



Illinois Decouples from Federal Law

Informational Bulletin

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For information or forms...

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To: All Income Tax Preparers

On March 9, 2002, President George W. Bush signed PL 107-147, the "Job Creation and Worker Assistance Act of 2002," also known as the Economic Stimulus package. Under this new federal law, there is a change to individual and business income tax filing for tax years 2001 and after.

For **federal income tax** purposes, taxpayers are able to deduct the "**bonus depreciation**" of 30 percent of the cost of capital assets acquired and placed in service between September 10, 2001, and September 11, 2004. Taxpayers depreciate the remaining 70 percent of the cost using their normal depreciation method. For most assets, the normal depreciation is 70 percent of what the amount would be if no bonus depreciation was claimed.

How do the new federal and Illinois laws affect Illinois Income Tax?

Generally, when a federal law changes the computation of federal taxable income or adjusted gross income, the computation of Illinois net income also changes.

However, Senate Bill 1543 (Public Act 92-603) "decouples" Illinois from the federal legislation by reversing its effects on depreciation. First, it requires taxpayers to add back on their Illinois return, the 30 percent federal bonus depreciation. Second, it allows taxpayers to deduct the depreciation amount that would have been allowed on their federal

return if the bonus depreciation law had not been enacted.

This deduction is allowed for each year that depreciation is claimed for an asset, not just for the year in which the bonus depreciation on the asset is added back.

What happens when the asset is sold?

Under federal law, when an asset is sold, the gain or loss on the sale of the asset is equal to the price, minus the cost of the asset, reduced by all depreciation deductions. By computing gains this way, taxpayers are allowed a deduction for the entire cost of the asset, either through depreciation or when the asset is sold. Whatever gain or loss is reported for federal purposes is reported for Illinois purposes as well.

After the Illinois changes to bonus and regular depreciation are made, total Illinois depreciation on an asset that is not fully depreciated will be less than total federal depreciation. This means that if federal gain on the asset is taxed by Illinois, taxpayers will not receive a deduction for the entire cost of the asset. To correct this problem, PA 92-603 requires all of the Illinois changes to bonus and regular depreciation for an asset to be reversed in the year the asset is sold. After the changes are reversed, total Illinois depreciation will equal total federal depreciation, and taxpayers will have received a deduction for the entire cost of the asset.

How do I report the Illinois law changes?

You will report the changes on Form IL-4562, Special Depreciation. This form allows you to figure your Illinois addition and subtraction modifications. Form IL-4562 **must** be completed and attached to your tax return or amended tax return.

Note: Partnerships, S corporations, trusts, and estates pass these modifications through to their owners in the same manner as income and report them on

- ◆ Schedule K-1-P, Partner's or Shareholder's Share of Income, Deductions, Credits, and Recapture or
- ◆ Schedule K-1-T, Beneficiary's Share of Income and Deductions.

What if I have already filed my tax return?

If you have already filed your federal and Illinois tax returns reflecting the additional deductions from the new federal law, you **must** amend your Illinois return to add the bonus depreciation back and to subtract the Illinois depreciation to comply with Illinois' new legislation.

You must file

- ◆ Form IL-1040-X, Amended Individual Income Tax Return;
- ◆ Form IL-1120-X, Amended Corporation Income and Replacement Tax Return; or
- ◆ Form IL-843, Amended Return or Notice of Change in Income.

Write "**bonus depreciation**" in red on the top of your amended return and attach a completed Form IL-4562.

The completed Form IL-4562 will show the amount you must report as an add back on the appropriate "other additions" line and the amount you are allowed to claim as a deduction on the "other subtractions" line of your amended return.

What about penalties and interest?

If you file an amended return reversing the "**bonus depreciation**" by October 15, 2002, we will not assess any interest or penalty on the resulting underpayment.

Note: If you receive a notice assessing penalty or interest, write "**bonus depreciation**" in red on the top of the notice and return to the address shown on the notice.

However, if you file an amended return reversing the "**bonus depreciation**" after October 15, 2002, you will be assessed interest and any applicable penalties. ▼

**Examples
begin on the next page.**

Examples



Using the information below, the following examples show how to figure depreciation prior to and after the new legislation for both federal and Illinois law.

Note: If you use the depreciation tables in the instructions for the federal Form 4562, some of the federal depreciation calculations will be different, but the end result will be the same.

An Illinois taxpayer purchased an asset costing \$20,000, which is depreciated as a 5-year property.

Note: No IRC, Section 179 deduction is claimed on this property.

Depreciation Figured Prior to the New Federal Law

For Federal Income Tax Purposes

Federal depreciation would have been figured as follows:

First year

The depreciation deduction would have been 20 percent (.20) of \$20,000, or \$4,000

$$(\$20,000 \times .20 = \$4,000).$$

Second year

The depreciation basis would have been \$16,000, which is the \$20,000 original cost minus the \$4,000 depreciation taken in the first year

$$(\$20,000 - \$4,000 = \$16,000).$$

The *second year* depreciation percentage would have been 40 percent (.40) of \$16,000, or \$6,400

$$(\$16,000 \times .40 = \$6,400).$$

For Illinois Income Tax Purposes

Any depreciation would have been deducted prior to federal taxable or adjusted gross income. No depreciation would have been figured on the Illinois return.

