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Increased Section 179 Deduction

On February 17, 2009 the American Recovery and Reinvestment Act of 2009 was signed into law. In lieu of depreciation, a taxpayer with a relatively small capital budget can elect to write off the cost of a limited amount of property for the year it is placed in service, rather than treating it as a capital expense. This has been a major tax savings for small businesses. In general, the amount for which this election was available was limited to $125,000, phased out to the extent the total amount of property placed in service exceeded $500,000. However, for 2008, these amounts were increased to $250,000 and $800,000, respectively.

The new law extends these higher amounts for 2009. Thus, for tax years beginning in 2009, a taxpayer may expense up to $250,000 of qualifying property. This amount is reduced, but not below zero, by the amount by which the cost of the qualifying property placed in service during the tax year exceeds $800,000.

Section 179 property is depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. Off-the-shelf computer software placed in service in tax years beginning before 2010 is also treated as Section 179 property.

Bonus Depreciation

The 50% first-year bonus depreciation deduction for qualified property placed in service in 2008 (2009 for certain property with longer production periods and certain noncommercial aircraft) is extended to property placed in service in 2009 (2010 for certain property with longer production periods and certain noncommercial aircraft). The bonus depreciation allowance is available for property whose original use begins with the taxpayer and (1) is depreciable under MACRS and has a recovery period of 20 years or less, (2) is MACRS water utility property, (3) is off-the-shelf computer software depreciable over 3 years, or (4) is qualified leasehold improvement property.

Caution: Property that must be depreciated using the alternative depreciation system (ADS) does not qualify. In addition, listed property (e.g., a passenger automobile, television, cell phone) that is used 50% or less for business and intangible property does not qualify.

Qualified property must also meet time requirements with respect to use and acquisition to be eligible. The original use of the property must commence with the taxpayer after December 31, 2007, and before January 1, 2010. The property must be acquired by the taxpayer after December 31, 2007, and before January 1, 2010, but only if no written binding contract for its acquisition was in effect before January 1, 2008, or acquired by the taxpayer as the result of a written binding contract entered into after December 31, 2007, and before January 1, 2010.

Comment: The taxpayers may elect not to take the allowance.

Election to Accelerate AMT and Research Credits in Lieu of Bonus Depreciation

Corporations otherwise eligible for the 50 percent first-year bonus depreciation could elect to accelerate the AMT or research credits for eligible qualified property placed in service after March 31, 2008, and before January 1, 2009. Corporations may now make this election with respect to property placed in service in 2009 that qualifies for the 50 percent first-year bonus depreciation allowance (extension property). A corporation had to make the acceleration election for its first tax year ending after March 31, 2008, to apply for that year and each subsequent year, even if it did not place in service any eligible qualified property in its first year ending after March 31, 2008. Taxpayers that did not make the previous acceleration election may make the election with respect to extension property placed in service in its first tax year ending after December 31, 2008, and each subsequent year.

Comment: S corporations and their shareholders may also make this election.

The increases in the allowable credits are treated as refundable for purposes of this provision. The research or minimum tax credit limitation is increased by the bonus depreciation amount, which is equal to 20% of the bonus depreciation for certain eligible qualified property that could be claimed absent an election under this provision.

S Corporations: Built-in Gains Tax

S Corporations are subject to the built-in gains (BIG) tax during the 10-year recognition period following the S election. The BIG tax applies to S corporation gain that arose prior to the conversion of the C corporation, and with respect to net recognized built-in gain attributable to property received by an S corporation from a C corporation in a carryover basis transaction. The Act provides relief from the BIG tax by providing that in the case of any tax year beginning in 2009 or 2010, no BIG tax is imposed if the seventh tax year in the recognition period preceded the tax year.

Comment: The reduction in the recognition period applies separately with respect to any asset acquired in a carryover basis transaction. Thus, for a tax year beginning in 2009 or 2010, in the case of gain that arose before the conversion of a C corporation to an S corporation, no built-in gain tax will be imposed on the corporation after the seventh tax year that the S corporation election is in effect. With respect to built-in gain attributable to an asset received by an S corporation from a C corporation in a carryover basis transaction, no tax will be imposed on the corporation if the gain is recognized after the date that is seven years following the date on which the asset was acquired. Shareholders will continue to take into account all items of gain and loss.

These are very complicated, sophisticated, and significant issues. They may have a major tax impact on businesses. If you would like more advice about these benefits, please call Goodman & Company, CPAs, **610-253-2745**

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