Section 179 Expensing and Depreciation for Small Businesses

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FCA Office of Tax Affairs

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Agenda

- Introductions
- Tax Planning
- Section 179 Expensing
- Depreciation
- Conclusion

Introductions

- Scot Ciarkowski is a Tax Specialist with Fiat Chrysler Automobile's Office of Tax Affairs. Scot has spent the last 13 years helping corporations and individuals with tax planning and compliance, focusing on U.S. Federal and State Taxation. He received his Bachelors of Accountancy and a Master's of Science in Taxation from Walsh College. Additionally, Scot is a Certified Public Accountant in Michigan and is a member of the Michigan Association of Certified Public Accountants.

- Matthew Flynn is a Tax Specialist with Fiat Chrysler Automobile's Office of Tax Affairs. Matthew has 10 years of service in the automotive industry primarily focusing on U.S. Federal and State Taxation. He received his Bachelors of Accounting and Management studies from the University of Michigan - Dearborn. Additionally, he is a member of the Beta Gamma Sigma business honors society.

This is too difficult for a mathematician. It takes a philosopher. The hardest thing in the world to understand is the income tax.

- Albert Einstein

New York Times “Tax Form Baffles Even Professor Einstein” March 11, 1944

Tax Planning

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Tax Planning

- Tax planning is the process of arranging your business affairs in a way that postpones or reduces tax expense.
- By employing effective tax planning strategies a business will have more money to reinvest in the business or distribute to its owners.
- Generally, the goals of tax planning are:
  - Reducing taxable income by deferring revenue,
  - Reducing taxable income by increasing deductions
  - Capitalizing on tax credits, and
  - Utilizing tax attributes before they expire.

Tax Planning

- For taxpayers, there isn’t a one size fits all tax planning strategy because it is dependent on the business’s current tax profile.
- Tax planning often involves a tax practitioner who is engaged by the taxpayer to ensure the planning is sound and achieves the desired outcome.
- Often tax practitioners are Attorney’s, Certified Public Accountant’s or Enrolled Agents.
- Tax planning is especially important when the rate of tax is being reduced because a permanent benefit may be recognized. This may be the case between tax years 2017 and 2018 based on current proposed tax legislation.

Example of Tax Planning

- Alpha Company, a C-Corporation, produces widgets and has taxable income of $20 million as of September 31, 2017.
- Alpha Company is considering purchasing $500,000 of machinery and equipment to expand its operations.
- In December 2017 the tax law changes and reduces the tax rate on C-Corporations from 35% to 20% in 2018.
- Assume Alpha's deduction would be $500,000 if the machinery and equipment was placed in service in either 2017 or 2018.
- Alpha would want to place the machinery and equipment in service in 2017 since it would pay $75,000 less of tax due to the 15% difference in the tax rate.

FIAT CHRYSLER AUTOMOBILES

Section 179 Expensing

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Internal Revenue Code Section 179

- Section 179 provides that a business may elect to deduct rather than capitalize and depreciate the cost of qualifying property placed in service during the taxable year.
- This tax provision encourages small businesses to make capital purchases and receive an immediate tax benefit.
- The provision was made permanent by the Protecting Americans From Tax Hikes Act of 2015 (PATH Act) and indexed for inflation.
- The election to use section 179 expensing is made on a timely filed Form 4562, which is included as part of the tax return for the business.

Who is Eligible for Section 179 Expensing?

- Businesses that have taxable income are eligible to elect to use section 179.
- This includes businesses choosing to operate as:
  - C-Corporations,
  - S-Corporations,
  - Partnerships,
  - Limited Liability Companies, and
  - Sole proprietorships.
- Please note that a business may not elect to take a section 179 deduction to create a net operating loss. The deduction is carried forward indefinitely until the entity has taxable income.

What Qualifies as Section 179 Property?

