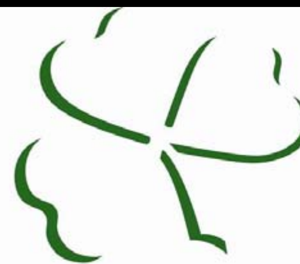

The Glynn Group, Ltd.

October 12, 2007 **Issue # 269**

Year end planning moves that optimize election to expense business

There are year-end planning opportunities (and pitfalls to avoid) for a calendar-year business that is eligible for a Code Sec. 179 expensing election and is thinking of buying additional eligible equipment before year-end. The timing of additional equipment purchases—whether to make them before year-end or defer acquisitions until next year—can have a big effect on an enterprise's tax bill. Fiscal-year taxpayers face similar timing considerations in the final quarter of their tax years.

Maximum expensing amount. For tax years beginning in 2007, the maximum annual expensing deduction under Code Sec. 179 is $125,000 ($128,000 for 2008 according to RIA calculations). As a result, a calendar-year business taxpayer may be able to elect to expense up to $125,000 of the cost of eligible property placed in service at any time before the end of this year.

Year-end move #1. Where possible, taxpayers should factor the annual expensing limit into their annual equipment-purchase plans so as to maximize the write-off for this year and the next.

Illustration 1: During the first eleven months of 2007, calendar-year Corp. Ace bought and placed in service $80,000 of expensing-eligible property. It plans to buy an additional $173,000 of expensing-eligible property next year. If it's feasible to do so from the business standpoint, Ace should consider accelerating $45,000 of next year's purchases into 2007 (and place the additional assets in service before year-end). This will leave Ace with $128,000 of property that it will be able to expense in 2008.

An additional $35,000 expensing allowance, for a total of $160,000 for 2007, is available for qualified zone property, and qualified renewal property (Code Sec. 1397A(a)(1), Code Sec. 1400J).

Taxable income limit. The expensing deduction is limited to taxable income from any of the taxpayer's active trades or businesses. This means that the taxable income limit doesn't bar an expense deduction just because the particular business in which the property is used doesn't produce any net income. So long as the taxpayer has aggregate net income from all his trades or businesses, the deduction is allowed. (Code Sec. 179(b)(3); Reg. § 1.179-2(c)(1)) Any amount that cannot be deducted because of the taxable income limit can be carried forward to later years until it is fully deducted. (Code Sec. 179(b)(3)(B))

Year-end move #2. Taxpayers should consider making the expense election even in a year where no immediate tax benefit is derived from the election because of the taxable income limit. This way, the taxpayer's right to carry the expensing deduction forward to other years is preserved. Without the election, the taxpayer can recover the cost of the investment only through depreciation deductions.

Illustration 2: In December of 2007, Widget Products, a calendar year business, places in service $20,000 of qualified property subject to the half-year depreciation convention. The asset is five-year recovery property. Say that Widget Products doesn't elect to expense any part of the $20,000. Under the half-year depreciation convention (and under the 200% declining balance method) Widget Products is entitled to a $4,000 depreciation deduction for this property for 2007 (20% of $20,000). On the other hand, electing to expense the cost of the asset would reduce business taxable income by $20,000. Moreover, even if Widget Products does not have sufficient taxable income to

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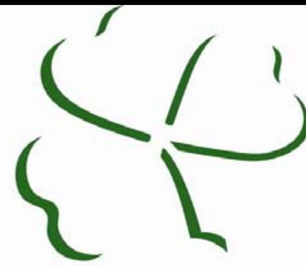

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to absorb the entire expensing deduction in 2007, the full amount of the excess will be available to offset taxable income in 2008.

Wages count for taxable income limit. Wages, salaries, tips and other compensation earned by employees count for purposes of their Code Sec. 179 taxable income limit. (Reg. § 1.179-2(c)(6)(iv))

Year-end move #3. Employees who carry on a sideline business may be able to reduce their 2007 tax bill by buying business equipment they need before the end of this year rather than in 2008.

Illustration 3: Jeniffer is employed as a fabric designer and earns $70,000 a year. In September of 2007, she started a sideline graphic arts business but will earn only $1,500 from it this year. Jennifer is planning to buy $2,000 of equipment (computer and printer) for her sideline business. If she buys and places the equipment in service this year, Jennifer can fully offset her $1,500 freelance income and $500 of her regular employment income.

Investment-based phaseout of expensing. For 2007, the maximum amount that can be expensed under Code Sec. 179 is reduced dollar-for-dollar for eligible property placed in service during the tax year in excess of $500,000 ($510,000 in 2008 according to RIA calculations). (Code Sec. 179(b)(2)) Only 50% of expensing-eligible qualified zone property and qualified renewal property is taken into account, however. (Code Sec. 1397A(a)(2); Code Sec. 1400J(a)) In addition, the regular phaseout level for the amount of expensing-eligible property placed in service during the year is increased by the lesser of (1) $600,000, or (2) the cost of qualified Code Sec. 179 GO Zone property placed in service during the tax year. (Code Sec. 1400N(e)(1))

Illustration 4: XYZ Corp is a calendar-year taxpayer. In 2007, it buys and places in service $520,000 of expensing-eligible 5-year MACRS property. XYZ may only expense $105,000 of its 2007 purchases [$125,000 —($520,000 — $500,000)] and must depreciate the $415,000 balance of its purchases over a period of years.

Year-end move #4. Businesses that are not capital equipment intensive should try to avoid buying and placing in service more than the ceiling amount of expensing-eligible property during the year, if it's possible from the business standpoint to defer additional purchases.

Caution: Amounts ineligible for expensing due to excess investments in expensing-eligible property can't be carried forward and expensed in a subsequent year. Rather, they can only be recovered through depreciation.

What's eligible for expensing. In general, property is eligible for Code Sec. 179 expensing if it is:
... tangible recovery property that's Code Sec. 1245 property

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property (most depreciable property other than buildings and other land improvements), regardless of its depreciation recovery period; and
... if placed in service in a tax year beginning before 2011, off-the-shelf computer software. (Code Sec. 179(d)(1))

Year-end move #5. To maximize the tax benefit to be gained through expensing, a taxpayer should make the expensing election for eligible property with the longest recovery period.

Illustration 5: In 2007, ABX Corp, a calendar-year taxpayer, purchases and places in service $125,000 of new 5-year MACRS property and $125,000 of new 7-year MACRS property. It doesn't purchase other property during the year and is subject to the half-year depreciation convention for 2007. If it elects to expense the 7-year property, ABX can write off the balance of its purchases over the 5-year MACRS recovery period (effectively 6 years because of the half-year convention). If it elects to expense the 5-year property, ABX will have to write off the balance of its purchases over the 7-year MACRS recovery period (effectively 8 years because of the half-year convention).

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