How to take the investment credit

Another title in the series

Marine business management

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This fact sheet will help you understand various Internal Revenue Service regulations and publications as they apply to your marine business. *It is not* a substitute for IRS regulations and publications, or for expert counsel you may obtain from the IRS or professional tax practitioners.

Investment credit is the part of the Federal IRS Code that allows a deduction from the amount of taxes owed to the government for certain types of business investments. This fact sheet summarizes the qualifications and the procedures for computing investment credit.

Applicable dates

Investment credit applies to all qualifying property acquired after August 15, 1971, or acquired on or before that date under special conditions. The credit also applies to property the construction, reconstruction, or erection of which was begun after March 31, 1971, or was completed after August 15, 1971.

Qualifying property

The property must:

1. be depreciable;
2. have a useful life of at least three years;
3. be tangible personal property or other tangible property (except land, buildings, or their structural components) used as an integral part of manufacturing, production, extraction, etc., and
4. be placed in service in a trade or business or for production of income by you during the year.

If the property qualifies, investment credit *must* be taken.

The table on the other side shows how to compute investment credit on electronic gear as well as other property. The Loran receiver (center) is an example of the type of equipment that qualifies for investment credit. (Brand-name equipment is shown here as an example only; its depiction does not constitute an endorsement of this equipment.)

Nonqualifying property

Intangible property (franchises, goodwill, etc.), houses, or real property (land, buildings, and structural components thereof) generally do not qualify for the credit. Property used predominantly outside the U.S. generally will not qualify for the credit. However, fishing vessels documented under U.S. laws that are operated in the foreign or domestic commerce of the U.S. can qualify for the credit.

Amount of allowable credit

The amount of your investment in qualifying property that is eligible for the investment credit depends upon the useful life of the property and whether the property is new or used. Moreover, the amount of credit allowable against your tax liability in any one year is limited, but any excess may be carried back or forward, as described in IRS Publication 572.

How the investment credit works

For the period after January 21, 1975, there is a temporary increase in the maximum investment credit allowed, from 7% to 10% of the investment eligible for credit. *You may deduct this amount from the total tax due on your return* except that the credit is limited to the income tax liability shown on the return, *or* $25,000 plus 50% of the tax liability in excess of $25,000, whichever is less. Use Form 3468.

Amount of investment subject to the credit

The useful life of the property determines the amount of the investment that is subject to the investment credit. The useful life of property is determined at the time you place it in service. You must use the same useful life in determining the amount of allowable investment credit as you use in computing depreciation or amortization on the qualifying property.

If the useful life of your "qualifying property" is less than three years, it does not qualify for the credit. Only *one-third* (⅓) of the investment in qualified property with a useful life to you of at least three years but less than five years

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qualifies for the credit. *Two-thirds* (⅔) of the investment qualifies for the credit if the property has a useful life to you of at least five years but less than seven years. The *full* investment qualifies for the credit if the property has a useful life to you of at least seven years. *For qualifying used property,* you may count no more than $100,000 of the investment in determining the credit for any one year.

Example: In September 1975 you purchase used fishing gear with a useful life of two years for $2,500; new fishing gear with a useful life of four years for $15,000; used electronic gear with a useful life of six years for $7,500; and a used fishing boat with a useful life of ten years for $25,000. This is all "qualified property" and therefore subject to the credit. Compute the amount of your investment that is "subject to the credit" according to Table 1.

Notice that the property with a useful life of only two years is not subject to the credit. Also notice that the computed credit based on the temporarily higher rate of 10% is $3,500. This amount is deducted directly from your tax liability, the taxes you owe.

Table 1.—*Investment credit computation*

Property	Basis or cost of qualifying property	Estimated useful life (years)	Part to be counted	Amount subject to the credit
Used fishing gear	$ 2,500	2	0	0
New fishing gear	15,000	4	⅓	$ 5,000
Used electronic gear	7,500	6	⅔	5,000
Used boat	25,000	10	all	25,000
Amount of investment subject to credit				$35,000

Computed investment credit (10% of $35,000) is $3,500

Other conditions, limitations, etc.

1. New property has some special definitions; these exclude that portion that might actually represent a used asset, as in the purchase of a rebuilt engine.
2. Used property, in addition to having a limit of $100,000 counting toward the credit, also must be adjusted in relation to tax-free exchanges or replacement of existing used equipment.
3. Property received as a gift does not qualify for the credit.
4. Temporarily, the limitation on used property has been raised to $100,000 (the old amount was $50,000).
5. Purchases from related taxpayers do not qualify for the investment credit.
6. Unused credit can be carried back and forward. There are procedures and forms for this.
7. You should file an amended return to claim unclaimed investment tax credit from previous years.
8. There are provisions for the recapture of investment credit allowed to you on investments that had shorter actual lives than the originally estimated lives.

Steps in using the investment credit

1. Determine whether your business investments meet the requirements and qualifications.
2. Estimate the useful life (lives) of your investment(s) (the same useful life as for depreciation).
3. Compute the allowable investment for the tax year and enter this on your Federal income tax form in the space provided for tax credits.

Reference materials

IRS Publication 595, *Tax Guide for Commercial Fishermen.*

IRS Publication 572, *Tax Information on Investment Credit.*

Glossary of terms

Depreciable property—Property with a useful life of more than one year. This property must be depreciated over its useful life. It must not be listed as a current expense.

Tangible personal property—(a) *Tangible* means something physical that can be touched and worked with. Things that are not tangible might include licenses, franchises, goodwill, etc. (b) *Personal property* is property other than real property (real estate, buildings, land, etc.). Tangible personal equipment might include a winch, electronic equipment, boats, vehicles, etc.

Amortization—Similar to depreciation, it is the writing-off of expenses over time, usually for intangible assets, e.g., franchises, incorporating expenses, etc.

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