Connecticut's Tax Treatment of Federal Bonus Depreciation

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Issue
What is bonus depreciation and how does Connecticut treat it for personal income and corporation business tax purposes?

Summary
Bonus depreciation is a federal tax break that allows businesses to recover the cost of capital asset purchases more quickly than standard depreciation. It is designed to stimulate the economy by incentivizing businesses to make capital investments.

The federal Tax Cuts and Jobs Act of 2017 extended and generally increased the bonus depreciation deduction. It authorizes a first-year deduction of 100% on qualified new and used property businesses acquire and place in service between September 27, 2017, and January 1, 2023. The 100% allowance phases down by 20% each year thereafter. Prior law generally provided for a 50% bonus depreciation deduction in 2017, 40% in 2018, and 30% in 2019.

Although the deduction is calculated at the federal level, it flows through for state tax purposes in states that conform to the federal rules for determining taxable income. In the case of Connecticut, state law has disallowed the federal bonus depreciation deduction for corporation business tax purposes since 2001, but until recently allowed the deduction for personal income tax purposes. Under a 2018 state law, personal income taxpayers must add back the federal bonus depreciation deduction for property placed in service after September 27, 2017, when calculating their Connecticut adjusted gross income for the state personal income tax. But the law allows them to
reclaim the amount added back in equal installments over the four succeeding tax years. The legislation applies to tax years beginning on or after January 1, 2017, thus requiring taxpayers who claimed the deduction on their 2017 returns to file an amended return to report the bonus depreciation deduction.

**What is bonus depreciation?**

The standard depreciation deduction is an annual federal income tax deduction for the exhaustion, wear, and tear of business property. It allows businesses to recover the cost (or other basis) of property over the time they use it. Most types of tangible property (e.g., buildings, machinery, vehicles, furniture, and equipment, but not land) and certain types of intangible property (e.g., patents, copyrights, and computer software) may be depreciated. Businesses can begin to depreciate the property in the tax year that it is placed in service and must stop depreciating it when the property is retired from service or is fully depreciated (i.e., the full cost or other basis has been recovered), whichever happens first ([How to Depreciate Property](https://www.irs.gov/businesses/small-businesses-self-employed/how-to-depreciate-property), Internal Revenue Services Publication No. 946 (2017)).

Bonus depreciation is a special depreciation deduction that allows businesses to recover the cost of certain qualified property more quickly than standard depreciation. It applies only in the first year that a business places property in service. Under the new federal tax law, the bonus depreciation rate is generally 100% for qualified property acquired and placed in service after September 27, 2017, and before January 1, 2023, but is 50% for certain specified property types (e.g., qualified reuse and recycling property). If property is acquired before September 28, 2017, the rate is determined as under prior law, according to the date it is placed in service (e.g., 40% in 2018). The 100% deduction phases down by 20% per year for each year after 2022 (i.e., 80% for 2023, 60% for 2024, 40% for 2025, 20% for 2026, and 0% for 2027) (26 U.S.C. 168(k)).

The bonus depreciation deduction generally applies to (1) tangible property that is depreciable over 20 years or less that is subject to the federal “modified accelerated cost recovery system” (MACRS) and (2) narrow categories of property or costs, including computer software depreciable over three years and qualified film, television, and live theatrical productions. Under the new tax law, used property acquired and placed in service after September 27, 2017, also qualifies for the deduction if it meets certain conditions (e.g., if the taxpayer did not acquire it from a related party).

**MACRS**

MACRS is a depreciation system used to recover the cost (basis) of most business and investment property placed in service after 1986. It provides different methods and recovery periods (i.e., useful lives) for specified property classes.
How Does Connecticut Treat Bonus Depreciation?

Connecticut disallows the federal bonus depreciation deduction for corporations, but until recently allowed it for businesses that are not organized as corporations (i.e., pass-through businesses). Under a 2018 law, individual taxpayers receiving income from pass-through businesses must add back the federal bonus depreciation deduction for property placed in service after September 27, 2017, when calculating their Connecticut adjusted gross income for the state personal income tax. Taxpayers may then subtract 25% of the disallowed deduction for the next four succeeding tax years. Thus, taxpayers are allowed to recapture the value of the federal deduction over a four-year period, rather than claim it all in the first year (CGS § 12-701(a)(20)), as amended by PA 18-49 § 11).

This new law took effect on May 31, 2018, but applies beginning with the 2017 tax year. Thus, taxpayers who previously claimed a bonus depreciation deduction in 2017 for property placed in service after September 27, 2017, must file an amended Connecticut income tax return to add back the deduction for 2017 (Regarding the Treatment of Bonus Depreciation for Connecticut Income Tax Purposes, Department of Revenue Services Office of the Commissioner Guidance No. OCG-5, June 14, 2018).

Beginning with the 2018 tax year, pass-through businesses are also subject to a new entity-level income tax. Under this new tax, businesses must calculate their taxable income subject to the modifications specified for the state personal income tax, including the bonus depreciation modification described above.

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