



ARIZONA INDIVIDUAL INCOME TAX PROCEDURE
ITP 16-2
(Supersedes ITP 15-1)

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Procedure for Individuals Who Claim Federal and/or Arizona Bonus Depreciation

ISSUE:

How does an individual who claims bonus depreciation for federal income tax purposes, claim depreciation on the Arizona individual income tax return?

PROCEDURE:

For Arizona income tax purposes, a taxpayer may not deduct federal bonus depreciation on the Arizona income tax return. To preclude a taxpayer from taking a deduction for federal bonus depreciation on the Arizona income tax return, the taxpayer must make an addition to Arizona gross income for the amount of depreciation deducted under I.R.C. § 167(a) for the taxable year (this is the entire amount [bonus plus regular] of depreciation deducted on the federal income tax return).

Once the taxpayer makes the required addition to income, the taxpayer must compute depreciation for Arizona income tax purposes. The taxpayer will then take a subtraction from income on the Arizona income tax return for the amount of depreciation computed on the Arizona basis. The amount of depreciation the taxpayer may subtract on the Arizona return will depend on when the asset was placed in service.

If a taxpayer sells or otherwise disposes of property for which the taxpayer made the required addition to income under A.R.S. § 43-1021(16), the taxpayer may claim a subtraction for the amount of depreciation that has been allowed pursuant to I.R.C. § 167(a), to the extent that the amount has not already reduced Arizona taxable income in the current or prior taxable years. This, in effect, allows the taxpayer to have the same basis for Arizona purposes as for federal purposes when the asset is sold or otherwise disposed.

Assets Placed in Service During Taxable Years Beginning Before January 1, 2013

For taxable years that began before 2013 (taxable years 2012 or earlier), Arizona did not allow bonus depreciation. Therefore a taxpayer that deducted bonus depreciation for federal income tax purposes was required to make an addition to income for the total amount of depreciation (bonus plus regular) deducted on the federal income tax return and then the taxpayer had to take a subtraction on the Arizona income tax return for the amount of depreciation computed under the Internal Revenue Code without bonus depreciation. This amount must be subtracted each year, until the asset is fully depreciated or until the taxpayer either sells or otherwise disposes of the asset. The

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following example will illustrate how a taxpayer computes the required additions and subtractions for an asset placed in service during a taxable year prior to 2013.

| EXAMPLE 1 - Property Placed in Service During 2012 | | | |
|---|--------------|----------------|--------------|
| Taxpayer A began operation on January 1, 2012, of the taxable year. Taxpayer A immediately placed into service new 5 year property costing \$100,000. The property has a \$0 salvage value. Taxpayer claims bonus depreciation on the federal return and uses the straight line depreciation method. Because Arizona does not allow any bonus depreciation for an asset placed in service during 2012, Taxpayer A must complete two depreciation schedules for the asset placed in service during 2012. One computing the allowable federal depreciation calculated without bonus depreciation and the second calculated with federal bonus depreciation. The annual depreciation calculated without the federal bonus depreciation is the amount of depreciation that Taxpayer A may subtract on the Arizona income tax return. The annual depreciation calculated with the federal bonus depreciation is the amount of depreciation that Taxpayer A must add to the Arizona income reported on the Arizona income tax return. | | | |
| Federal Depreciation Schedule Calculated Using NO Bonus Depreciation (amount allowed on Arizona return) | | | |
| Year | Depreciation | | |
| 2012 | \$20,000 | | |
| 2013 | \$20,000 | | |
| 2014 | \$20,000 | | |
| 2015 | \$20,000 | | |
| 2016 | \$20,000 | | |
| Total 2012 -2016 | \$100,000 | | |
| Federal Depreciation Schedule WITH Bonus Depreciation Allowance (amount claimed on federal return) | | | |
| Year | Cost | Depreciation % | Depreciation |
| | \$100,000 | X .50 | |
| | | <\$50,000> | \$50,000 |
| | \$50,000 | | |
| 2012 | | | \$10,000 |
| 2013 | | | \$10,000 |
| 2014 | | | \$10,000 |
| 2015 | | | \$10,000 |
| 2016 | | | \$10,000 |
| Total 2012 -2016 | | | \$100,000 |

Based on the above depreciation schedules, Taxpayer A must make the following additions to and subtractions from Arizona gross income to reflect the depreciation allowed to be claimed on the Arizona income tax return.

| Year | Addition | Subtraction |
|--------------------|-----------|-------------|
| 2012 | *\$60,000 | \$20,000 |
| 2013 | \$10,000 | \$20,000 |
| 2014 | \$10,000 | \$20,000 |
| 2015 | \$10,000 | \$20,000 |
| 2016 | \$10,000 | \$20,000 |
| Total Additions | \$100,000 | |
| Total Subtractions | | \$100,000 |

* Total depreciation claimed on federal return (\$50,000 bonus plus \$10,000 regular depreciation).

