# SMALL BUSINESS EXPENSING

*BENEFITTING FROM SECTION 179*

NFIB

The Voice of Small Business.®

# Meet Our Speaker

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# Session Overview

- New Permanent Tax Legislation
- Sec. 179 Basics
- Qualifying Property
- Limitations
- Sec. 179 and Vehicles
- How to Elect Sec. 179
- Q&A

# Permanent Tax Legislation

**PATH ACT – "Tax Extenders" and More**

- *Protecting Americans from Tax Hikes Act of 2015*, signed into law on December 18, 2015.
- The Act extended over 50 expiring tax provisions, making more than 20 of them permanent, over $620 billion in tax reductions.

**Most Important Provisions Small Business**

- Section 179 Small Business Expensing
- Bonus Depreciation
- Deduction Of State And Local Sales Tax
- S Corporations Built-In Gains Tax
- R&D Tax Credit
- 15-year Cost Recovery for Qualified Real Property

# Permanent Sec. 179

- Permanent at $500,000 / $2 million

- Deduction would have fallen to $25,000

- NFIB members sent over 10,000 letters and emails to Members of Congress on the importance of making small business expensing permanent.

# What is Sec. 179?

- **General Rule = Business Property Depreciated Over Years**
  - Items with an expected life of more than a year must generally be capitalized.
  - Most items of tangible personal property (equipment, desks, etc.) can't be deducted, but must be capitalized and depreciated over a number of years.

- **Sec. 179 Provides Immediate Deduction for Most Business Equipment**
  - Immediately deduct, or “expense,” the cost of qualified business assets bought and placed in service during the year.

- **General Rules to Qualify:**
  - Eligible property
  - Acquired for business use
  - Acquired by purchase

# Sec. 179 – Some Basics

- **For 2016, deduction limit is $500,000**
  - New and used equipment, equipment must be financed/purchased and put into service by the end of the day, 12/31/2016.

- **Overall limitation is $2,000,000**
  - The $500,000 is reduced, dollar for dollar, if the total amount of qualifying property placed in service during the year exceeds $2,000,000.

# Limitation Examples

- ***Example 1—$500,000 limit***
  - Business buys $625,000 of qualifying property in 2016. It can take the Section 179 election on $500,000. The $2,000,000 limit doesn't apply.

- ***Example 2—$2,000,000 limit***
  - Business buys $2,075,000 of qualifying property in 2016. The maximum Section 179 election is $425,000 ($500,000 less $75,000, the excess over the $2,000,000 limitation).

# Limited to income from trade or business

- **Business income limitation**
  - Limits total deduction to the taxpayer's taxable income from the active conduct of a trade or business for that year.
  - Applies at both business and owner level

- **Active Business Income**
  - Total income from all businesses <u>actively</u> conducted
  - Net income before 179, Salary, NOL, and SE Tax
    - Example: Business with $26,000 in net income, but owners paid $50,000 salary, for limitation purposes is $76,000
  - At Individual Level- Includes any W-2 income (+ spouse) earned as an employee

- **Example**:
  - AB Partnership has net income of $8,000 for 2016. AB purchases $10,000 in Sec. 179 property. Partnership allocates $4,000 income to A and B.
  - Result: AB limited to $8,000 deduction, and must carryforward $2,000 it elected to expense.
  - Alternative: If AB had $10,000 income, AB partnership no longer limited, but individual partners might be.

# Sec. 179 Limitations

- **Sec. 179 Applied Item-by-Item**
  - You do not have to claim the full amount. It's up to you to decide how much of the cost of property you want to deduct.
  - If some of your Sec. 179 deduction cannot be used because of a limitation, option to divide the deduction among all items.

- **Selecting Property**
  - Longer lived property makes the most sense.
  - Property unlikely to dispose of early or convert to personal use.
    - Example: if you generally keep a laptop only three years. Take the 179 election on the desks and chairs instead.

- **Recordkeeping**: Identify the specific property in your books and records.

# Sec. 179 Carryforward

- **Unused Sec. 179 deductions can be carried forward indefinitely and used in future years.**
  - Note: Possible downside, have to reduce your basis in the S corporation or partnership by the amount of the deduction passed through, partner cannot currently deduct the total amount.
- **Tax Tip: Planning Your Deductions**
  - You may want to take a lower (or no) Sec. 179 deduction and take depreciation on the assets to even out your income over several years.
  - For example, if total allowed deduction would put you in the 15% bracket in 2016, only find yourself paying taxes at 25% in the following year.