Depreciation Figured After the New Federal Law

For Federal Income Tax Purposes

Federal depreciation is figured as follows:

First year

The bonus depreciation is 30 percent (.30) of \$20,000, or \$6,000

$$(\$20,000 \times .30 = \$6,000).$$

The \$6,000 bonus depreciation is subtracted from the \$20,000 original cost to equal the regular first-year basis of \$14,000

$$(\$20,000 - \$6,000 = \$14,000).$$

The regular first-year depreciation is 20 percent (.20) of \$14,000, or \$2,800

$$(\$14,000 \times .20 = \$2,800).$$

The \$6,000 bonus depreciation is added to the \$2,800 regular first-year depreciation to equal the total first-year federal depreciation deduction of \$8,800

$$(\$6,000 + \$2,800 = \$8,800).$$

For Illinois Income Tax Purposes

Illinois addition and subtraction amounts for federal depreciation are figured as follows:

First year

Addition – The federal bonus depreciation of \$6,000 is added back to Illinois income on the Illinois return.

Subtraction – The Illinois depreciation subtraction is figured by multiplying the federal regular first-year depreciation of \$2,800 by 42.9 percent (.429*), or \$1,201

$$(\$2,800 \times .429 = \$1,201).$$

*The .429 is 30 divided by 70. The 30 represents the percentage of bonus depreciation and the 70 represents the percentage of normal depreciation.

The 42.9 percent multiplied by the normal depreciation on 70 percent of the asset's cost equals the 30 percent reduction in normal depreciation required when the bonus depreciation is taken.

Note: The following calculation is used to figure the “end result” (shown at the bottom of the next page).

The \$2,800 **federal** regular depreciation plus the \$1,201 **Illinois** depreciation subtraction equals the **combined** first-year depreciation deduction amount allowed for this property on the federal and the state returns

$$(\$2,800 + \$1,201 = \$4,001).$$

For Federal Income Tax Purposes

Second year

The second-year basis is figured by subtracting the \$8,800 first-year federal depreciation deduction from the \$20,000 original cost, or \$11,200

$$(\$20,000 - \$8,800 = \$11,200).$$

The regular second-year depreciation is 40 percent (.40) of \$11,200, or \$4,480

$$(\$11,200 \times .40 = \$4,480).$$

For Illinois Income Tax Purposes

Second year

Addition – No Illinois addition is required after the first year.

Subtraction – The Illinois depreciation subtraction is figured by multiplying the federal regular second-year depreciation of \$4,480 by 42.9 percent (.429*), or \$1,922

$$(\$4,480 \times .429 = \$1,922).$$

Note: The following calculation is used to figure the “end result” (shown at the bottom of this page).

The \$4,480 **federal** regular depreciation plus the \$1,922 **Illinois** depreciation subtraction equals the **combined** second-year depreciation deduction amount allowed for this property on the federal and the state returns.

$$(\$4,480 + \$1,922 = \$6,402).$$

Note: Calculations for federal and state income tax purposes continue until the asset is either sold or totally depreciated.

Depreciation Figured When the Asset is Sold

Using the information below, the following examples show how to figure depreciation reflecting the new legislation for both federal and Illinois law when the asset is sold.

An Illinois taxpayer purchased an asset costing \$20,000, which is depreciated as a 5-year property.

The taxpayer sells the asset at the end of the second year.

Note: No IRC, Section 179 deduction is claimed on this property.

For Federal Income Tax Purposes

End of second year

The \$6,000 bonus depreciation is added to the \$2,800 regular depreciation in the first year plus the \$4,480 regular depreciation in the second year for total federal depreciation of \$13,280

$$(\$6,000 + \$2,800 + \$4,480 = \$13,280).$$

Note: The \$13,280 is used to reduce the \$20,000 original cost to reach the adjusted basis of \$6,720 that is used to compute the federal gain or loss on federal Form 4797.

For Illinois Income Tax Purposes

End of second year

The addition reported and the subtractions claimed for this asset are reversed.

Addition – The \$1,201 Illinois depreciation subtraction claimed in the first year plus the \$1,922 Illinois depreciation subtraction claimed in the second year equals the total addition reported in the year of the sale, or \$3,123

$$(\$1,201 + \$1,922 = \$3,123).$$

Subtraction – The \$6,000 special depreciation addition reported in the first year is subtracted in the year of the sale.

Note: With the reversal of the Illinois addition and subtraction amounts, the result is a net subtraction of \$2,877

Illinois depreciation for this asset in the year of the sale

$$(\$6,000 - \$3,123 = \$2,877).$$

End result – The **Illinois combined** first-year depreciation deduction of \$4,001 plus the **Illinois combined** second-year depreciation deduction of \$6,402 equals the total Illinois depreciation deduction allowed for this asset in the first two years, or \$10,403

$$(\$4,001 + \$6,402 = \$10,403).$$

The \$10,403 plus the \$2,877 net subtraction in the year of the sale equals the total Illinois depreciation deducted. This is the same total amount of depreciation deducted for federal income tax purposes, as shown above

$$(\$10,403 + \$2,877 = \$13,280).$$