Assets Placed in Service During the 2013 Taxable Year

For a taxable year beginning in 2013, Arizona did not allow federal bonus depreciation. Therefore a taxpayer that deducted bonus depreciation for federal income tax purposes was required to make an addition to income for the total amount of depreciation (bonus plus regular) deducted on the federal income tax return. The taxpayer then must take a

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subtraction on the Arizona income tax return for the amount of depreciation allowable for Arizona income tax purposes.

The amount of depreciation allowed to be taken as a subtraction on the 2013 Arizona income tax return is the amount of depreciation computed under I.R.C. § 167(a) without any federal bonus depreciation.

For assets placed in service in 2013, Arizona law allowed a taxpayer that claimed bonus depreciation on the federal return to make an election to claim bonus depreciation on the Arizona income tax return. The Arizona bonus depreciation is 10% of the amount of bonus depreciation claimed on the federal income tax return. However, a taxpayer making this election for an asset placed in service during the 2013 taxable year, had to make the election on his or her 2014 Arizona income tax return by taking the subtraction on the 2014 Arizona income tax return. Therefore, for an asset placed in service during 2013, the amount of depreciation claimed for that asset on the Arizona income tax returns filed for taxable years 2014 and later, will depend on whether the taxpayer elects to claim Arizona bonus depreciation for that asset.

If the taxpayer does not make the election to take Arizona bonus depreciation for the asset placed in service during 2013, the amount of depreciation allowed to be taken as a subtraction, for that asset, on the Arizona income tax returns filed for taxable years 2014 and later is the amount of depreciation computed under I.R.C. § 167(a) without any federal bonus depreciation. This amount must be subtracted each year, until the asset is fully depreciated or until the taxpayer either sells or otherwise disposes of the asset.

If the taxpayer makes an election to take a subtraction for Arizona bonus depreciation for an asset (for which federal bonus depreciation was claimed) placed in service during 2013, the Arizona bonus depreciation is equal to 10% of the federal bonus depreciation claimed as a deduction on the 2013 federal income tax return. A taxpayer making this election for an asset placed in service during the 2013 taxable year, must make the election on his or her 2014 Arizona income tax return by taking the subtraction on the 2014 Arizona income tax return. The taxpayer must also take a subtraction for regular depreciation, using the same method of depreciation used for federal income tax purposes, but calculated on the Arizona basis. The recomputed regular depreciation must be subtracted each year, until the asset is fully depreciated or until the taxpayer either sells or otherwise disposes of the asset.

The following examples will illustrate how a taxpayer computes the additions to income and the subtractions from income for an asset placed in service during taxable year 2013, depending on whether or not the taxpayer made the 2013 Arizona bonus depreciation election in 2014.

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EXAMPLE 2 - Property Placed in Service During 2013

Taxpayer B began operation on January 1, 2013 of the taxable year. Taxpayer B immediately placed into service new 5 year property costing \$100,000. The property has a \$0 salvage value. Taxpayer B claimed 50% of the cost as bonus depreciation on Taxpayer B's 2013 federal income tax return. Taxpayer B uses the straight line depreciation method to depreciate the remaining basis of the property.

Federal Depreciation Schedule Calculated Using NO Bonus Depreciation (this is the amount of depreciation that will be allowed for Arizona purposes if no 2013 AZ depreciation bonus election is made on the 2014 return.)

| Year | Depreciation | | | |
|------------------|--------------|--|--|--|
| 2013 | \$20,000 | | | |
| 2014 | \$20,000 | | | |
| 2015 | \$20,000 | | | |
| 2016 | \$20,000 | | | |
| 2017 | \$20,000 | | | |
| Total 2013 -2017 | \$100,000 | | | |

Federal Depreciation Schedule WITH Federal Bonus Depreciation Allowance (claimed on federal return)

| Year | | | Depreciation |
|------------------|----------------------|-----------------|------------------|
| | Cost | \$100,000 | |
| | Bonus depreciation % | X .50 | |
| | Bonus depreciation | <\$50,000> | \$50,000 |
| | Basis | <u>\$50,000</u> | |
| 2013 | | | \$10,000 |
| 2014 | | | \$10,000 |
| 2015 | | | \$10,000 |
| 2016 | | | \$10,000 |
| 2017 | | | \$10,000 |
| Total 2013 -2017 | | | <u>\$100,000</u> |

WITH 2013 AZ BONUS ELECTION

Arizona Depreciation Schedule Calculated as if the 2013 Arizona Bonus Depreciation Election Were Made on the 2013 Return

| | | | |
|--------------------------------|-----------------------|----------------|-----------------------------|
| Cost | | | \$100,000 |
| AZ Bonus | Federal Bonus Allowed | \$50,000 | |
| | X | .10 | |
| | AZ Bonus Depreciation | <u>\$5,000</u> | <\$5,000> |
| Basis for Arizona depreciation | \$100,000 - \$5,000 | | <u>\$95,000</u> |
| Year | | | Arizona Depreciation |
| 2013 | AZ Bonus | \$5,000 | |
| | AZ Regular | \$19,000 | |
| 2013 total | | | \$24,000 |
| 2014 | | | \$19,000 |
| 2015 | | | \$19,000 |
| 2016 | | | \$19,000 |
| 2017 | | | \$19,000 |
| Total 2013 -2017 | | | <u>\$100,000</u> |

