

Business incentives in the Economic Stimulus Act of 2008

Congress recently passed an economic stimulus package (the Economic Stimulus Act of 2008) which is intended to jump-start our economy, in part through tax incentives aimed at encouraging businesses to increase their investments in new equipment by the end of 2008. Under the Act, small businesses will be able to write off up to \$250,000 of qualifying expenses in 2008. In addition, businesses will be able to deduct an additional 50% of the cost of certain investments in 2008. Here are the details.

Boosted section 179 expensing. Under pre-Act law, taxpayers can expense (i.e., deduct currently, as opposed to taking depreciation deductions over a period of years) up to \$128,000 for 2008. This annual expensing limit is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during 2008 exceeds \$510,000. The expensing rules are eased for qualifying empowerment zone property, renewal property, and GO Zone property. The amount of the expensing deduction is limited to the amount of taxable income from any of the taxpayer's active trades or businesses.

Under the Act, for tax years beginning in 2008, the \$128,000 expensing limit is increased to \$250,000, and the overall investment limit is increased from \$510,000 to \$800,000.

As a result of this incentive, most small businesses, and even some moderate-sized businesses with moderate capital equipment needs, will be able to obtain a full deduction for the cost of business machinery and equipment purchased in 2008, thereby reducing their effective cost for those assets. What's more, there is no alternative minimum tax (AMT) adjustment with respect to property expensed under Code Sec. 179.

Bonus depreciation makes a comeback. Bonus first year depreciation was first allowed following the terrorist attacks of 2001 but generally isn't available for property acquired after 2004. (There are some exceptions, such as for qualified GO Zone property generally placed in service before 2008.)

The Act provides for bonus (accelerated) depreciation by allowing a bonus first-year depreciation deduction of 50% of the adjusted basis of qualified property placed in service after Dec. 31, 2007, and, generally, before Jan. 1, 2009. The basis of the property and the depreciation allowances in the year the property is placed in service and later years are appropriately adjusted to reflect the additional first-year depreciation deduction. The amount of the additional first-year depreciation deduction is not affected by a short taxable year. The taxpayer may elect out of additional first-year depreciation for any class of property for any taxable year.

The interaction of the additional first-year depreciation allowance with the otherwise applicable depreciation allowance may be illustrated as follows. Assume that in 2008 a taxpayer purchases

new depreciable property and places it in service. The property's cost is \$1,000 and it is 5-year property subject to the half-year convention. The amount of additional first-year depreciation allowed under the provision is \$500. The remaining \$500 of the cost of the property is deductible under the rules applicable to 5-year property. Thus, 20 percent, or \$100, is also allowed as a depreciation deduction in 2008. Accordingly, the total depreciation deduction with respect to the property for 2008 is \$600. The remaining \$400 cost of the property is recovered under otherwise applicable rules for computing depreciation.

Bonus depreciation is allowed for AMT purposes as well as for regular tax purposes. Additionally, bonus depreciation is permitted only for: (1) property to which MACRS applies that has an applicable recovery period of 20 years or less, (2) water utility property, (3) non-custom-made computer software, and (4) qualified leasehold improvement property. Original use of the property must begin with the taxpayer after Dec. 31, 2007. Additionally, the placed-in-service cutoff date is extended for an additional year (i.e., before Jan. 1, 2010) for certain property with a recovery period of ten years or longer and certain transportation and aircraft property.

The otherwise applicable "luxury auto" cap on first-year depreciation is increased by \$8,000 for vehicles that qualify.

If you would like more details about these aspects or any other aspect of the new law, please do not hesitate to contact us.