Federal Tax Incentives for Businesses in Indian Country

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Depreciation: What is it?

- Depreciation is a way of deducting the purchase cost of a major capital asset, like the land and buildings of a business over a fixed period of time, usually fiver years. This prevents some problematic accounting issues that would otherwise happen – for example, if businesses could deduct the entirety of a building's purchase price in the year of acquisition, they would be underreporting their income over the remainder of the time they held the building. There are several ways to calculate depreciation.
- The basic concept of depreciation is that as any property or goods ages, there is wear and tear which can transform the item to lessen its value.
- Depreciation takes into consideration the reduced worth and permits businesses to enroll an equitable and fair current value upon assessing the whole net worth of the company.
- That certain amount of depreciation is usually considered as a tax deduction for the whole year.

Business Investment Incentives

- Business operators generally deduct the costs of machinery, equipment, or structures, which have a useful life of more than one year, through depreciation. For income tax purposes, the depreciation for most business property is calculated using the Modified Cost Recovery System (MACRS)
- Another method of depreciation is known as Straight Line Depreciation, which takes an end term for depreciation (five years is typical), and divides the purchase cost by that number of years. So if you spent $100,000 on a piece of equipment, you would be able to deduct $20,000 of that purchase price each year from your taxes for the next five years.

What is Accelerated Depreciation?

Accelerated depreciation is the set of Internal Revenue Service (IRS) rules that allow businesses to deduct from their taxable income the declining value of business-related investments, such as equipment and machinery, faster than the value of those assets actually declines.

For example: A delivery business purchases a new truck to expand its business and thus increases its revenues each year. But the truck is only expected to last several years before it breaks down. This is a "depreciating" asset.

The business is allowed to deduct from its income the cost of the truck – but the deduction must be spread out over the number of years that the truck is expected to be used in the business. In theory, the annual deduction should reflect how much the property has depreciated that year.

Accelerated depreciation allows taxpayers to take larger deductions, and therefore reduces their tax bills, in the earlier years of the investment

Depreciation of Assets

- For tax purposes, the IRS establishes six categories of non-real estate assets. Each has a designated number of years over which the asset can be depreciated. The most common categories: Three year property (tractors, certain manufacturing tools, and some livestock)
- Five year property (including computers, office equipment, cars, light trucks, and assets used in construction)
- Seven year property (including office furniture, appliances, and property that hasn't been placed in another category)

Depreciation examples

Business XYZ buys a copy machine for $1,600 in March. Assuming the machine has a salvage value of $400, you can depreciate $1,200 of the cost over the life of the copier. A copy machine is considered 5-year property for tax purposes. Under the normal rules, using a straight-line method, the business takes the following deductions in the first three years:

- First year-$1,200/5 x 75% equals a deduction of $180
- Second year - $1, 200 /5 equals a deduction of $240
- Third year - $1,200/5 equals a deduction of $240

Accelerated Depreciation example

Business XYZ buys $2,000 of office furniture and started using it May 1. Office furniture falls into the 7- year category. The first three years of MACRS deductions would be:

- First year - $2,000/7 x 200% x 50% equals a deduction of $286
- Second year - ($2,000-$286)/7 x 200% equals a deduction of $490
- Third year - $200-$776/7x 200% equals a deduction of $350

Wisconsin Depreciation law: differences exist because some sections of the Internal Revenue Code (IRC) have not been adopted for WI tax purposes. Current WI law, taxpayers must compute amortization and depreciation under the federal IRC as amended to December 31, 2000. Any changes to federal law after that time have not been adopted for Wisconsin purposes.

Efforts to update WI law to adopt federal changes

2011 WI Senate Bill 14 would adopt changes related to depreciation allowing a 100% depreciation in the first year. This has the effect of reducing revenue in the near term, as taxpayers claim higher depreciation deductions. DOR estimated the fiscal effect of SB 14 as a reduction in revenue of $132.6 million in FY 2011, $178.6 million in FY2012, and $34.2 million in FY 2013.

Congress Reinstates Tax Incentives for Indian Reservations and Trust Lands

Renewed is I.R.C. sec. 168(j), which provides for accelerated depreciation for qualified property placed in service on an Indian reservation. Property is "qualified" if it is:

- Used by the taxpayer predominantly in the active conduct of a trade or business within an Indian reservation,
- Not used or located outside the Indian reservation on a regular basis,
- Not acquired (directly or indirectly) by the taxpayer from a person who is related to the taxpayer, and
- Not property (or any portion thereof) placed in service for purposes of conducting of housing certain gaming.

Businesses with facilities on Indian Lands can use shorter recovery periods when calculating depreciation deductions for production equipment. "Qualified Indian reservation property" must be used predominately in the active conduct of a trade or business on the Reservation and, must be 3-, 5-, 7-, 10-, 15-, or 20-year property or non-residential real property. "Qualified infrastructure property" that is located off-reservation, but connected to qualified infrastructure within the reservation, is also eligible for shorter recovery periods. Power lines, water systems and telecommunication facilities are examples of qualified infrastructure property.