

Consider accelerating new equipment purchases into 2004

If your business is contemplating the purchase of new machinery equipment or other depreciable business assets, then a soon-to-expire tax benefit may be just the impetus you need to help you make your decision quickly.

Bonus first-year depreciation, which was put into law by President Bush as an economic stimulus following the 9/11 terrorist attacks, will end on Dec. 31, 2004. If their goal is to maximize deductions this year, businesses have an additional incentive to accelerate new equipment purchases into 2004.

Background

Under the Jobs and Growth Tax Relief Reconciliation Act of 2003, taxpayers are allowed to deduct a bonus first-year depreciation allowance of 50 percent of the cost of "qualified property" purchased and placed into service between May 6, 2003, and Dec. 31, 2004.

Qualified property, for purposes of this deduction, generally includes:

- ❖ New (unused) business fixed assets with recovery period of 20 years or less as determined by the modified accelerated cost recovery system (MACRS)
- ❖ Many types of computer software
- ❖ Certain leasehold improvements to non-residential buildings that are more than 3 years old

Claiming the deduction

On qualifying property, the 50 percent bonus first-year depreciation deduction is automatic, unless the taxpayer elects to claim the deduction at a reduced rate of 30 percent or elects not to claim bonus first-year depreciation at all. This might be the case if the taxpayer would not fully benefit from the increased deduction in the year the property is placed into service and wishes to preserve the deduction for future tax years.

The bonus depreciation can be especially valuable as a year-end tax planning tool, as the deduction is not prorated for the time that the fixed assets are in service during the tax year. The full 50 percent bonus depreciation deduction is available even if the qualifying property is in service for only a few days in 2004.

Illustration

XYZ Corporation is a calendar-year taxpayer that purchases and places into service a new computer system on Dec. 19, 2004, at a cost of \$80,000. Assuming XYZ does not expense any portion of the computer system and does not elect out of the bonus depreciation, the company can claim a MACRS depreciation deduction of \$48,000 for 2004, which is derived by taking the \$40,000 bonus depreciation plus the \$8,000 regular depreciation on the remaining \$40,000.

If XYZ had put off the purchase by a mere two weeks – and thus placed the property into service in 2005 – its first-year depreciation deduction would be only \$16,000 (\$80,000 multiplied by the applicable depreciation factor of 20 percent for a 5-year MACRS property).

Summary

Businesses should always carefully consider whether or not new equipment purchases are necessary and what impact they will have on the company in terms of increased efficiency and profits. If it is determined that new equipment is needed, then timing the purchase to maximize the related tax deductions can be a great way to let Uncle Sam help pay for the purchase.

The information mentioned here in above is of general nature and cannot be regarded as legal or tax advice. For more information, please contact Anne Tahim at 714-772-4744

