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Key Depreciation Changes And How They Impact Your Business

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As 2012 came to an end, there was a lot of confusion around two key depreciation rules, making it difficult to make decisions on capital investments. The 2012 Taxpayer Relief Act extended the deductions for bonus depreciation as well as the Section 179 Allowance. We have laid out the rules below so taxpayers can make decisions for 2013. Hopefully you will find answers to your questions in this article. If not, the experts at Waldron Rand are available to discuss this with you one-on-one.

Bonus Depreciation

Before the miracle fix to the “Fiscal Cliff” crisis, the IRS Code provided for additional first-year depreciation expense equal to 50% of the adjusted basis of qualified property acquired and placed in service after Dec. 31, 2011, and before Jan. 1, 2013. This is commonly referred to as “bonus” depreciation. The additional first-year depreciation deduction is allowed for both regular tax and alternative minimum tax purposes. The basis of the property and the depreciation deductions in the year of purchase and later years are appropriately adjusted to reflect the bonus depreciation taken. A taxpayer may elect out of taking bonus depreciation for any class of property for any tax year.

We are often asked how an asset qualifies for a bonus depreciation allowance. To qualify the asset must meet the following criteria:

- It falls into one of the following categories:
 - Property to which the modified accelerated cost recovery system (MACRS) rules apply with a recovery period of 20 years or less
 - Computer software other than computer software covered by **Code Sec. 197**
 - Qualified leasehold improvement property or
 - Certain water utility property
- It is placed in service before Jan. 1, 2013. (Certain long-production-period property and certain transportation property may be placed in service before Jan. 1, 2014)
- Its original use commences with the taxpayer. Original use is the first use to which the property is put, whether or not that use corresponds to the taxpayer's use of the property.

Under pre-Act law, these bonus depreciation provisions generally didn't apply to property placed in service after Dec. 31, 2012.

New Law: 2012 Taxpayer Relief Act

The 2012 Taxpayer Relief Act extends the 50% first-year bonus depreciation described above so that it applies to qualified property acquired and placed in service before Jan. 1, 2014 (before Jan. 1, 2015 for certain longer-lived and transportation property).

The Act also retroactively revives and extends through 2013 the rule treating qualified leasehold improvement property, qualified retail improvement property and qualified restaurant property each as 15-year property. This means that such property is eligible for a bonus 50% first-year depreciation deduction if placed in service before Jan. 1, 2014.

Taxpayer Deductions Under Section 179

Under IRS **Code Sec. 179**, taxpayers, other than an estate, a trust, or certain non-corporate lessors, can elect to deduct as an expense, rather than to depreciate, up to a specified amount of the cost of new or used tangible personal property placed in service during the tax year in the taxpayer's trade or business. The maximum annual expensing amount generally is reduced dollar-for-dollar by the amount of property placed in service during the tax year in excess of a specified investment ceiling. Amounts ineligible for expensing due to excess investments in expensing-eligible property can't be carried forward and expensed in a subsequent year. However, they can be recovered through regular depreciation. The amount eligible to be expensed for a tax year cannot exceed the taxable income derived from the taxpayer's active conduct of a trade or business. And any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding tax years.

Under pre-Act law, the maximum amount that may be expensed for tax years beginning in 2012 was \$139,000. For tax years beginning after 2012, the maximum amount was further reduced to \$25,000. For tax years beginning in 2012, the maximum annual expensing amount generally would have been reduced dollar-for-dollar by the amount of **section 179** property placed in service during the tax year in excess of \$560,000 (the investment ceiling). For tax years beginning after 2012, the investment ceiling was scheduled to be \$200,000.

It's important to understand that under pre-Act law, property is eligible for **Code Sec. 179** expensing if it is:

- Tangible property that's considered **Code Sec. 1245** property (generally, machinery and equipment), depreciated under the MACRS rules of **Code Sec. 168**, regardless of its depreciation recovery period;
- For any tax year beginning in 2010 or 2011, up to \$250,000 of qualified real property (qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property); and
- Off-the-shelf computer software, but only if placed in service in a tax year beginning before 2013.

Retroactively, effective for tax years beginning in 2012 and through 2013, the 2012 Taxpayer Relief Act increases the maximum expensing amount under **Code Sec. 179** from \$139,000 (in 2012) and \$25,000 (in 2013) to \$500,000. The 2012 Taxpayer Relief Act also increases the investment ceiling for tax years beginning in 2012 or 2013 to \$2,000,000. However, for tax years beginning after 2013, the maximum expensing amount is scheduled to drop to \$25,000 and the investment ceiling is scheduled to drop to \$200,000.

This is a windfall for eligible taxpayers that placed in service more than \$139,000 of eligible property, since it is a retroactive boost for tax years beginning in 2012.

The 2012 Taxpayer Relief Act also provides that:

- Off-the-shelf computer software is expensing-eligible property if placed in service in a tax year beginning before 2014 (a one-year extension).
- For tax years beginning before 2014 (also a one-year extension), an expensing election or specification of property to be expensed may be revoked without IRS's consent. But, if such an election is revoked, it can't be reelected.
- For any tax year beginning in 2010, 2011, 2012, or 2013 (a two-year extension), up to \$250,000 of qualified real property (qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property) is eligible for expensing under **Code Sec. 179**.

We hope that you have found this information to be valuable for your business. If you have any questions, please don't hesitate to contact any of the experts at Waldron Rand.

About the Author, Bob Gorton

Bob Gorton has provided strategic counsel at Waldron H. Rand & Company, P.C., since 2005. Bob works with clients' management teams to analyze their businesses, formulate short-and long-term business, financial and tax plans based on that analysis, and implement steps to ensure their success. He is highly skilled in the field of mergers and acquisitions, and has advised many clients in this area on due diligence, negotiations and integration activities. Bob is certified in financial forensics and has significant experience in litigation support and forensic accounting.

Prior to joining Waldron H. Rand & Company, P.C., Bob served for five years as the Chief Financial Officer of a privately held company. There, he was responsible for all aspects of the company's financial management, as well as human resources and general operations. He played a significant role in the company's early-stage growth, in obtaining increased working capital funding and in the sale of a large portion of the company to a strategic investor. Prior to that, Bob spent 12 years as a Manager at a CPA firm, where he worked with client management to analyze their businesses and plan for the future.

About Waldron H. Rand & Company, P.C.

Waldron Rand, located in Needham, MA, provides unmatched accounting, auditing, tax, and consulting services to individuals and privately held businesses in a wide range of industries throughout the U.S. and globally.

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