

Code Section 179 expense election

Many have asked about the annual election to claim *immediate* deductions, instead of deductions in later years, for business property.

Generally, the cost of property placed in service in a trade or business can't be deducted in the year it's placed in service if the property will be useful beyond the year. Instead, the cost is "capitalized" and depreciation deductions are allowed for the property, but are spread out over a period of years (a "cost recovery period"). Capitalization delays the tax benefits of business expenditures. For example, you may spend \$50,000 on a new computer system today, but must spread your depreciation deductions over a five-year period. That's why the election to take immediate deductions is valuable.

The expense election is made available, on a tax year by tax year basis, under Section 179 of the Internal Revenue Code (the "Code"), and is often referred to as the "Section 179 election" or the "Code Section 179 election."

Subject to a dollar limit, the election allows you to deduct, in the tax year for which the election is made, the cost of qualifying property (described below) placed in service during the tax year. The immediate deductions allowed are in lieu of capitalization and later depreciation deductions. The deduction limit is \$128,000 for tax years beginning in 2008 and \$125,000 for tax years beginning in 2007. Based on the rate of inflation, the limit may be raised higher in 2009 and 2010. However, for tax years beginning after 2010 (i.e., 2011 and later) the deduction limit is scheduled to drop to \$25,000. As discussed below, the deduction is phased-out (i.e. gradually reduced) if more than \$510,000 of qualifying property is placed in service during the 2008 tax year, more than \$500,000 of qualifying property is placed in service during the 2007 tax year, or if taxable income from your trade or business is relatively low for the tax year. On the other hand, higher limits apply to certain property used in a qualified business in designated geographic areas, such as the DC Zone, the New York Liberty Zone, and the Gulf Opportunity Zone.

Qualifying property. To qualify for the election, the property must be "tangible personal" property. This means that real estate (land, buildings, and their structural components) does not qualify, nor do intangibles such as patent rights. However, for tax years beginning before Jan. 1, 2011, off-the-shelf computer software qualifies. Also, to qualify, property must be "purchased." Thus, if you acquired the property in a tax-free exchange or from an individual or entity to which you bear a close relationship specified in the Code, the property does not qualify.

Dollar limit. The dollar limit doesn't mean the election can't be made for property costing more than that amount. For example, if you buy a machine for \$133,000 and place it in service in a business in a tax year beginning in 2008, you can elect to immediately deduct \$128,000 of its cost for that year. The remainder (\$5,000) is capitalized and depreciated. If you placed that same machine in service in a tax year beginning in 2007, you can elect to immediately deduct \$125,000 and capitalize \$8,000 for later depreciation. Also, you can make the election for two or more separate assets as long as the total cost covered by the election doesn't exceed the dollar limit for that year.

As mentioned above, if the total cost of qualifying property that you place in service during a tax year beginning in 2008 is over \$510,000 (the "phaseout" amount), the immediate deduction limit is reduced by that extra amount. For example, if you place in service \$520,000 of qualifying property in a tax year beginning in 2008, you can make the election for no more than \$118,000 of property (\$128,000 minus \$10,000 [excess of

\$520,000 over \$510,000]). For tax years beginning in 2007, the phaseout begins at \$500,000. Based on the rate of inflation, the phaseout amount may be raised higher in 2009 or 2010. For tax years beginning after 2010, the phaseout amount is scheduled to drop to \$200,000.

You should consider postponing, to later tax years, or accelerating, into earlier tax years, placing the property into service, to take best advantage of the dollar limits (as further limited by the phaseout rule). For example, if you order two items of qualifying property costing \$130,000 each, you might want to consider placing one in service during the 2007 tax year and the other during the 2008 tax year. Doing so will permit you to elect to expense \$125,000 in 2007 and \$128,000 in 2008. If both are placed in service in 2007, your expense election for the two items is limited to one immediate deduction of \$125,000. The balance would be capitalized and depreciated in later years.

Taxable income limit. Also, as mentioned above, if your taxable income from all of your trades or businesses is less than the dollar limit for that year, the amount for which you can make the election is limited to that taxable income. However, any amount you can't immediately deduct because of the taxable income limitation is carried forward and may be deducted in later years (to the extent that the applicable dollar limit, the phaseout rule and the taxable income limit permit).

Recapture. If you dispose of the property, or stop using it in a trade or business, before the end of the cost recovery period that would have applied to the property had you not made the election for the property, all or part of the amount of the deduction you claimed under the election must be taken back into income ("recaptured"). Exactly how much will depend on the type of property and how long you used the property in a trade or business.

The above information covers the essential elements of the Code Section 179 election. Clearly, many considerations go into each decision to acquire business assets, and many involve non-tax factors. However, the election should play a role; accelerated tax benefits may enable you to obtain the property you need earlier and at reduced after-tax costs.