



## **Equipment Deduction for 2011 and 2012**

### **The Bonus Depreciation and Sec. 179 Increases Can Mean Big Savings**

*On Dec. 17, 2010 President Barack Obama signed the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (TRJA). In addition to providing incentives for small business, the TRJA extended the depreciation bonus for 2011 and 2012 and extended Sec. 179 expensing limits through the end of 2012 to encourage equipment purchasing. The economic stimulus law can potentially mean big tax savings for you. This article is intended to help those of you that are considering buying equipment in 2011 and 2012 understand the basics of the TRJA and answer common questions.*

#### **What exactly do the TRJAs capital investment incentives mean for my business?**

By lowering your taxable income, the depreciation bonus (for new equipment) and Sec. 179 (for new and used equipment) can dramatically cut your 2011 and 2012 federal tax bills, thereby freeing up cash in the near term.

#### **That sounds too good to be true. What's the catch?**

The more you depreciate now, the less you'll be able to depreciate later. In other words, your tax bill in future years will be higher because you'll have less to deduct. But ask yourself this: Would you rather have the tax savings in your pocket now to invest in your company or would you rather have Uncle Sam hold on to your money for a couple of extra years?

Additionally, several states do not recognize the bonus depreciation and limit Sec 179 deductions. Maximizing federal deductions usually results in additional tax complexity for state reporting.

#### **How does the depreciation bonus work?**

Companies that buy new equipment in 2011 can depreciate 100 percent of the cost in the first year. For new equipment purchased in 2012, the bill provides for 50 percent depreciation bonus, plus the percentage of the remaining basis in the equipment that would ordinarily be depreciable under the Modified Accelerated Cost Recovery System (MACRS). For a \$100,000 piece of equipment with a five-year MACRS life, the first year depreciation under the TRJA would be \$100,000 in 2011 and \$60,000 in 2012: \$50,000 depreciation bonus, plus 20 percent of the remaining \$50,000 in basis. (See other limitations below)

#### **Does the equipment have to be new to qualify for the depreciation bonus?**

Yes. To be eligible for the bonus depreciation in 2011, the "original use" of the equipment must commence with the taxpayer claiming the bonus depreciation.

There is one very limited exception to the “new” requirement. If Company A is leasing a piece of equipment (e.g., from a distributor) and Company A is the first and only user of the equipment (i.e., it hasn’t been rented or leased to any other customer) and Company A converts the lease to a purchase within three months of the start of the lease period, then Company A may claim the depreciation bonus on the equipment. Check with your tax professional for more details.

**Do I have to use the depreciation bonus?**

No. The bonus depreciation is elective – it’s your choice whether to use it. The depreciation bonus also applies for both regular and alternative minimum tax purposes. In some situations, it may not be wise to accelerate the depreciation deductions.

**How did recent economic stimulus legislation change the Sec. 179 expensing law?**

The Small Business Jobs Act of 2010 (SBJA) increased the expensing limits under Sec. 179 of the Internal Revenue Code for any taxable year beginning in 2010 and 2011. For both tax years, companies can expense up to \$500,000 as long as total annual purchases in the respective year does not exceed \$2,000,000. For each dollar over, the eligible expensing amount correspondingly drops by one dollar. Thus, companies that spend more than \$2,500,000 on tangible personal property cannot take advantage of Sec. 179. (But they can still use the depreciation bonus.) The TRJA extends the 179 expensing through 2012 but lowers the benefit to \$120,000 with a \$500,000 threshold.

**To qualify for Sec. 179, does the equipment have to be new?**

No. Unlike the depreciation bonus, Sec. 179 expensing can be applied to both new and used equipment.

**Can Sec. 179 and the depreciation bonus be combined?**

Yes. Companies eligible for Sec. 179 can also combine it with the depreciation bonus for even bigger tax savings.

**Do the SBJA and TRJA capital investment incentives apply only to construction equipment?**

No. A broad range of tangible personal property (but not real estate) is eligible for bonus depreciation and Sec 179 deduction tax treatment this year. Generally, real estate is ineligible property for these accelerated depreciation deductions.

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