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| WITH 2013 AZ BONUS ELECTION ON THE 2014 RETURN | | | |
|---|------------------|---|---------|
| Taxpayer B's Required Additions and Subtractions | | | |
| If Taxpayer B makes the 2013 Arizona bonus depreciation election on the 2014 Arizona return, Taxpayer B must make the following additions to and subtractions from Arizona gross income to reflect the depreciation allowed to be claimed on the Arizona income tax return. | | | |
| Year | Addition | Subtraction | |
| 2013 | *\$60,000 | \$20,000 | |
| 2014 - Adjustment made on 2014 return for 2013 AZ Bonus Depreciation | | Allowed \$24,000 Less Claimed <\$20,000> Adjustment | \$4,000 |
| 2014 -Regular Depreciation | \$10,000 | \$19,000 | |
| 2015 | \$10,000 | \$19,000 | |
| 2016 | \$10,000 | \$19,000 | |
| 2017 | \$10,000 | \$19,000 | |
| Total Additions 2013 - 2024 | <u>\$100,000</u> | | |
| Total Subtractions 2013 - 2014 | | <u>\$100,000</u> | |
| * Total depreciation claimed on federal return (\$50,000 bonus plus \$10,000 regular depreciation). | | | |

| NO 2013 AZ BONUS ELECTION | | | |
|--|------------------|------------------|--|
| Taxpayer B's Required Additions and Subtractions | | | |
| If Taxpayer B claims bonus depreciation on the 2013 federal return, but DOES NOT make the 2013 Arizona bonus depreciation election on the 2014 Arizona return, Taxpayer B must make the following additions to and subtractions from Arizona gross income to reflect the depreciation allowed to be claimed on the Arizona income tax return. | | | |
| Year | Addition | Subtraction | |
| 2013 | *\$60,000 | \$20,000 | |
| 2014 | \$10,000 | \$20,000 | |
| 2015 | \$10,000 | \$20,000 | |
| 2016 | \$10,000 | \$20,000 | |
| 2017 | \$10,000 | \$20,000 | |
| Total Additions | <u>\$100,000</u> | | |
| Total Subtractions | | <u>\$100,000</u> | |
| * Total depreciation claimed on federal return (\$50,000 bonus plus \$10,000 regular depreciation). | | | |

Passenger Automobile Placed in Service During 2013 with I.R.C. § 280F Limits

I.R.C. § 280F imposes dollar limitations on the depreciation deduction for the year the taxpayer places a passenger automobile in service and for each succeeding year prescribes depreciation limits for passenger vehicles. When computing depreciation for Arizona income tax purposes, these limitations apply. The following example will illustrate how to compute depreciation for Arizona income tax purposes, when the passenger automobile limits apply.

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EXAMPLE 3 - Passenger Auto Placed in Service During 2013

In May 2013, Taxpayer C bought and placed in service a car costing \$31,500. The car was 5 year property under GDS (MACRS). Taxpayer C did not elect a section 179 deduction. Taxpayer C used the car exclusively for business during the recovery period.

Federal Depreciation Schedule Calculated Using NO Bonus Depreciation (this is the amount of depreciation that will be allowed for Arizona purposes if no 2013 AZ bonus depreciation election is made on the 2014 Arizona return.)

| Year | Percentage | Amount | Limit | Allowed |
|------------------|------------|----------|---------|----------|
| 2013 | 20.0% | \$6,300 | \$3,160 | \$3,160 |
| 2014 | 32.0% | \$10,080 | \$5,100 | \$5,100 |
| 2015 | 19.2% | \$6,048 | \$3,050 | \$3,050 |
| 2016 | 11.52% | \$3,629 | \$1,875 | \$1,875 |
| 2017 | 11.52% | \$3,629 | \$1,875 | \$1,875 |
| 2018 | 5.76% | \$1,814 | \$1,875 | \$1,814 |
| Total 2013 -2018 | | | | \$16,874 |

At the end of 2018, Taxpayer C has an unrecovered basis of \$14,626 (\$31,500-\$16,874). If in years 2019 and later, Taxpayer C continues to use the car 100% for business, Taxpayer C can deduct in each of those future years, the lesser of \$1,875 or the remaining unrecovered basis.

| | | | | |
|-----------------|--|--|---------|----------|
| 2019 | | | \$1,875 | \$1,875 |
| 2020 | | | \$1,875 | \$1,875 |
| 2021 | | | \$1,875 | \$1,875 |
| 2022 | | | \$1,875 | \$1,875 |
| 2023 | | | \$1,875 | \$1,875 |
| 2024 | | | \$1,875 | \$1,875 |
| 2025 | | | \$1,875 | \$1,875 |
| 2026 | | | \$1,875 | \$1,501 |
| Total 2019-2026 | | | | \$14,626 |
| Total all years | | | | \$31,500 |

