News | HOSPITALITY

May 2012

We turn expertise into results. J.H. COHN LLP ACCOUNTANTS & CONSULTANTS

Understanding Changes to Bonus Depreciation and Section 179 for the Restaurant Industry

Over the past ten years, depreciation laws have changed on a near-annual basis. Failure to apply these changes correctly may have a significant impact on your organization's taxable income. Bonus depreciation was reinstated, retroactive to January 1, 2010, by the Job Creation Act of 2010 and the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010.

As of this writing, the rules for Bonus Depreciation and Section 179 expensing have changed for 2012, as compared to 2011. While Congress has suggested that some of the previous laws may be reinstated (and possibly retroactively to the beginning of 2011), there are no assurances that this will happen.

As such, following is a summary of the significant changes to bonus depreciation and Section 179 expensing rules for 2012. Due to these changes, companies may benefit from completing new projects by the end of this year or conducting cost segregation studies.

Bonus Depreciation (additional first-year depreciation deduction)

For 2012, bonus depreciation has been reduced to 50 percent of qualifying assets acquired and placed in service in 2012 (as compared to 100 percent in 2011). Bonus depreciation has been eliminated for assets placed in service after 2012, except for certain property with long production periods.

Generally speaking, bonus depreciation applies to new property with a recovery period (tax life) of 20 years or less and Qualified Leasehold Improvement Property ("QLIP"). QLIP refers to improvements to the interior of non-residential real property if the following exists: 1) pursuant to a lease by the lessee, any sublessee, or the lessor; 2) between unrelated parties; 3) occupied exclusively by the lessee or sublessee; 4) improvement is Section 1250 property (generally building components); and 5) improvements placed in service more than three years after the date that the building was first placed in service. Non-qualifying improvements include 1) enlargement of the building; 2) elevators and escalators; 3) structural components that benefit a common area; and 4) internal structural framework.

Qualified Restaurant Property ("QRP") and Qualified Retail Improvement Property ("QRIP") were not subject to bonus depreciation in 2011 and are not in 2012, unless they also meet the definition for QLIP.

QRP, starting in 2009, is defined as a building and improvements to a building if more than 50 percent of the building's square footage is devoted to the preparation of, and seating for, on-premises consumption of prepared meals.

QRIP includes improvements to an **interior** portion of a nonresidential building if that portion of the building is open to the general public and is used in the retail trade or business of selling tangible personal property to the general public, and the improvement is placed in service more than three years after the date the building was first placed in service. Improvements made by an owner qualify as QRIP so long as such improvements are held by such owner. A lease is not required. Non-qualifying improvements are the same as for QLIP.

For 2012, all leasehold improvement property is depreciated over 39 years, versus 15 years, which was the case in 2011.

Section 179 (expensing qualifying property additions)

For 2012, the maximum deduction under Section 179 is $139,000 (as compared to $500,000 in 2011) with the phase-out of the deduction starting at $560,000 (as compared to $2,000,000 in 2011). Section 179 is fully phased out when qualifying additions reach $699,000 in 2012 (as compared to $2,500,000 in 2011). Section 179 generally applies to both new and used property.

For 2013, the maximum deduction under Section 179 reverts to $25,000, with the phase-out of the deduction starting at $200,000. Section 179 is fully phased out when qualifying additions reach $250,000 in 2013.

After 2011, there is no provision to include any qualifying leasehold improvements under Section 179 (as compared to up to $250,000, of the $500,000 maximum, in 2011).

To further illustrate the impact of the changes in bonus depreciation and Section 179, following are four examples:

- *Example One:* In 2011, a restaurant operator leased space in a building and spent $1,000,000 for leasehold improvements (“LHI”) and $500,000 for furniture, fixtures, and equipment (“FF&E”). The LHI and FF&E were placed in service more than three years after the building was originally placed in service.

  If the LHI and FF&E are placed in service by December 31, 2011, both the LHI and the FF&E would be subject to 100 percent bonus depreciation.

  If the LHI and FF&E are placed in service **after** December 31, 2011, for example January 15, 2012, both the LHI and the FF&E would be subject to only 50 percent bonus depreciation with the remaining 50 percent depreciated over 39 years (LHI) and five years (FF&E), respectively. **The difference in first-year depreciation is over $725,000.**

For 2012, the maximum deduction under Section 179 is $139,000 (as compared to $500,000 in 2011) with the phase-out of the deduction starting at $560,000 (as compared to $2,000,000 in 2011).

- *Example Two:* Taking into account the same facts as example one, with the exception that the **building is new**.

  If the LHI and FF&E are placed in service by December 31, 2011, only the FF&E would be subject to 100 percent bonus depreciation. The LHI would most likely meet the QRP definition and be depreciable over 15 years, with no bonus depreciation. **The difference in first-year depreciation is over $990,000.**

  If the LHI and FF&E are placed in service **after** December 31, 2011, for example January 15, 2012, only the FF&E would be subject to 50 percent bonus depreciation with the remaining 50 percent depreciated over five years. The LHI would be depreciable over 39 years. **The difference in first-year depreciation is over $1,225,000.**

- *Example Three:* Taking into account the same facts as example one, with the exception that the LHI and FF&E are placed in service in January **2013.**

  Neither the LHI nor FF&E are subject to bonus depreciation. The LHI would be depreciable over 39 years. The FF&E would be depreciable over five years.

  The difference in first-year depreciation, as compared to example one, is over $1,462,000.

- *Example Four:* In 2011, a restaurant operator leased space in a building in New York City and spent $400,000 for LHI and $200,000 for FF&E. The LHI and FF&E were placed in service more than three years after the building was originally placed in service. The restaurant has sufficient taxable income to take a Section 179 deduction.