- New and used tangible property, which is subject to depreciation and used 50% or more in the active conduct of trade or business primarily used in the United States.
- Generally, qualifying section 179 property includes:
  - Machinery and Equipment
  - Tooling
  - Computers
  - Computer Software
  - Office Equipment
- Trucks, vans, and sport utility vehicles qualify for the section 179 expensing election.

Section 179 Limitations

- To ensure that the provision is used by small businesses and not large corporations section 179 provides three general limitations that must be met to receive a deduction in 2017:
  - The total section 179 deduction may not exceed $510,000,
  - The taxpayer may not place more than $2,030,000 of qualifying section 179 property in service during the tax year, and
  - The section 179 deduction may not exceed the taxable income of the taxpayer for all trade or businesses during the tax year.

- In addition to these general limitations there are specific limitations regarding sport utility vehicles and automobiles.

Section 179 SUV Limitations

- Section 179 specifically limits the expensing of sport utility vehicles to $25,000.
- For purposes of section 179 a sport utility vehicle is defined as:
  - A vehicle primarily designed to carry passengers,
  - Which is not listed property as defined in section 280F, and
  - Has a GVWR of less than 14,000 pounds.
- Exceptions to the definition of a sport utility vehicle:
  - A vehicle designed to seat more than 9 persons behind the drivers seat,
  - Trucks equipped with a 6’ or longer bed, or
  - Vehicles which do not have seating behind the driver’s seat and has less than 30 inches protruding ahead of the leading edge of the windshield.

Section 179 Example 1

J’s Landscaping, a C-Corporation, purchased and placed in service two Ram Trucks at a cost of $100,000. The trucks are used 100% for business use and no other property is purchased and placed in service in 2017. J’s Landscaping elects to expense the vehicles on its 2017 corporate tax return. Prior to expensing the vehicles J’s had taxable income of $1,000,000.

What is J’s taxable income and section 179 deduction for 2017?

Section 179 Example 1

J’s Landscaping, is allowed a $100,000 section 179 deduction in 2017. This will reduce taxable income to $900,000. The decrease in taxable income from $1,000,000 to $900,000 would represent a $35,000 savings in cash taxes to the corporation assuming a 35% tax rate.

Section 179 Example 2

J’s Landscaping, a C-Corporation, purchased and placed in service two Ram Trucks at a cost of $100,000. When purchasing the trucks J’s traded in two trucks from its current fleet and received a $10,000 credit on the invoice towards the purchase of the new trucks. The trucks are used 100% for business use and no other property is purchased and placed in service in 2017. Prior to expensing the vehicles J’s had taxable income of $1,000,000.

What is J’s taxable income and section 179 deduction for 2017?

Section 179 Example 2

J’s Landscaping, is allowed a $90,000 section 179 deduction which will reduce taxable income to $910,000 for 2017.

The cost of section 179 property does not include the basis of other property held at any time by the taxpayer. Therefore, J’s would not be able to expense the portion of the new trucks that were paid for by trading in the old trucks from its fleet.

Section 179 Example 3

J's Landscaping, a C-Corporation, purchased and placed in service two Ram Trucks at a cost of $100,000. The trucks are used 100% for business use. J's also purchased $2,000,000 of excavating equipment in 2017. Prior to expensing the vehicles J's had taxable income of $3,000,000.

What is J's section 179 deduction for 2017?

Section 179 Example 3

J’s Landscaping has exceeded the $2,030,000 investment limitation of qualifying section 179 property placed in service in 2016 by $70,000. The $510,000 aggregate section 179 deduction must be reduced by $70,000 and the company will only be able to expense $440,000 of the assets placed in service in 2017.

Depreciation

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What is Depreciation?

- Depreciation is the process of recovering the cost of business or income producing property over its useful life.
- Depreciation expense is generally calculated differently for financial statement and tax purposes.
- The Internal Revenue Code provides for several different methods of calculating depreciation.
- When choosing a method of depreciation a taxpayer may elect to take the largest permissible depreciation deduction in order to minimize taxable income or may elect to minimize depreciation expense and maximize taxable income.