Federal depreciation schedule calculated using federal bonus depreciation

| | Cost | \$31,500 | | |
|-------------------------------|---------------------------------|----------|----------|----------|
| | X .50 | \$15,750 | | |
| | Limit | \$11,160 | | |
| Bonus Depreciation | Smaller of \$15,750 or \$11,160 | | | \$11,160 |
| Basis for Depreciation | \$31,500 - \$11,160 | | | \$20,340 |
| Year | Percentage | Amount | Limit | Allowed |
| 2013 | Bonus | \$15,750 | \$11,160 | \$11,160 |
| 2014 | 32.0% | \$6,509 | \$5,100 | \$5,100 |
| 2015 | 19.2% | \$3,905 | \$3,050 | \$3,050 |
| 2016 | 11.52% | \$2,343 | \$1,875 | \$1,875 |
| 2017 | 11.52% | \$2,243 | \$1,875 | \$1,875 |
| 2018 | 5.76% | \$1,172 | \$1,875 | \$1,172 |
| Total 2013 -2018 | | | | \$24,232 |

At the end of 2018, Taxpayer C has an unrecovered basis of \$7,268 (\$31,500-\$24,232). If in years 2019 and later, Taxpayer C continues to use the car 100% for business, Taxpayer C can deduct in each of those future years, the lesser of \$1,875 or the remaining unrecovered basis.

| | | | | |
|-----------------|--|--|---------|----------|
| 2019 | | | \$1,875 | \$1,875 |
| 2020 | | | \$1,875 | \$1,875 |
| 2021 | | | \$1,875 | \$1,875 |
| 2022 | | | \$1,643 | \$1,643 |
| Total 2019-2022 | | | | \$7,268 |
| Total all years | | | | \$31,500 |

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| WITH 2013 AZ BONUS ELECTION | | | | |
|--|-----------------------|---------------|--------------|----------------|
| Arizona Depreciation Schedule Calculated as if the 2013 Arizona Bonus Depreciation Election Were Made on the 2013 Return | | | | |
| Cost | | | | \$31,500 |
| AZ Bonus | Federal Bonus Allowed | \$11,160 | | |
| | X | .10 | | |
| | AZ Bonus Depreciation | \$1,116 | | <\$1,116> |
| Basis for Arizona depreciation | \$31,500 - \$1,116 | | | \$30,384 |
| Year | Percentage | Amount | Limit | Allowed |
| 2013 | Bonus | \$1,116 | | |
| | 20.0% | \$6,077 | | |
| 2013 total | | \$7,193 | \$11,160 | \$7,193 |
| 2014 | 32.0% | \$9,723 | \$5,100 | \$5,100 |
| 2015 | 19.2% | \$5,834 | \$3,050 | \$3,050 |
| 2016 | 11.52% | \$3,500 | \$1,875 | \$1,875 |
| 2017 | 11.52% | \$3,500 | \$1,875 | \$1,875 |
| 2018 | 5.76% | \$1,750 | \$1,875 | \$1,750 |
| Total 2013 -2018 | | | | \$20,843 |
| At the end of 2018, Taxpayer C has an unrecovered basis of \$10,657 (\$31,500-\$20,843). If in years 2019 and later years, Taxpayer C continues to use the car 100% for business, Taxpayer C can deduct in each of those future years, the lesser of \$1,875 or the remaining unrecovered basis. | | | | |
| 2019 | | | \$1,875 | \$1,875 |
| 2020 | | | \$1,875 | \$1,875 |
| 2021 | | | \$1,875 | \$1,875 |
| 2022 | | | \$1,875 | \$1,875 |
| 2023 | | | \$1,875 | \$1,875 |
| 2024 | | | \$1,282 | \$1,282 |
| Total 2019-2024 | | | | \$10,657 |
| Total all years | | | | \$31,500 |

| WITH 2013 AZ BONUS DEPRECIATION ELECTION ON THE 2014 RETURN | | | |
|---|-----------------|---|----------|
| Taxpayer C's Required Additions and Subtractions | | | |
| If Taxpayer C makes the 2013 Arizona bonus depreciation election on the 2014 Arizona return, Taxpayer C must make the following additions to and subtractions from Arizona gross income to reflect the depreciation allowed to be claimed on the Arizona income tax return. | | | |
| Year | Addition | Subtraction | |
| 2013 | \$11,160 | | \$3,160 |
| 2014 - Adjustment made on 2014 return for 2013 AZ Bonus Depreciation | | Allowed \$7193 Less Claimed <\$3160> Adjustment | \$4,033 |
| 2014 -Regular Depreciation | \$5,100 | | \$5,100 |
| 2015 | \$3,050 | | \$3,050 |
| 2016 | \$1,875 | | \$1,875 |
| 2017 | \$1,875 | | \$1,875 |
| 2018 | \$1,172 | | \$1,750 |
| 2019 | \$1,875 | | \$1,875 |
| 2020 | \$1,875 | | \$1,875 |
| 2021 | \$1,875 | | \$1,875 |
| 2022 | \$1,643 | | \$1,875 |
| 2023 | 0 | | \$1,875 |
| 2024 | 0 | | \$1,282 |
| Total Additions 2013 - 2024 | \$31,500 | | |
| Total Subtractions 2013 - 2024 | | | \$31,500 |

