Temporary law can mean HUGE tax savings for 2011 equipment buyers
By Christian A. Klein

Improving business conditions aren't the only reason forward-thinking companies are making new capital investments this year. Congress and the president have enacted temporary tax laws to encourage companies to buy now. The incentives created in December 2010 are the most significant in a generation. If your company purchases equipment in 2011, you can dramatically reduce what you send to Uncle Sam this year.

The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (TRJA) extended and expanded the depreciation bonus created in 2008. For 2011, it's an unprecedented 100 percent; for 2012, it's 50 percent. By lowering your taxable income, bonus depreciation can significantly cut your 2011 and 2012 federal tax bills, freeing up cash in the near term.

Assume you buy and place in service in 2011 a new piece of equipment costing $100,000. Using bonus depreciation, you can "write off" the full amount this year, reducing your taxable income by $100,000. If you're in the 35 percent tax bracket, that can reduce your 2011 tax bill by $35,000.

In 2012, things get a little more complicated: the depreciation bonus will fall to 50 percent. You'll be able to write off half the purchase cost plus the percentage of the remaining basis you'd ordinarily write off in the first year. For a $100,000 machine with a five-year MACRS life you'll be able to write off $60,000 ($50,000 with bonus depreciation plus one-fifth of the remaining $50,000 in basis).

There are some important nuances to keep in mind:

First, to qualify for bonus depreciation, the equipment must be new. That means the "first use" must occur with the taxpayer who claims the benefit. Used equipment that doesn't qualify for bonus depreciation might still qualify for Sec. 179 expensing (see below).

The equipment has to be placed in service in the year in which you claim the bonus (2011 for 100 percent and 2012 for 50 percent). In other words, if what you're buying takes a long time to deliver, don't wait until December to place your order.

Next, the property must to fit into one of the categories for which bonus depreciation is allowed: property depreciable under the Modified Accelerated Cost Recovery System (MACRS) with a recovery period of 20 years or less (most tangible property used in a business will fall into this category), as well as select water utility property, computer software, and leasehold improvements.

Bonus depreciation is elective, not mandatory. You don't have to use it if you don't want to. And it applies for both regular and alternative minimum tax purposes.

But there are some potential downsides. The more you depreciate now, the less you'll be able to depreciate later. In other words, your tax bill in future years may be higher because you'll have less to deduct. Also, if you depreciate 100 percent now and sell the asset before the end of the asset's MACRS recovery period, it may increase your tax bill in the year you sell. (Like-kind exchange (LKE) can help mitigate some of that potential depreciation bonus "hangover".) And some states don't recognize the depreciation bonus, which may result in additional tax complexity.

But when considering the downsides, consider this: Would you rather take the tax break now and invest the money in your company, or would you rather let the U.S. government hold onto it for you for the next several years?

Congress also recently changed Sec. 179 expensing rules. For the 2011 tax year, companies can expense up to $500,000 as long as total purchases don't exceed $2,000,000. For each dollar over, the eligible expensing amount correspondingly drops by one dollar. The TRJA extended Sec. 179 expensing through 2012 but lowers the benefit to $120,000 with a $500,000 phase out threshold. Eligible taxpayers can combine Sec. 179 and bonus depreciation for even bigger tax savings.

From a tax standpoint, there's never been a better time to invest in your company's future. Of course, this article doesn't constitute specific tax or legal advice, so be sure to check with your accountant or tax professional if you want to take advantage of the law. But don't wait … the clock is ticking!

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