# Eligible Property

- Almost all types of “business equipment” that your company buys or finances qualifies for the Section 179 deduction.

- To qualify for the Section 179 expense deduction, your property must be one of the following types of depreciable property:

**Tangible Personal Property**

- Machinery and equipment
- Office furniture, computers
- Property in or attached to buildings – refrigerators, counters, signs, manufacturing tools and equipment.
- Gasoline storage tanks and pumps at retail stations
- Livestock – horses, cattle, hogs, goats, sheep and furbearing animals.
- Certain Vehicles (with limitations)

# Eligible Property

**Other tangible property**

- An integral part of manufacturing, production, or extraction or of furnishing transportation, communications, electricity, gas, water, or sewage disposal services.
- Storage facilities used in connection with distributing petroleum or any primary product of petroleum

**Agricultural Related Property**

- A facility used for the bulk storage of fungible commodities, i.e. grain bin
- Single purpose livestock or horticultural structures. Structures needed to house, raise, or feed the livestock, greenhouse used in commercial production of plants.

**Partial Business Use**

- Must have been acquired for use in business and used greater than 50% business of the time.  Deduction based on the percentage of time you use the equipment for business purposes.

# New Qualifying Property

- **"Qualified Sec. 179" Real Property:**
  – (1) Qualified leasehold improvement, (2) qualified restaurant and (3) qualified retail improvement property are eligible for expensing ($250,000 cap on real property removed in 2016).
  – Generally applies to interior renovations.

- **HVAC:** Air conditioning and heating units placed in service in tax years beginning after 2015 are eligible for expensing.

- **Software:** Off-the-shelf computer software.

# What Property Does Not Qualify?

- **Real Property**
  - Defined as land, buildings, permanent structures and the components of the permanent structures (including improvements).
- **Land improvements**
  - Sidewalks, parking areas and fences.
  - However, agricultural fences do qualify as Section 179 property.
- **Gifted and Inherited Property**
  - Property must have been acquired by purchase. Property acquired from a related person (that is, your spouse, ancestors, or lineal descendants) is not considered acquired by purchase.
- **Residential Rental Property**
  - Landlords can't use Section 179 to deduct the cost of items they purchase for use inside rental units—for example, kitchen appliances, carpets, drapes, or blinds.
  - Exception is for property in hotels and motels.
  - OK for personal property used in your rental business not located inside your rental buildings.

# Sec. 179 and Vehicles

**Passenger Vehicles Subject To Special Rules Depending On Type And Weight**

1. **2016 Passenger Vehicle Limits** (up to 6,000 pounds)
   – Automobiles: $3,160 / $11,160
   – Light trucks / vans: $3,560 / $11,560

2. **$25,000 Limit Heavy SUVs over 6,000 pounds and less than 14,001 pounds**

3. **Full Deduction (No limitation on amount)**
   – Trucks with gross vehicle weights over 14,000 pounds
   – Truck with cargo area of at least six feet, not directly accessible from passenger compartment
   – Classic cargo van
   – Vehicles that can seat nine-plus passengers behind the driver's seat (i.e.: Hotel / Airport shuttle vans
   – Special Purpose Vehicles - For example, tractors, dump trucks, forklifts and other special purpose farm vehicles can be fully written off up to the annual limits for section 179

- **Recordkeeping:** Must establish through contemporaneous records (such as a mileage log) that you use the vehicle over 50% of the time for business.

# First-year Deduction Examples:

- **Heavy SUV $65,000 used 100% business**: $49,000
- **New $65,000 passenger car:** $11,160 (or $11,560 for a light truck or van)
- **Heavy pickup truck (six-foot cargo bed):** $65,000 fully deductible under Section 179

FCA FIAT CHRYSLER AUTOMOBILES — **Snapshot of 2016 Chrysler, Dodge, Jeep®, Ram, FIAT® Section 179 Expense Allowance**