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| NO 2013 AZ BONUS ELECTION | | |
|--|----------|-------------|
| Taxpayer C's Required Additions and Subtractions | | |
| If Taxpayer C claims bonus depreciation on the 2013 federal return, but DOES NOT make the 2013 Arizona bonus depreciation election on the 2014 Arizona return, Taxpayer C must make the following additions to and subtractions from Arizona gross income to reflect the depreciation allowed to be claimed on the Arizona income tax return. | | |
| Year | Addition | Subtraction |
| 2013 | \$11,160 | \$3,160 |
| 2014 | \$5,100 | \$5,100 |
| 2015 | \$3,050 | \$3,050 |
| 2016 | \$1,875 | \$1,875 |
| 2017 | \$1,875 | \$1,875 |
| 2018 | \$1,172 | \$1,814 |
| 2019 | \$1,875 | \$1,875 |
| 2020 | \$1,875 | \$1,875 |
| 2021 | \$1,875 | \$1,875 |
| 2022 | \$1,643 | \$1,875 |
| 2023 | 0 | \$1,875 |
| 2024 | 0 | \$1,875 |
| 2025 | 0 | \$1,875 |
| 2026 | 0 | \$1,501 |
| Total Additions 2013 - 2024 | \$31,500 | |
| Total Subtractions 2013 - 2014 | | \$31,500 |

Assets Placed in Service During a Taxable Year Beginning in 2014 or 2015

For taxable years beginning in 2014 and 2015, Arizona did not allow federal bonus depreciation. Therefore a taxpayer that deducts bonus depreciation for federal income tax purposes is required to make an addition to income for the total amount of depreciation (bonus plus regular) deducted on the federal income tax return. The taxpayer then must take a subtraction on the Arizona income tax return for the amount of depreciation allowable for Arizona income tax purposes.

For taxable years 2014 and 2015, Arizona law required a taxpayer that claimed bonus depreciation on the federal return to claim Arizona bonus depreciation on the Arizona income tax return filed for that year. The Arizona bonus depreciation is 10% of the amount of bonus depreciation claimed on the federal income tax return. The taxpayer takes the subtraction on his or her Arizona income tax return filed for the taxable year for which the asset was placed in service and for which federal bonus depreciation was claimed. The taxpayer must also take a subtraction for regular depreciation, using the same method of depreciation used for federal income tax purposes, but calculated on the Arizona basis. This amount must be subtracted each year, until the asset is fully depreciated or until the taxpayer either sells or otherwise disposes of the asset. The following example will illustrate how a taxpayer computes the required additions to and subtractions from income for property placed in service during the 2014 taxable year.

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EXAMPLE 4 - Property Placed in Service During 2014

Taxpayer D began operation on January 1, 2014 of the taxable year. Taxpayer D immediately placed into service new 5 year property costing \$100,000. The property has a \$0 salvage value. Taxpayer D claimed 50% of the cost as bonus depreciation on Taxpayer D's 2014 federal income tax return. Taxpayer D uses the straight line depreciation method to depreciate the remaining basis of the property.

Federal Depreciation Schedule WITH Federal Bonus Depreciation Allowance (claimed on federal return)

| Year | | | Depreciation |
|------------------|--|----------------------|---------------------|
| | | Cost | \$100,000 |
| | | Bonus depreciation % | X .50 |
| | | Bonus depreciation | <\$50,000> \$50,000 |
| | | Basis | <u>\$50,000</u> |
| 2014 | | | \$10,000 |
| 2015 | | | \$10,000 |
| 2016 | | | \$10,000 |
| 2017 | | | \$10,000 |
| 2018 | | | \$10,000 |
| Total 2014 -2018 | | | <u>\$100,000</u> |

Arizona Depreciation Schedule Calculated with Arizona Bonus Depreciation

| | | | |
|--------------------------------|-----------------------|----------------|-----------------------------|
| Cost | | | \$100,000 |
| AZ Bonus | Federal Bonus Allowed | \$50,000 | |
| | X | .10 | |
| | AZ Bonus Depreciation | <u>\$5,000</u> | <\$5,000> |
| Basis for Arizona depreciation | \$100,000 - \$5,000 | | <u>\$95,000</u> |
| Year | | | Arizona Depreciation |
| 2014 | AZ Bonus | \$5,000 | |
| | AZ Regular | \$19,000 | \$24,000 |
| 2015 | | | \$19,000 |
| 2016 | | | \$19,000 |
| 2017 | | | \$19,000 |
| 2018 | | | \$19,000 |
| Total 2014 -2018 | | | <u>\$100,000</u> |

