Extended depreciation-related deductions are good news

By Keith Laudenberger, CPA
Councilor, Buchanan & Mitchell, P.C.

At the end of last year, the outlook was cloudy for 2013 depreciation-related deductions. One valuable break was scheduled to become a lot less valuable starting on Jan. 1, while another was set to disappear. But then Congress passed the American Taxpayer Relief Act of 2012 (ATRA), which extended both expanded Section 179 expensing and 50% bonus depreciation through 2013. And the forecast changed to sunny.

The scoop on Sec. 179

The Sec. 179 expensing election allows businesses to immediately deduct, rather than depreciate over a period of years, the cost of qualifying asset purchases up to an annual limit. ATRA extends the $500,000 limit, which had expired at the end of 2011, through 2013.

The break is subject to a dollar-for-dollar phaseout when total asset acquisitions for the year exceed $2 million. So the tax benefit is completely phased out when asset purchases total $2.5 million. (Dealers with multiple business interests: Note that the limit and threshold are per *taxpayer*, not per *entity*.)

Without ATRA, the expensing limit would have dropped to merely $25,000 in 2013, subject to a phaseout threshold of only $200,000. Now these levels are scheduled to return in 2014.

New and used furniture and equipment qualifies for Sec. 179 expensing, as does off-the-shelf computer software. ATRA also extended the provisions making dealership building or leasehold improvements — new electrical and plumbing systems, doors, windows, ceilings and so on — eligible for Sec. 179 expensing, as long as the facility is more than three years old. Ineligible improvements include those that enlarge the building, add an elevator or escalator, or modify the building's existing framework. Only up to $250,000 of the $500,000 expensing limit can be applied to qualifying improvements.

The buzz on bonus depreciation

Under the 50% bonus depreciation provision, half of the purchase price of qualifying assets can be deducted the year the asset is placed in service. Bonus depreciation had been scheduled to expire Dec. 31, 2012, for most asset purchases, but ATRA extended it through 2013 (2014 for certain long-lived and transportation property).

Qualifying assets include new, not used, tangible personal property with a recovery period of 20 years or less, such as furniture, equipment, off-the-shelf computer software, and qualified leasehold improvement property.

Bonus depreciation may be beneficial if your 2013 asset purchases exceed the $2 million Sec. 179 phaseout threshold or if the cost would exceed net income. Only bonus depreciation can be used to reduce net income below zero to create a net operating loss that can be carried back or forward to reduce tax in other years.

The lowdown on vehicle deduction limits

There's one caveat that dealers should know: Sec. 280F "luxury auto" rules limit the deductions that can be claimed on cars, vans and trucks under Sec. 179 expensing and bonus depreciation.

For passenger vehicles purchased for business purposes, Sec. 280F limits the total first-year depreciation deduction to $11,160 for cars and $11,360 for light trucks and vans in 2013. Vehicles with gross vehicle ratings above 6,000 pounds but not above 14,000 pounds may qualify for Sec. 179 expensing up to $25,000. Some vehicles — classic cargo vans, shuttle vans or pickups with full-size cargo beds, for example — that are unlikely to be used for personal purposes may be exempt from the luxury auto limits.

Benefit to dealers as *buyers*

The extension of enhanced depreciation-related breaks is good news for dealers looking to purchase qualifying assets in 2013. You can, say, replace the carpeting in your showroom or install new service lifts and deduct all, or at least 50%, of the cost now. For leased and financed purchases, your 2013 deduction may even exceed your out-of-pocket costs for lease or loan payments.

But be aware that taking these breaks now will reduce or eliminate depreciation deductions in subsequent years. In other words, these breaks don't reduce a dealer's overall tax obligation; they simply defer taxes. And if tax rates go up or you're in a higher tax bracket in the future, these breaks could ultimately result in *greater* total tax liability.

Benefit to dealers as *retailers*

Another benefit dealers reap from the extension of these enhanced breaks is that it may spur vehicle sales in 2013. The breaks provide businesses an incentive to replenish their vehicle fleets now, in case they're not extended again.

Educate your salespeople about these breaks, so they can use them as a sales tool, especially at year end.

Time for tax planning

ATRA is 157 pages long, and depreciation deductions are just a small piece. The act also extends many other breaks that might benefit your dealership.

Unfortunately, ATRA also has some downsides. Some dealership owners may face *higher* taxes under the act, especially if the dealership is an S corporation or LLC, because dealership income flows through to the owner's personal return. Specifically, singles with taxable incomes above

$400,000 and married couples with taxable income above $450,000 will face the return of the 39.6% top ordinary-income tax rate in 2013.

Contact your tax advisor now about how ATRA will affect your business and personal tax returns. Smart tax planning doesn't wait until year end.

Keith Laudenberger, CPA is an accounting and auditing manager with CBM and serves on the firm's Automotive Industry Committee. He has more than 12 years of public accounting experience providing services to automotive, construction, real estate and technology companies as well as not-for-profit organizations and government contractors. Keith provides audit, accounting, tax preparation, management consulting, financial services, 401(k), profit sharing and pension plan audits and compliance services. He can be reached at klaudenberger@cbmcpa.com or 301.986.0600.