Expensing and additional first-year depreciation in the 2012 American Taxpayer Relief Act

The recently enacted 2012 Taxpayer Relief Act includes a wide-ranging assortment of tax changes affecting both individuals and business. On the business side, two of the most significant changes provide incentives to invest in machinery and equipment by allowing for faster cost recovery of business property. Here are the details.

Enhanced small business expensing (Code Sec. 179 expensing). Generally, the cost of property placed in service in a trade or business can't be deducted in the year it's placed in service if the property will be useful beyond the year. Instead, the cost is "capitalized" and depreciation deductions are allowed for most property (other than land), but are spread out over a period of years. However, to help small businesses quickly recover the cost of capital outlays, small business taxpayers can elect to write off these expenditures in the year they are made instead of recovering them through depreciation. The expense election is made available, on a tax year by tax year basis, under Code Sec. 179 of the Internal Revenue Code, and is often referred to as the "Section 179 election" or the "Code Section 179 election." The new law makes three important changes to the Code Sec. 179 expense election

First, the new law provides that for tax years beginning in 2012 or 2013, a small business taxpayer will be allowed to write off up to $500,000 of capital expenditures subject to a phaseout (i.e., gradual reduction) once capital expenditures exceed $2,000,000. For tax years beginning after 2013, the maximum expensing amount will drop to $25,000 and the phaseout level will drop to $200,000.

Second, the new law extends the rule which treats off-the-shelf computer software as qualifying property through 2013.

Finally, the new law extends through 2013 the provision permitting a taxpayer to amend or irrevocably revoke an election for a tax year under Code Sec. 179 without IRS's consent.

Extension of additional first-year depreciation. Businesses are allowed to deduct the cost of capital expenditures over time according to depreciation schedules. In previous legislation, Congress allowed businesses to more rapidly deduct capital expenditures of most new tangible personal property, and certain other new property, by permitting an additional fist-year write-off of the cost. For qualified property acquired and placed in service after Dec. 31, 2011 and before Jan. 1, 2013 (before Jan. 1, 2014 for certain longer-lived and transportation property), the additional first-year depreciation was 50% of the cost. The new law extends this additional first-year depreciation for investments placed in service before Jan. 1, 2014 (before Jan. 1, 2015 for certain longer-lived and transportation property).

The new law also extends for one year the election to accelerate the AMT credit instead of claiming additional first-year depreciation.

The new law leaves in place the existing rules as to what kinds of property qualify for additional first-year depreciation. Generally, the property must be (1) depreciable property with a recovery period of 20 years or less; (2) water utility property; (3) computer software; or (4) qualified leasehold improvements. Also the original use of the property must commence with the taxpayer - used machinery doesn't qualify.

I hope this information is helpful. If you would like more details about the new cost recovery provisions or any other aspect of the new legislation, please do not hesitate to call.