Taxpayer D's Required Additions and Subtractions

| Year | Addition | Subtraction |
|--------------------------------|------------------|------------------|
| 2014 | \$60,000 | \$24,000 |
| 2015 | \$10,000 | \$19,000 |
| 2016 | \$10,000 | \$19,000 |
| 2017 | \$10,000 | \$19,000 |
| 2018 | \$10,000 | \$19,000 |
| Total Additions 2014 - 2018 | <u>\$100,000</u> | |
| Total Subtractions 2014 - 2018 | | <u>\$100,000</u> |

Assets Placed in Service During the 2016 Taxable Year

For a taxable year beginning in 2016, Arizona does not allow federal bonus depreciation. Therefore a taxpayer that deducts bonus depreciation for federal income tax purposes is required to make an addition to income for the total amount of depreciation (bonus plus regular) deducted on the federal income tax return. The

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taxpayer then must take a subtraction on the Arizona income tax return for the amount of depreciation allowable for Arizona income tax purposes.

For taxable year 2016, Arizona law requires a taxpayer that claims bonus depreciation on the federal return to claim Arizona bonus depreciation on the Arizona income tax return filed for that year. The Arizona bonus depreciation is 55% of the amount of bonus depreciation claimed on the federal income tax return. The taxpayer takes the subtraction on his or her Arizona income tax return filed for the taxable year for which the asset was placed in service and for which federal bonus depreciation was claimed. The taxpayer must also take a subtraction for regular depreciation, using the same method of depreciation used for federal income tax purposes, but calculated on the Arizona basis. This amount must be subtracted each year, until the asset is fully depreciated or until the taxpayer either sells or otherwise disposes of the asset. The following example will illustrate how a taxpayer computes the required additions to and subtractions from income for property placed in service during the 2016 taxable year.

EXAMPLE 5 - Property Placed in Service During 2016

Taxpayer D began operation on January 1, 2016 of the taxable year. Taxpayer D immediately placed into service new 5 year property costing \$100,000. The property has a \$0 salvage value. Taxpayer D claimed 50% of the cost as bonus depreciation on Taxpayer D's 2016 federal income tax return. Taxpayer D uses the straight line depreciation method to depreciate the remaining basis of the property.

Federal Depreciation Schedule WITH Federal Bonus Depreciation Allowance (claimed on federal return)

| Year | | | | Depreciation |
|------------------|--|----------------------|-----------------|------------------|
| | | Cost | \$100,000 | |
| | | Bonus depreciation % | X .50 | |
| | | Bonus depreciation | <\$50,000> | \$50,000 |
| | | Basis | <u>\$50,000</u> | |
| 2016 | | | | \$10,000 |
| 2017 | | | | \$10,000 |
| 2018 | | | | \$10,000 |
| 2019 | | | | \$10,000 |
| 2020 | | | | \$10,000 |
| Total 2016 -2020 | | | | <u>\$100,000</u> |

Arizona Depreciation Schedule Calculated with Arizona Bonus Depreciation

| | | | |
|--------------------------------|-----------------------|-----------------|----------------------|
| Cost | | | \$100,000 |
| AZ Bonus | Federal Bonus Allowed | \$50,000 | |
| | X | .55 | |
| | AZ Bonus Depreciation | <u>\$27,500</u> | <\$27,500> |
| Basis for Arizona depreciation | \$100,000 - \$27,500 | | <u>\$72,500</u> |
| Year | | | Arizona Depreciation |
| 2016 | AZ Bonus | \$27,500 | |
| | AZ Regular | \$14,500 | \$42,000 |
| 2017 | | | \$14,500 |
| 2018 | | | \$14,500 |
| 2019 | | | \$14,500 |
| 2020 | | | \$14,500 |
| Total 2016 -2020 | | | <u>\$100,000</u> |

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| Taxpayer D's Required Additions and Subtractions | | |
|--|-----------|-------------|
| Year | Addition | Subtraction |
| 2016 | \$60,000 | \$42,000 |
| 2017 | \$10,000 | \$14,500 |
| 2018 | \$10,000 | \$14,500 |
| 2019 | \$10,000 | \$14,500 |
| 2020 | \$10,000 | \$14,500 |
| Total Additions 2016 - 2020 | \$100,000 | |
| Total Subtractions 2016 - 2020 | | \$100,000 |

Assets Placed in Service During a Taxable Year Beginning in 2017 or Later (Providing Federal Bonus Depreciation is Allowed)

For assets placed in service during taxable years beginning in 2017 and later, Arizona law requires a taxpayer that claims bonus depreciation on the federal return to claim Arizona bonus depreciation on the Arizona income tax return filed for that year. The Arizona bonus depreciation is 100% of the amount of bonus depreciation claimed on the federal income tax return. The taxpayer takes the subtraction on his or her Arizona income tax return filed for the taxable year for which the asset was placed in service and for which federal bonus depreciation was claimed. The taxpayer must also take a subtraction for regular depreciation, using the same method of depreciation used for federal income tax purposes, but calculated on the Arizona basis. This amount must be subtracted each year, until the asset is fully depreciated or until the taxpayer either sells or otherwise disposes of the asset. The following example will illustrate how a taxpayer computes the required additions to and subtractions from income for property placed in service during the 2017 taxable year.

