Larger Tax Breaks for Small Businesses

The government is offering companies larger tax cuts on their technology and equipment purchases — including the option of writing off all their technology and equipment spending in 2011 – thanks to two laws passed last fall.

On December 17, 2010, President Obama signed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010. The legislation offers numerous tax breaks aimed at businesses – including small business.

Two of the most high-profile provisions include extensions of a "sweetened" Bonus Depreciation along with the popular Section 179 Expense Deduction. However, both deductions will be at reduced rates for 2012. These changes may allow your firm to save on technology and IT assets such as computer hardware, networking equipment and off-the-shelf software.

Bonus Depreciation — The legislation allows an extension of the Bonus Depreciation from the Small Business Jobs and Credit Act of 2010 as well as an increase in the amount. Previously, it had been 50 percent but now will grow to a full 100 percent through 2011. In 2012, the Bonus Depreciation returns to 50 percent.

This will help small businesses to quickly recover new capital investment costs by providing 100 percent first-year depreciation for IT equipment placed in service after Sept. 8, 2010 and before Jan. 1, 2012. Your firm can now immediately deduct the costs of all qualifying purchases instead of depreciating them over time.

Section 179 Expense Deduction — A company that invests in qualifying property may elect under Section 179 to deduct (or "expense") the cost, rather than recover it through depreciation deductions. Just as in 2010, for 2011 the maximum amount a firm may expense is $500,000, with a spending limit or "phase-out threshold" of $2 million.

This allows your business to immediately expense new equipment. For 2012, the maximum expense amount is scheduled to drop to $125,000 with a spending limit of $500,000. Section 179 expensing is scheduled to return to its original $25,000 in 2013 .

The Tax Cuts Work

The latest tax laws allow multiple options for writing off new tech and equipment purchases. They give companies — particularly those who spend more than $500,000 in equipment – different tax options, depending on what is most advantageous to them.

First, firms can deduct the equipment purchases under the regular depreciation schedule. Second, they can write it all off with 100 percent bonus depreciation. And third, they could use the Section 179 Expense Deduction alone or combined with Bonus Depreciation. With this third option, a company can write off all or part of the equipment purchases at once, and deduct any remaining costs under the normal depreciation schedule.

For example, if a qualifying small business buys $1 million of new IT equipment in the current year, $500,000 can immediately be deducted under Section 179.

Of the remaining $500,000, the business can deduct the rest through bonus depreciation or under the normal depreciation schedule, which depends on the type of equipment and life of the assets. If the equipment is depreciated over a five-year period, for example, a firm can deduct $100,000 of the remaining $500,000 in the first year. As a result, the immediate first-year deduction and depreciation is $600,000.

Again, businesses can't write off the full amount if they go over the $2 million spending limit. For every dollar spent above the limit, a firm must subtract the same amount from the deduction. For example, if they go $50,000 over the spending limit, they can only deduct $450,000.

Small businesses should consult with their accountants on whether to take Section 179 deductions or the 100 percent Bonus Depreciation. It may not always make the most economic sense to take the entire tax write-off up front.

This is especially true if the business is not generating huge profits and is in a low tax bracket for the current year. Some small businesses may get more of a tax benefit if they use the normal depreciation schedule and spread the deductions over future, more profitable years.

Examples of Bonus Depreciation Use in 2011 and 2012

2011: Assume that in 2011, a small business purchases new, depreciable IT equipment and places it in service. The cost of the equipment is $1 million and it has a five-year life subject to the half-year convention. The full $1 million cost is allowed as a depreciation deduction in 2011. The adjusted basis of the equipment after 2011 will be $0.

2012: The facts are the same as in the previous example except that the equipment is purchased and placed in service in 2012. The amount of additional first-year depreciation allowed is $500,000. The remaining $500,000 of the cost of the equipment is depreciable under the rules applicable to five-year property. Thus, 20 percent, or $100,000, is also allowed as a depreciation deduction in 2012. The total depreciation deduction allowed with respect to the property in 2012 is $600,000. The remaining $400,000 adjusted basis of the property is recovered through otherwise applicable depreciation rules.

Qualifying Equipment or Property

All companies need equipment on an ongoing basis, be it machinery, computers, software, office furniture, vehicles or other tangible goods. That's why almost all types of business equipment qualifies for tax beaks under Bonus Depreciation and Section 179 Expense Deduction guidelines. Examples include:

- Computers
- Networking equipment
- Computer software (including off-the-shelf software)
- Office furniture
- Equipment (machines, etc.) purchased for business use
- Tangible personal property used in business
- Property attached to a building that is not a structural component of the building (for example a printing press, large manufacturing tools and equipment)

It's very likely that your business has purchased many of these items during the past year and will do so again and again. Bonus Depreciation and Section 179 expensing make purchasing this equipment more financially attractive during the 2011 calendar year.

Keep in mind, to qualify for Bonus Depreciation and the Section 179 Expense Deduction, the equipment must be purchased and put into use between Sept. 8, 2010 and Dec. 31, 2011. (Note: Equipment purchased before that – between Jan. 1, 2010 to Sept. 7, 2010 – qualifies for 50 percent Bonus Depreciation.)

Act Now

Bonus Depreciation and Section 179 Expense Deduction parameters are scheduled to change yearly. Therefore, it may benefit a business to take full advantage of this generous tax code while it's available. There's no better way to maximize your purchasing power.

Much of the equipment your firm purchases will likely qualify for these deductions. So do your homework and verify that you are leveraging Bonus Depreciation and Section 179 expensing this year.

Leasing and Section 179

Your business can also lease technology equipment and still take full advantage of the Section 179 Expense Deduction. In fact, leasing technology equipment and/or software with the Section 179 deduction can be a preferred financial strategy for many businesses because it can help cash flow.

With a non-tax/capital lease, a firm can take advantage of the Section 179 deduction, yet make smaller payments. Therefore, you can acquire and write off up to $500,000 worth of equipment this year, without actually spending $500,000 this year.

Advantages of Leasing and Financing

You may also obtain an equipment loan using an Equipment Finance Agreement (EFA) and still take the Section 179 Expense Deduction.

The obvious advantage to leasing or financing equipment and then taking the Section 179 deduction is that you can deduct the full amount of the equipment, without paying the full amount this year. The amount you save in taxes in the first year may exceed the payments.

Speak to an Expert

This information is not meant as tax advice. You should consult personal financial advisors and/or tax and accounting professionals for information pertinent to your situation.

Internal Revenue Service

For more information, visit Section179.org, or Internal Revenue Service website (www.irs.gov) and search for IRS Publication 946 "How to Depreciate Property." Or contact your tax professional.