Internal Revenue Code §179 expensing

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New technologies and entrepreneurs need a new financial model based on equity capital. Over the past 100 years, rural America has developed an elaborate debt financing network. Yet, many new rural enterprises struggle with financing because their opportunities do not lend themselves to collateral based lending. The U.S. economy is becoming more knowledge-based where success is based on intellectual capabilities that are difficult if not impossible to turn into collateral. Knowledge based activities are more conducive to equity financing instead of debt financing. But, rural America does not have an elaborate equity capital network. Despite possessing 20 percent of the business establishments in the nation, rural America has only claimed 2 percent of the nation’s venture capital investment. While new equity capital networks are emerging, they are few and far between.

**Conclusion**

Globalization presents new challenges to the rural economy. The challenges are especially intense for commodity industries that are no longer the lowest cost producers. Rural America needs new sources of competitive advantage that emerge from demand-driven technologies that produce new products developed by entrepreneurs. Seizing these opportunities may require rural America to blaze a new trial of partnership, regional competitiveness and equity capital in the 21st century.

Internal Revenue Code §179 expensing*

by Gary Hoff, Extension Specialist—Taxation, University of Illinois Income Tax School.

Taxpayers who have a farm or business have been allowed to claim a first year tax deduction up to $24,000 on qualifying purchases, e.g., of machinery and equipment. This deduction reduces the basis in the asset for purposes of regular depreciation. The Jobs and Growth Tax Relief Reconciliation Act of 2003 increased this deduction to $100,000 for tax years 2003 - 2005. The deductions will be reduced to $25,000 in 2006. The rules governing §179 are discussed in this article, using primarily agricultural examples.

**The law**

Taxpayers who are in a trade or business may elect to expense up to $100,000 of qualifying purchases in 2003 through 2006 if they meet certain conditions.

**Deduction limit**

The taxpayer may not expense an amount greater than the net income from their business plus any earned income from other sources. The taxpayer is further limited to $100,000 of IRC §179 deduction. If filing separately, one taxpayer may take a disproportionate share of the deduction with written permission of the spouse.

**Example 1** In 2003, Tom is an active farmer and has a net farm profit of $70,000 before any §179 depreciation. His wife Mary has a part-time craft business which reports a loss of $5,000 and she also works at the local WalMart where she has a gross income of $15,000. Tom and Mary are limited to a total §179 deduction of $80,000 if they have at least that amount of qualifying purchases.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Farm profit</td>
<td>$70,000</td>
</tr>
<tr>
<td>Craft business loss</td>
<td>-5,000</td>
</tr>
<tr>
<td>W-2 gross earnings</td>
<td>15,000</td>
</tr>
<tr>
<td>Eligible income</td>
<td>$80,000</td>
</tr>
</tbody>
</table>

The deduction becomes limited if the taxpayer has over $400,000 of qualifying purchases during the year and is completely phased-out at $500,000 of purchases.

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Example 2 Assume Tom and Mary had $470,000 of eligible purchases in 2003. Their §179 deduction will be limited to $30,000 calculated as follows:

- Maximum amount of 179 deduction: $100,000
- Eligible purchases: $470,000
- Threshold cost of eligible purchases: $400,000
- Reduction in limitation: $70,000
- Dollar limitation for 2003: $30,000

If their total purchases had been $420,000 or less, they could have taken a $80,000 deduction.

Entities are also allowed the §179 deduction. The dollar limit is determined at the entity level. Therefore, a partnership or S corporation is limited to a $100,000 deduction, regardless of the number of partners or shareholders involved. Since these two entities do not pay income tax, the deduction passes through to the partner or shareholder where it is further limited based on their individual income.

Example 3 ABC Partnership has three equal partners, A, B, and C. If the partnership has a $30,000 profit, it is limited to a $30,000 §179 deduction. Each partner will receive $10,000 of the deduction and $10,000 of pass-through profit.