NOTE: A taxpayer who also claims Arizona bonus depreciation for assets placed in service prior to January 1, 2017, must compute the allowable bonus depreciation for each asset based on the allowable subtraction established for the taxable year in which the asset was placed in service.

| EXAMPLE 6 - Property Placed in Service During 2017 | | | | |
|--|--|----------------------|------------|--------------|
| Taxpayer D (same Taxpayer as in Example 5) began operation on January 1, 2016 . In 2017, Taxpayer D immediately placed into service new 5 year property costing \$100,000. The property has a \$0 salvage value. Taxpayer D claimed 50% of the cost as bonus depreciation on Taxpayer D's 2017 federal income tax return. Taxpayer D uses the straight line depreciation method to depreciate the remaining basis of the property. | | | | |
| Federal Depreciation Schedule WITH Federal Bonus Depreciation Allowance (claimed on federal return) | | | | |
| Year | | | | Depreciation |
| | | Cost | \$100,000 | |
| | | Bonus depreciation % | X .50 | |
| | | Bonus depreciation | <\$50,000> | \$50,000 |
| | | Basis | \$50,000 | |
| 2017 | | | | \$10,000 |
| 2018 | | | | \$10,000 |
| 2019 | | | | \$10,000 |
| 2020 | | | | \$10,000 |
| 2021 | | | | \$10,000 |
| Total 2017 -2021 | | | | \$100,000 |

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| Arizona Depreciation Schedule Calculated with Arizona Bonus Depreciation (for Assets Placed in Service during 2017) | | | |
|---|-----------------------|-----------------|----------------------|
| Cost | | | \$100,000 |
| AZ Bonus | Federal Bonus Allowed | \$50,000 | |
| | AZ Bonus Depreciation | <u>\$50,000</u> | <\$50,000> |
| Basis for Arizona depreciation | \$100,000 - \$50,000 | | \$50,000 |
| Year | | | Arizona Depreciation |
| 2017 | AZ Bonus | \$50,000 | |
| | AZ Regular | \$10,000 | \$60,000 |
| 2018 | | | \$10,000 |
| 2019 | | | \$10,000 |
| 2020 | | | \$10,000 |
| 2021 | | | \$10,000 |
| Total 2017 -2021 | | | \$100,000 |

| Taxpayer D's Required Additions and Subtractions (for Assets Placed in Service during 2017) | | | |
|---|----------------------------|------------------|-------------------------------------|
| Year | Addition | Subtraction | |
| 2017 | \$60,000 | \$60,000 | |
| 2018 | \$10,000 | \$10,000 | |
| 2019 | \$10,000 | \$10,000 | |
| 2020 | \$10,000 | \$10,000 | |
| 2021 | \$10,000 | \$10,000 | |
| Required Additions for taxable years 2017 – 2021 for asset placed in service during 2017 | <u>\$100,000</u> | | |
| Allowable Subtractions for taxable years 2017 – 2021 for asset placed in service in 2017 | | <u>\$100,000</u> | |
| Taxpayer D's Total Additions and Subtractions Reported for Taxable Year 2017 | | | |
| | 2016 Asset (see example 5) | \$10,000 | 2016 Asset (see example 5) \$14,500 |
| | 2017 Asset | \$60,000 | 2017 Asset \$60,000 |
| Total Addition for taxable year 2017 | | <u>\$70,000</u> | |
| Total Subtraction for taxable year 2017 | | | <u>\$74,500</u> |

Sale or Disposition of Asset for Which Bonus Depreciation Was Claimed

If a taxpayer later sells or otherwise disposes of property for which the taxpayer made the required additions to income under A.R.S. § 43-1021(16), the taxpayer may claim a subtraction for the amount of depreciation that has been allowed pursuant to section 167(a) of the internal revenue code to the extent that the amount has not already reduced Arizona taxable income in the current or prior taxable years. This, in effect, allows the taxpayer to have the same basis for Arizona purposes as for federal purposes when the asset is sold or otherwise disposed. The following example will illustrate this concept.

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EXAMPLE 7 - Partially Depreciated Asset Sold

Taxpayer E began operation on January 1, 2012 of the taxable year. Taxpayer E immediately placed into service new property with a cost of \$100,000. The property has a \$0 salvage value. Taxpayer E claimed 50% of the cost as bonus depreciation on Taxpayer E's federal income tax return filed for 2012. Taxpayer E sold the asset on January 1, 2016.

