Is Section 179 Right for You?

Michael C. Zahrt
Foster Swift Business & Corporate Law News
October 31, 2016

AUTHORS/ CONTRIBUTORS
Michael C. Zahrt

PRACTICE AREAS
Business & Tax
Federal Taxation
Tax Law

While there is no "magic bullet" available to fix a large anticipated tax bill, there are several strategies available to businesses and entrepreneurs to turn ordinary purchases into tax saving deductions. This article is the first of a two-part series and discusses the deduction available under Code Section 179. Part 2 addresses ways the capital expense regulations and bonus depreciation rules can be paired with Section 179 for effective and powerful year-end tax planning.

WHAT IS SECTION 179?

The general rule under the Internal Revenue Code (the "Code") requires taxpayers to capitalize asset purchases and depreciate the assets pursuant to the applicable depreciation schedule. Under Code Section 179, taxpayers may instead deduct the cost of tangible personal property placed into service during the year. The most common asset expensed under Section 179 is "Section 1245 property," which includes machinery and equipment purchases. Importantly, there is no requirement that the purchased property be new—Section 179 applies to both new and used property.

The use of Section 179 is subject to two limits. First, the limit on the available deduction is $500,000 ($510,000 in 2017). Accordingly, if you purchase $600,000 in equipment, you may deduct $500,000 under Section 179 and you must depreciate the remaining $100,000. The second limit reduces the available deduction by the amount your total property purchases exceed an "investment ceiling." For 2016, this investment ceiling is $2,010,000 ($2,030,000 in 2017). Accordingly, if you purchase $2,110,000 of equipment during the year, the $500,000 deduction is reduced by $100,000 ($2,110,000 - $2,010,000).

The benefits of Section 179 are useful to both established businesses and entrepreneurs starting a new side business.

Scenario 1 – Businesses with Substantial Anticipated Equipment Purchases

One of the benefits of Section 179 is that taxpayers are entitled to the full deduction amount regardless of when property is placed into service. Accordingly, if you anticipate that your business will make a large equipment purchase in the early part of 2017, you may want to consider accelerating a portion of that purchase to late 2016. For example, if you purchased and placed into service $300,000 of equipment this year and plan to purchase $710,000 in equipment next year, you should accelerate $200,000 of that second purchase to 2016 if possible. This allows you to utilize the full Section 179 deduction for both years instead of being short of the deduction limit this year and exceeding it the next.

Taking advantage of this timing rule can also be beneficial for companies approaching the investment ceiling for 2016. For example, if you have currently purchased $2,000,000 of property in 2016 and plan to purchase and place into service an additional $110,000 before the end of the year, your Section 179 deduction amount will be reduced to $400,000. If you are able to defer this purchase until early 2017, you successfully **maintain the full $500,000 limit.**

Scenario 2 – Equipment Purchases in a Down Year

A second benefit of Section 179 is that the deduction can be carried over into a subsequent year if a business does not have sufficient income to offset the deduction. Even in a down year, taking the 179 deduction could be beneficial to receive accelerated tax benefits. For example, imagine a business with $400,000 in taxable income is forced to purchase replacement equipment for $500,000 that has a depreciable life of 7 years. If this business takes the Section 179 deduction, its taxable income is reduced to zero and it can carry over the remaining $100,000 deduction to the subsequent year. If, on the other hand, this business did not take the Section 179 deduction, it would only be able to depreciate $71,429 and would take 8 years (using the half year convention) to fully recover its cost.

Scenario 3 – Entrepreneur with a Side Business

A third advantage of the Section 179 deduction is that it includes wages, salaries, tips and other compensation as taxable income. This is beneficial to an entrepreneur moonlighting in a side business in addition to their day job. Take for example an employee earning a salary of $55,000 per year who is also starting a side business as a woodworker. The employee may spend $10,000 on new equipment for his side business during the year but only earn $5,000 in business income. Because the entrepreneur’s salary also counts as taxable income, he can fully deduct the $10,000 in expenses.

Section 179 is not the only advantageous Code provision available to businesses and entrepreneurs for year-end tax planning. Part 2 of this series will discuss other Code provisions that may be paired with Section 179 to maximize your year-end deductions. For more information on how Section 179 can benefit your specific business, contact a **Foster Swift tax attorney** today.