

**Abstract:** A valuable depreciation-related tax break has been extended by the Hiring Incentives to Restore Employment (HIRE) Act of 2010: higher Section 179 expensing limits. The break can make purchasing needed equipment more affordable. But businesses need to act soon to ensure they benefit — the HIRE Act extended the higher limits only for 2010, and it's uncertain whether they'll be extended again for 2011. This article provides an overview of the break and how to time purchases to make the most of depreciation-related deductions.

## **Plan now to maximize deductions for equipment purchases**

A valuable depreciation-related tax break was extended by the Hiring Incentives to Restore Employment (HIRE) Act of 2010: higher Section 179 expensing limits. The break can make purchasing needed equipment more affordable. But you need to act soon to ensure you benefit — the HIRE Act extended the higher limits only for 2010, and it's uncertain whether they'll be extended again for 2011.

### **Depreciation 101**

Ordinarily when you buy equipment and other assets for your business, you're required to depreciate the costs over several years for tax purposes. Sec. 179 allows you to "expense" — in other words, deduct immediately — as much as 100% of the cost of a qualified asset in the year you place it in service.

To qualify for depreciation or expensing, an asset must be "placed in service." That means the asset is ready and available for use in your business — in other words, it's operational and at the work site. But you don't necessarily have to be using the asset. Backup equipment and replacement parts, for example, are placed in service when they're available for use.

The Sec. 179 election is available for most equipment, "off-the-shelf" computer software, machinery, furniture and other tangible personal property purchased for use in an active trade or business.

The amount you can expense under Sec. 179 is subject to an annual limit, which is phased out on a dollar-for-dollar basis when your total investment in Sec. 179 property exceeds the phaseout threshold. Under the HIRE Act, for 2010 the expensing limit has been increased to \$250,000 and the phaseout threshold to \$800,000. The \$250,000 limit is reduced by \$1 for every dollar of 2010 qualified purchases exceeding \$800,000. So, for example, if you spend \$900,000 on qualified property this year, the most you can expense is \$150,000.

### **Meeting the income limit**

Sec. 179 limits expensing to a taxpayer's taxable income from all sources, so you can't use the election to generate a loss. If the taxable income limit prevents you

from deducting all of your Sec. 179 expenses this year, you can carry over the unused deductions to future years. However, you may be better off forgoing some or all of the election this year and using ordinary depreciation deductions to generate a loss.

If you're a sole proprietor for federal tax purposes, taxable income includes any wages you earn as an employee plus your spouse's wages or self-employment income if you file a joint return. And you can carry over and deduct in future tax years expenses you're unable to deduct because of the income limit.

Let's say, for example, John invests \$100,000 in equipment for a startup business. The company has no taxable income for the year, but John's wife, Mary, has \$110,000 in taxable income from her job. John and Mary can deduct the entire \$100,000 investment on their tax return. (The rules are more complicated for pass-through entities, such as partnerships and S corporations.)

### **Timing purchases**

The higher Sec. 179 expensing limits apply for calendar year 2010 or a business's fiscal year that begins in 2010. If Congress doesn't extend the higher amounts, the limits for 2011 will drop to \$125,000 and \$500,000, respectively — though both limits will be indexed for inflation.

A tax rule of thumb advises that you should take as many deductions as possible this year and defer as much income as possible to later years. So if you can afford it, accelerating purchases into 2010 can make sense.

But like all rules, there are exceptions. For example, if you anticipate being in a higher income tax bracket in future years, you may be better off holding off on asset purchases — even if it means you'll be subject to lower Sec. 179 expensing limits. Why? Because deductions save more tax dollars when you're paying tax at a higher rate. For example, a \$10,000 deduction saves \$2,800 in taxes if you're being taxed at the 28% rate, but it saves \$3,500 if you're being taxed at the 35% rate.

### **No more bonus depreciation?**

As of this writing, the 50% bonus depreciation that was available in 2009 hasn't been extended to 2010. Bonus depreciation allowed you to accelerate your depreciation deduction for a qualified asset by taking more of it for the year of purchase, in this case 50% of an eligible asset's adjusted basis.

Bonus depreciation wasn't subject to any asset purchase limits, so businesses ineligible for Sec. 179 expensing could take advantage of it. And businesses that qualified for Sec. 179 expensing could take bonus depreciation on asset purchases in excess of the \$250,000 Sec. 179 limit. (Of course, they had to keep in mind the \$800,000 Sec. 179 phaseout threshold.)

Because bonus depreciation could save you considerable taxes, keep an eye out to see if Congress extends this break. Your tax advisor can provide the latest information.

### **Getting the best result**

To get the best tax result from your asset purchases and depreciation-related deductions, examine your overall tax situation with your tax advisor — before year end, so you still have time to make asset purchases and benefit from the 2010 tax breaks if appropriate.

### **Sidebar: How to avoid recapture**

Be sure that property you expense under Section 179 is used more than 50% of the time for business. If business use drops below 50%, you'll have to recapture a portion of the Section 179 deduction and pay taxes and interest on that amount. Penalties may apply.

The recaptured amount is the excess amount you expensed minus the amount you would have deducted under regular depreciation rules.