				2,000,000	
Corporate marginal tax rate				0.35	
Discount rate for present value computations				0.05	
<b>Maximum Bonus Amount Computation:</b>					
3-Year property				0	
5-Year property				240,000	
7-Year property				428,500	
10-Year property				0	
15-Year property				0	
20-Year property				0	
a. Total initial maximum bonus amount				668,500	
b. \$30,000,000 maximum				30,000,000	
c. 6% of total available credits				600,000	
<i>Maximum bonus amount (smallest of a, b, or c)</i>				600,000	
<b>Expected alternative usage of a portion or all qualifying credits with no election:</b>					
				<i>Year</i>	<i>Amount</i>
				1	10,000
				2	10,000
				3	10,000
				4	10,000
				5	10,000
				6	10,000
				7	10,000
				8	10,000
				9	10,000
				10	10,000
				11	10,000
				12	10,000
				13	10,000
				14	10,000
				15	10,000

<b>Present Value of Tax Savings Without an Accelerated Credits Election</b>						
<b>Year</b>	<b>Bonus Depreciation</b>	<b>Regular MACRS</b>	<b>Savings - Depreciation</b>	<b>Qual. Credits Utilized</b>	<b>Total Savings</b>	<b>P.V. of Savings</b>
1	4,000,000	657,250	1,630,038	10,000	1,640,038	1,640,038
2	0	1,092,250	382,288	10,000	392,288	373,607
3	0	725,250	253,838	10,000	263,838	239,308
4	0	485,050	169,768	10,000	179,768	155,290
5	0	396,050	138,618	10,000	148,618	122,268
6	0	309,400	108,290	10,000	118,290	92,683
7	0	223,250	78,138	10,000	88,138	65,770
8	0	111,500	39,025	10,000	49,025	34,841
9	0	0	0	10,000	10,000	6,768
10	0	0	0	10,000	10,000	6,446
11	0	0	0	10,000	10,000	6,139
12	0	0	0	10,000	10,000	5,847
13	0	0	0	10,000	10,000	5,568
14	0	0	0	10,000	10,000	5,303
15	0	0	0	10,000	10,000	5,051
16	0	0	0	0	0	0
17	0	0	0	0	0	0
18	0	0	0	0	0	0
19	0	0	0	0	0	0
20	0	0	0	0	0	0
21	0	0	0	0	0	0
Total present value of expected tax savings						2,764,928
<b>Present Value of Tax Savings With An Acceleration Election</b>						
<b>Year</b>	<b>Bonus Depreciation</b>	<b>Regular SL MACRS</b>	<b>Savings - Depreciation</b>	<b>Refunded Credits</b>	<b>Total Savings</b>	<b>P.V. of Savings</b>
1	0	657,143	230,000	600,000	830,000	830,000
2	0	1,314,286	460,000	0	460,000	417,234
3	0	1,314,286	460,000	0	460,000	397,365
4	0	1,314,286	460,000	0	460,000	378,443
5	0	1,314,286	460,000	0	460,000	360,422
6	0	1,014,286	355,000	0	355,000	264,906
7	0	1,014,286	355,000	0	355,000	252,292
8	0	357,143	125,000	0	125,000	84,605
9	0	0	0	0	0	0
10	0	0	0	0	0	0
11	0	0	0	0	0	0
12	0	0	0	0	0	0
13	0	0	0	0	0	0
14	0	0	0	0	0	0
15	0	0	0	0	0	0
16	0	0	0	0	0	0
17	0	0	0	0	0	0
18	0	0	0	0	0	0
19	0	0	0	0	0	0
20	0	0	0	0	0	0
21	0	0	0	0	0	0
Total present value of expected tax savings						2,985,267

