Year-end Depreciation Considerations

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Federal tax law changes frequently and these changes seem to be occurring closer to the end of every calendar tax year. Given the last-second theatrics relating to the tax rates at the end of 2010, nothing is ever certain. However, despite the unpredictability of these changes, the current federal depreciation laws will likely never again be this generous.

Section 168(k) "bonus depreciation"—a one-time depreciation deduction taken in the year a new capital asset is purchased—has historically allowed for an immediate 50 percent deduction upon the purchase of newly-manufactured machinery and equipment. The additional depreciation resulting from bonus depreciation can still be taken during a year that already has net losses. For the remainder of 2011:

- Bonus depreciation can be used to expense all (100 percent) of the purchase price for qualified assets

- Qualified Assets:
  - → Must be new
  - → Must be depreciable over a period less than 20 years (most non-real estate purchases)
  - → Includes full-business use SUVs rated over 6,000 pounds
  - → Includes qualified leasehold improvement property (restaurant and retail improvement)

For assets placed into service after December 31, 2011, bonus depreciation is allowed for only 50 percent of the purchase price.

Section 179 depreciation is a one-time depreciation deduction taken in the year a capital asset is purchased. Unlike bonus depreciation, section 179 depreciation is available for 'used' asset purchases. Unfortunately, section 179 can only be used to offset positive net income. However, if unused, Section 179 can be carried forward for use at a later date. For the remainder of 2011:

- Section 179 depreciation can be used to expense up to $500,000 worth of asset purchases

- Phase-outs of eligible depreciation start after an entity has purchased over $2,000,000 worth of capital assets during a year

- Section 179 depreciation can be used to expense up to $250,000 of qualified real property.

The section 179 depreciation will drop precipitously to $125,000 with a phase-out that starts at $500,000 of overall purchases for all assets bought and placed into service after December 31, 2011.

Of course, taking full advantage of the accelerated depreciation available in 2011 does necessitate a business being in position to expand its machinery and equipment in service. Moreover, the purchasing decision should be based on sound business judgment and not just on short-term tax laws. Other factors weigh into if and how to apply the current and future tax laws to business purchases. For example, accelerated depreciation may not make optimal use of soon-to-expire Net Operating Losses. Also, some states disregard different federal statutes, offsetting tax benefits (for example, Georgia does not recognize bonus depreciation). Please consult your Certified Public Accountant in implementing your year-end tax planning strategies and purchases. ❖