What Property is Eligible to be Depreciated?

- Tangible or intangible property with a determinable life of one year or more used in a trade or business.
- Examples of fixed assets eligible for deprecation and their depreciable tax lives:
  - Specialized tooling – 3 years
  - Computer software – 3 years
  - Trucks, vans, and automobiles – 5 years
  - Computer and peripheral equipment – 5 years
  - Machinery & equipment – 7 years
  - Leasehold and land improvements – 15 years
  - Commercial Buildings – 39.5 years

When Does Depreciation Begin?

- Assets may only be depreciated once they are placed in service.

- The term placed in service means that the property is in a condition or state of readiness and available for a specifically assigned function.

How is Property Depreciated?

- Property is depreciated using the Modified Adjusted Depreciation System (MACRS).
- For tax years 2017 through 2020 additional first year expensing may be elected on qualifying new property purchases by the business entity on a timely filed Form 4562.
- This provision is commonly referred to as bonus depreciation and the applicable percentages are as follows:
  - 2017 – 50%
  - 2018 – 40%
  - 2019 – 30%
  - 2020 – 0%

How is Property Depreciated?

- After bonus depreciation is taken MACRS depreciation tables are used to determine the proper amount of regular tax depreciation.
- The MACRS table provides the applicable percentage that is applied to the adjusted basis of the asset (cost of the asset less – bonus depreciation taken).

Table A-1. **3-, 5-, 7-, 10-, 15-, and 20-Year Property Half-Year Convention**

Year	Depreciation rate for recovery period					
	3-year	5-year	7-year	10-year	15-year	20-year
1	33.33%	20.00%	14.29%	10.00%	5.00%	3.750%
2	44.45	32.00	24.49	18.00	9.50	7.219
3	14.81	19.20	17.49	14.40	8.55	6.677
4	7.41	11.52	12.49	11.52	7.70	6.177
5		11.52	8.93	9.22	6.93	5.713
6		5.76	8.92	7.37	6.23	5.285
7			8.93	6.55	5.90	4.888
8			4.46	6.55	5.90	4.522
9				6.56	5.91	4.462
10				6.55	5.90	4.461
11				3.28	5.91	4.462
12					5.90	4.461
13					5.91	4.462
14					5.90	4.461
15					5.91	4.462
16					2.95	4.461
17						4.462

Depreciation Example 1

J’s Landscaping, a C-Corporation, purchased and placed in service two Ram Trucks at a cost of $100,000. The trucks are used 100% for business use and no other property is purchased and placed in service in 2017.

What is J’s deprecation deduction and taxable income for 2017?

Depreciation Example 1

J’s Landscaping, is allowed a $60,000 depreciation deduction. This will reduce taxable income to $940,000 and reduce the tax owed by $21,000 assuming a 35% tax rate.

Section 179 Expensing vs Depreciating - Example 1

To put the benefit of section 179 in perspective let's determine the additional cash tax benefit J's received in 2017 by electing to expense rather than depreciating the trucks.

	Section 179 Exp.	Depreciation
Net Income	1,000,000	1,000,000
Sec 179 or Depr.	(100,000)	(60,000)
Taxable Income	900,000	940,000
Tax Rate	35%	35%
Tax Expense	315,000	329,000

Conclusion and Takeaways

Conclusion and Takeaways

- Section 179 may provide profitable small businesses an opportunity to acquiring vehicles or equipment to maintain or expand their business and reduce the business's current year tax liability.

- Keep in mind that there are limitations when taking a section 179 deduction.
  - Business must have taxable income or the section 179 deduction is carried forward to future years.
  - $510,000 maximum deduction.
  - $2,030,000 section 179 spending cap on qualifying purchases.

Retail Incentives/Discounts

Associated Builders and Contractors, Inc.

+

RAM COMMERCIAL

$500 CASH ALLOWANCE towards a purchase or lease

Questions?

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