Many States Are Decoupling from Federal “Bonus Depreciation” Tax Cut

by Nicholas Johnson

From the late 1980s until 2001, nearly all states used the federal definition of taxable business income — including the federal allowance for depreciation — as the basis for their own tax calculations. A federal tax law enacted March 9, 2002, however, created a new tax deduction for “bonus depreciation” that threatens to cost states very large amounts of revenue. In response, many states are moving quickly to “decouple” from the federal code — in effect, disallowing the new bonus depreciation provision.

Thirty states plus the District of Columbia that previously followed federal depreciation rules are now decoupled.

• In 23 states — Arizona, Connecticut, Georgia, Hawaii, Illinois, Indiana, Iowa, Maryland, Massachusetts, Minnesota, Missouri (for one year), Nebraska, New Jersey, North Carolina, Ohio, Oklahoma, Pennsylvania, Rhode Island, South Carolina, Tennessee, Vermont (for corporate income tax filers only), Virginia, and Wisconsin — and in D.C. the decoupling resulted from, or was confirmed by, explicit legislative action following enactment of the federal law.

• Six other states, Arkansas, Idaho, Kentucky, New Hampshire, South Dakota and Texas, decoupled automatically under pre-existing tax law.

• The 30th decoupled state is Mississippi, as a result of a ruling by the state tax commissioner.

Among remaining states, California historically has not conformed to federal depreciation rules; Nevada, Washington and Wyoming do not have corporate or personal income taxes. Only a small number of states have enacted legislation to conform to the federal change. Florida, Maine (for tax years 2001 and 2003) and West Virginia have passed laws to conform. Alabama, Alaska (for non-oil and gas corporations), Colorado, Delaware, Kansas, Louisiana, Michigan, New Mexico, New York, Oregon and Utah, where legislative budget sessions have ended, and Montana and North Dakota, where there were no sessions this year, are conforming automatically to the change.