For taxable years, 2012, 2013, 2014 and 2015, Taxpayer E made all of the additions to income required under A.R.S. § 43-1021(16). Therefore, Taxpayer E would take a subtraction from income for the difference between the amount of total depreciation Taxpayer E claimed for the asset for federal income tax purposes and the amount of depreciation claimed for the asset for Arizona income tax purposes.

| Federal Depreciation Straight Line 10 Year | | | AZ Depreciation Deduction Straight Line 10 Year | | |
|--|----------------------|---------------|---|-----------------------------|-----------------|
| Cost | | \$100,000 | Cost | | \$100,000 |
| Salvage | | 0 | Salvage | | 0 |
| Federal Bonus | | \$50,000 | AZ Bonus | | 0 |
| Basis | | \$50,000 | Basis | | \$100,000 |
| Year | Federal Depreciation | Federal Basis | AZ Addition Made in 2012, 2013, 2014 and 2015 | AZ Depreciation Subtraction | AZ Basis |
| 2012 | \$5,000 | \$45,000 | \$55,000 | \$10,000 | \$90,000 |
| 2013 | \$5,000 | \$40,000 | \$5,000 | \$10,000 | \$80,000 |
| 2014 | \$5,000 | \$35,000 | \$5,000 | \$10,000 | \$70,000 |
| 2015 | \$5,000 | \$30,000 | \$5,000 | \$10,000 | \$60,000 |
| Taxpayer E sold the property on January 1, 2016 for \$85,000. For federal income tax purposes, Taxpayer E reported a capital gain on the sale of the asset in the amount of \$55,000 (sale price \$85,000 less adjusted basis \$30,000). Since the starting point for the Arizona return is the federal adjusted gross income, the \$55,000 capital gain included in federal adjusted gross income will also be included in Arizona gross income. However, since Taxpayer E made all of the additions to income required under A.R.S. § 43-1021(16), Taxpayer E will be allowed to take a subtraction from income for the difference between the amount of depreciation claimed for the asset for federal income tax purposes and the amount of depreciation claimed for the asset for Arizona income tax purposes. This will, in effect, allow Taxpayer E to have the same basis for Arizona purposes as for federal purposes when the asset is sold or otherwise disposed. | | | | | |
| Total depreciation deducted on federal returns filed for taxable years 2012, 2013, 2014 and 2015 | | | | | \$70,000 |
| Less total depreciation deducted on AZ returns filed for taxable years 2012, 2013, 2014 and 2015 | | | | | <\$40,000> |
| Subtraction allowed on AZ return filed for 2016 (the year of disposition) | | | | | \$30,000 |
| AZ basis prior to subtraction | | | | | \$60,000 |
| Less catch-up subtraction | | | | | <\$30,000> |
| AZ basis after catch-up subtraction | | | | | \$30,000 |

APPLICABLE LAW:

Arizona Revised Statutes (A.R.S.) § 43-1021(16) requires an addition to Arizona gross income for the amount of any depreciation allowance allowed pursuant to section 167(a) of the internal revenue code to the extent not previously added.

A.R.S. § 43-1022(20) provides a subtraction from Arizona gross income for the amount of any depreciation allowance allowed pursuant to section 167(a) of the internal revenue code to the extent not previously added. This section also provides a subtraction for Arizona bonus depreciation in an amount equal to 10% of the federal bonus depreciation allowed on the federal income tax return for property placed in service during taxable year 2013, 2014 and 2015. This section also provides a subtraction for Arizona bonus depreciation in an amount equal to 55% of the federal bonus

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depreciation allowed on the federal income tax return for property placed in service during taxable year 2016 and allows a subtraction for Arizona bonus depreciation in an amount equal to 100% of the federal bonus depreciation allowed on the federal income tax return for property placed in service during taxable year 2017 or later.

A.R.S. § 43-1022(21) provides for a subtraction from income with respect to property that is sold or otherwise disposed of during the taxable year by a taxpayer that complied with A.R.S. § 43-1021(16) with respect to that property, in the amount of depreciation that has been allowed pursuant to section 167(a) of the internal revenue code, to the extent that the amount has not already reduced Arizona taxable income in the current or prior taxable years.

I.R.C. § 167(a) generally provides, as a depreciation deduction, a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence) of property used in the trade or business, or property held for the production of income.

I.R.C. § 168(k) generally provides for an additional amount of deductible depreciation that is awarded above and beyond what would normally be available for property acquired and placed in service during applicable years.

I.R.C. § 280F imposes dollar limitations on the depreciation deduction for the year the taxpayer places a passenger automobile in service and for each succeeding year prescribes depreciation limits for passenger vehicles.

Grant Nülle, Deputy Director

Signed: September 13, 2016

Explanatory Notice

The purpose of a tax procedure is to provide procedural guidance to the general public and to Department personnel. A tax procedure is a written statement issued by the Department to assist in the implementation of tax laws, administrative rules, and tax rulings by delineating procedures to be followed in order to achieve compliance with the law. Relevant statute, case law, or administrative rules, as well as a subsequent procedure, may modify or negate any or all of the provisions of any tax procedure. See GTP 96-1 for more detailed information regarding documents issued by the Department of Revenue.