Example 4 Assume the same facts as Example 3 except Partner B has already used $95,000 of §179 deductions from purchases made by his sole proprietor business. Since he is personally limited to a $100,000 deduction, he will only want to elect to expense $90,000 of purchases from his business. If B has excess-pass through §179 deductions, they are lost.

Example 5 Assume the same facts as Example 3 except Partner C has a $6,000 loss from his sole proprietor business. When the $6,000 loss is combined with the $10,000 partnership pass through gain, he has net eligible income of $4,000. Therefore, he is limited to a $4,000 §179 deduction. The remaining §179 deduction of $6,000 will be lost.

Any §179 deduction from eligible purchases in a partner’s sole proprietor business can be carried forward.

Qualifying purchase

The following property qualifies for the IRC §179 deduction:

1. Tangible personal property.
2. Other tangible property (except buildings and their structural components) used as:
   a. An integral part of manufacturing, production, or extraction or of furnishing transportation, communications, electricity, gas, water, or sewage disposal services.
   b. A research facility used in connection with any of the activities listed previously, or
   c. A facility used in connection with any of those activities for the bulk storage of fungible commodities.
3. Single purpose agricultural (livestock) or horticultural structures.
4. Storage facilities (except buildings and their structural components) used in connection with distributing petroleum or any primary product of petroleum.

Tangible personal property is any tangible property that is not real property. It includes the following property:

1. Machinery and equipment.
2. Property contained in or attached to a building (other than structural components), such as refrigerators, grocery store counters, office equipment, printing presses, testing equipment, and signs.
3. Gasoline storage tanks and pumps at retail service stations.

Note. Land and land improvements, such as buildings and other permanent structures, and their components, are real property, not personal property. Land improvements include swimming pools, paved parking areas, wharfs, docks, bridges, and fences. However, agricultural fences and drainage tile do qualify for IRC §179, as do single purpose agricultural or horticultural structures.
4. Breeding livestock, including horses, cattle, hogs, sheep, goats, mink, and other furbearing animals.

Non-qualifying property
Certain types of property do not qualify for the §179 deduction, such as:
1. Certain property leased to others,
2. Certain property used predominantly to furnish lodging or in connection with the furnishing of lodging,
3. Air conditioning or heating units,
4. Property used predominantly outside the United States (except property described in IRC §168(g)(4) —commercial airliners, ships, containers, etc.)

These non-qualifying property types are not normally found on farm and ranch tax returns.

Timing of the IRC §179 election
The election must be made on the first tax return filed after the taxable year to which the election applied. It does not matter if the return is timely filed, however, a taxpayer can only amend a return to claim the election if the amended return is filed within the time limit for filing the original return plus extensions.

Example 6 Kevin is a calendar year tax filer. His 2003 tax return is due no later than April 15, 2004, but he may file for up to a six months extension. Therefore, the last date for Kevin to file his 2003 return is October 15, 2004. Assuming Kevin does not file by this time, he can still claim the §179 deduction when he files.

Example 7 Horace timely files his 2003 return on April 15, 2004. He later wishes to claim a §179 deduction. The last date Horace may claim the deduction on an amended return is October 15, 2004. When Horace files his amended return he must write “Filed pursuant to section 301.9100-2” on the amended return.

Tax planning using the IRC §179 deduction
From a tax-planning standpoint, many variables have to be taken into account to determine if the election of the IRC §179 deduction is appropriate to a specific taxpayer. Some of the more common planning considerations are:

- Marginal tax bracket of the taxpayer.
- Profitability of the business and availability of other income to satisfy the taxable income limitation.
- Future marginal tax rates of the client.
- Other asset acquisitions during the year.
- Status of estimated tax payments made for the current year.
- Does the client need the asset for the business, or is the acquisition more tax motivated?
- Will the subject asset(s) be sold or traded in later years?
- Did the taxpayer purchase both shorter use-life and longer use-life assets?
- IRC §179 deduction used as an effective means to reduce possible vulnerability to repair versus capital improvement issues with the IRS.
- Allocation of IRC §179 from other entities.
- Use of IRC §179 and its impact on social security benefits.