  Since New York State and New York City accept the Federal Section 179 deduction, there is a distinct advantage to using Section 179 over bonus depreciation (as most states do not accept bonus depreciation). If the LHI and FF&E are placed in service by December 31, 2011, the business would first take a Section 179 deduction of $200,000 for FF&E, plus a Section 179 deduction of $250,000 for LHI (the maximum allowed in 2011). The remaining $150,000 of LHI would be deducted as 100 percent bonus depreciation. The result is the same for Federal tax purposes (a $600,000 deduction using both Section 179 and bonus depreciation), but by using Section 179, there would be a New York Section 179 tax deduction of $450,000, with the remaining $150,000 of LHI depreciated over 15 years.

If the LHI and FF&E are placed in service **after** December 31, 2011, for example January 15, 2012, the Section 179 deduction would be limited to $139,000. The balance of the FF&E ($61,000) would be subject to 50 percent bonus depreciation with the remaining 50 percent depreciated over five years. The LHI would be subject to 50 percent bonus depreciation (if it meets the QLIP definition) with the remaining 50 percent depreciated over 39 years.

If the LHI and FF&E are placed in service **in 2013**, the Section 179 deduction would be limited to $25,000. The balance of the FF&E ($175,000) would be depreciated over five years. The LHI would be depreciable over 39 years.

Bonus Depreciation (New Property)	**2011**	**2012**	**2013**
Personal Property (i.e. furniture and equipment) IRC §1245	100%	50%	0%
Qualified Leasehold Improvement Property as defined in IRC §168(k)(3) (QLIP)	100%	50%	0%
Qualified Restaurant Property IRC §168(e)(7) (QRP)	0%	0%	0%
Qualified Retail Improvement Property IRC §168(e)(8) (QRIP)	0%	0%	0%
Building and improvements IRC §1250	0%	0%	0%

Tax Lives/Depreciation Method	**2011**	**2012**	**2013**
Personal Property (i.e. furniture and equipment) IRC §1245	5 or 7 years DDB	5 or 7 years DDB	5 or 7 years DDB
Qualified Leasehold Improvement Property as defined in IRC §168(k)(3) (QLIP)	15 Years S/L	39 Years S/L	39 Years S/L
Qualified Restaurant Property IRC §168(e)(7) (QRP)	15 Years S/L	39 Years S/L	39 Years S/L
Qualified Retail Improvement Property IRC §168(e)(8) (QRIP)	15 Years S/L	39 Years S/L	39 Years S/L
Building and improvements IRC §1250	39 Years S/L	39 Years S/L	39 Years S/L

Section 179 (New or Used Property) — Max Amount/Phase Out Commences

	2011	**2012**	**2013**
Personal Property (i.e. furniture and equipment) IRC §1245	$500,000/$2,000,000	$139,000/$560,000	$25,000/$200,000
Qualified Leasehold Improvement Property as defined in IRC §168(k)(3) (QLIP)	$250,000/$2,000,000 (*)	$0	$0
Qualified Restaurant Property IRC §168(e)(7) (QRP)	$250,000/$2,000,000 (*)	$0	$0
Qualified Retail Improvement Property IRC §168(e)(8) (QRIP)	$250,000/$2,000,000 (*)	$0	$0
Building and improvements IRC §1250	$0	$0	$0

** $250,000 amount included as part of $500,000 annual maximum*

As a result of these changes, companies should try to complete new projects by December 31, 2012, and consider a cost segregation study to help maximize depreciation deductions. ■

David Grant, CPA, is a partner at J.H. Cohn LLP. He can be reached at dgrant@jhcohn.com or 973-403-6905.

Gary Levy, CPA, is a partner at J.H. Cohn and director of the Firm's Hospitality Industry Practice. He can be reached at glevy@jhcohn.com or 646-254-7403.

For more information on J.H. Cohn's Hospitality Industry Practice, go to http://www.jhcohn.com/industry

CALIFORNIA

Los Angeles
11755 Wilshire Boulevard
17th Floor
Los Angeles, CA 90025
310-477-3722

San Diego
9255 Towne Centre Drive
Suite 250
San Diego, CA 92121
858-535-2000

Warner Center
21700 Oxnard Street
7th Floor
Woodland Hills, CA 91367
818-205-2600

CAYMAN ISLANDS

P.O. Box 1748 GT
27 Hospital Road
George Town, Grand Cayman
877-704-3500 x7839

CONNECTICUT

Glastonbury
180 Glastonbury Blvd.
Glastonbury, CT 06033
860-633-3000

Farmington
76 Batterson Park Road
Farmington, CT 06032
860-678-6000

New London
125 Eugene O'Neill Drive
Suite 120
New London, CT 06320
860-442-4373

Stamford
1177 Summer Street
Stamford, CT 06905
203-399-1900

MASSACHUSETTS

Springfield
One Monarch Place
Suite 2020
Springfield, MA 01144
413-233-2300

NEW JERSEY

Roseland
4 Becker Farm Road
Roseland, NJ 07068
973-228-3500

Eatontown
27 Christopher Way
Eatontown, NJ 07724
732-578-0700

Metro Park
333 Thornall Street
Edison, NJ 08837
732-549-0700

Princeton
103 Carnegie Center
Suite 311
Princeton, NJ 08540
609-896-1221

NEW YORK

Manhattan
1212 Avenue of the Americas
New York, NY 10036
212-297-0400

Long Island
100 Jericho Quadrangle
Suite 223
Jericho, NY 11753
516-482-4200

White Plains
1311 Mamaroneck Avenue
White Plains, NY 10605
914-684-2700

J.H. COHN LLP
ACCOUNTANTS & CONSULTANTS

877-704-3500
www.jhcohn.com