| | | | | | |
|---|---|---|---|---|---|
| **Tax Treatment** | Up to $37,345 of the purchase cost in the first year ($500,000 aggregate limit) | Up to $25,000 of the purchase cost in the first year ($500,000 aggregate limit) | Up to $24,445 in the first year (plus any remaining basis using MACRS method) | Up to $11,560 in the first year (plus any remaining basis using MACRS method) | Up to $11,160 in the first year (plus any remaining basis using MACRS method) |
| **Applies to:** | Trucks and Cargo Vans over 6,000 lbs. GVWR[B,E] | Passenger Trucks/Vans and SUVs over 6,000 lbs. GVWR[C,E] | Trucks and Cargo Vans under 6,000 lbs. GVWR[B,E] | Passenger Automobiles under 6,000 lbs GVWR[A,E] | Passenger Automobiles under 6,000 lbs GVWR[A,E] |
| **Eligible New FCA US Vehicles** | Ram 1500 Regular Cab 6'4" box<br>Ram 1500 Quad Cab 6'4" box<br>Ram 2500<br>Ram 3500<br>Ram 4500<br>Ram 5500<br>Ram ProMaster® | Chrysler Town & Country<br>Dodge Durango<br>Jeep Grand Cherokee<br>Ram 1500 Crew Cab 5'7" box | Ram ProMaster City®<br>Dodge Grand Caravan | 2017 Chrysler Pacifica | Chrysler 200<br>Chrysler 300<br>Dodge Challenger<br>Dodge Charger<br>Dodge Dart<br>Dodge Journey<br>Jeep® Renegade<br>Jeep® Cherokee<br>Jeep® Patriot<br>Jeep® Compass<br>Jeep® Wrangler<br>Jeep® Wrangler Unlimited<br>FIAT® 500<br>FIAT® 500c<br>FIAT® 500e[D]<br>FIAT® 500L<br>FIAT® 500 Abarth |

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# Electing Sec. 179

- **Sec. 179 Election:** Business must elect to take the Section 179 to ensure that your business captures the available tax savings (it is not automatic). Form 4562 is attached to your timely-filed tax return, including extensions.

- **Form 4562:** List on your depreciation schedule (Form 4562) the assets you wish to expense. Description of the property (e.g., desk, computer), Cost basis, and Elected cost. Do not have to expense entire cost of property.

- **Placed in Service:** Property eligible for year *placed in service*. Generally, that's the year of acquisition. An item of property is placed in service when it's available for use.

- **Record Keeping:** Must keep complete records. Keep a more detailed record--date acquired, complete description to match the original invoices, and date of when asset is disposed of.

# Avoiding Recapture

- **Business Use Falls Below 50%**
  - If property not used in trade business during normal recovery period, portion of deduction recaptured as ordinary income.
  - **Example -** Business purchases a copier on Jan. 1, 2015 (5-year property) and expenses $10,000. On Jan. 1, 2016, no longer used in business.
    - Normal depreciation for 2015, 2016 would have been $3,000.
    - Result: $7,000 recaptured for 2016 tax year, the excess of Sec. 179 amount over normal depreciation.
- **Recordkeeping**: Essential to keep adequate records to show that business use greater than 50%.
  - Courts will deny Sec. 179 deduction and require recapture where businesses cannot substantiate business use.

# Additional Considerations

- **Use. Sec. 179 to Avoid Conventions**
  - **Half- year convention**: Half-year of depreciation is allowed in the first year, applies regardless of when you actually placed the asset in service.
  - **Mid-quarter convention:** Applies if at least 40% of the cost basis acquired in a year occurs in the fourth quarter. Considered in service at the midpoint of a quarter, deduction will be lower than if you were using the half-year convention.
  - **Example:** Business purchases $100,000 of property for 2016, but $52,000 was purchased in October. Assets placed in service in October will generate little depreciation in 2016. Avoid this trap by electing to expense some of the late-year purchases. These will be taken out of the equation.
- **AMT** - One of the preference items for alternative minimum tax purposes is accelerated depreciation. The Section 179 expense option is not considered a preference item, could help avoid or reduce an AMT problem.
- **State rules.** Not all states recognize the same limits for the Section 179 election. Check the rules in your state.

# Brief Recap

1. **Sec. 179 Basics**
   – Deduct up to $500,000 annually, up to your business income
   – Now Permanent
2. **Eligible Property**
   – Personal Tangible Property / Generally not real property
3. **Vehicles**
   – Passenger vehicles might be subject to restrictions
4. **Election**
   – Elected on Form 4562 with tax return, applies to individual property, still maintain records

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| Minimum 10% discount on over 1 million maintenance, repair and operational supplies. | Save up to 40% on select systems with exclusive member discounts. | Members receive $500 cash allowance and up to $1,000 in incentives on most vehicle models. | Lines of credit up to $100,000 to finance your qualified business purchases. |

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# Question & Answer