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The Economic Stimulus Act of 2008: Depreciation Provisions

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Along with the much-trumpeted personal rebates, the Economic Stimulus Act of 2008 (P.L. 110-185) provides substantial, if temporary, incentives for businesses to acquire certain business assets during 2008. The intent of these incentives was to stimulate the economy by stimulating the production of capital assets and, not incidentally, to create the appearance of a concerned federal government ahead of the November elections. The incentives come from a temporary liberalization of the Section 179 provisions and a temporary renewal of the Section 168(k) bonus depreciation provisions.

Section 179 provides for the immediate deduction of the cost of certain new business assets purchased by small businesses. This section allows for certain costs that would normally be depreciated to instead be expensed in the year of acquisition. The deduction is limited by a cap on total asset purchases during the year. Once the cap is reached, the deduction is reduced dollar for dollar for each excess dollar of assets purchased. In 2007, the indexed deduction limit was $125,000, and the indexed asset cap was $500,000. The Act dramatically increased these amounts for one year. For tax years beginning in 2008 only, the deduction limit increased to $250,000, and the cap increased to $800,000. This provision, therefore, provides additional cash to small business owners by allowing them to write off the cost of purchased assets in the year of purchase. For example, a company that purchases $250,000 of qualified assets and that has a 35% tax rate can reduce its tax liability by $87,500 ($250,000 x 0.35) less the tax savings from the depreciation that could have been taken on these assets. But even a company purchasing *$1 million* in new qualifying assets could still have a Section 179 "small" business deduction of $50,000 (or a tax savings of approximately $17,500 ($50,000 x 0.35), as demonstrated in Table 1).

There are several restrictions on the use of Section 179. First, the assets must be tangible, business property (or certain qualifying computer software) used in an active trade or business. Next, the deduction is only allowable to the extent that the business has income. Section 179 deductions in excess of business income do not create losses; rather, the deductions are deferred

Table 1. Section 179 Deduction with $1 Million in New Asset Purchases

Qualifying new assets	$1,000,000
Section 179 cap (2008 only)	(800,000)
Disallowed deduction	200,000
Maximum deduction (2008 only)	250,000
less Disallowance	(200,000)
Section 179 Deduction	50,000

Note: This table assumes the business has taxable income of $50,000.

and carried forward to future tax years. Finally, since Section 179 is effectively treated as an immediate form of depreciation, it is subject to the same recapture provisions as MACRS for early disposition or reduced business use.

The Act's second major business incentive is the renewal of the Section 168(k) 50% bonus depreciation provisions for assets placed in service during calendar year 2008. Section 168(k) was originally enacted to stimulate business investment after September 11, 2001, and remained active in some form until December 31, 2004. The current form allows for an immediate deduction of 50% of the acquisition cost of qualifying assets. In order to qualify, the asset must: (1) have a MACRS class of 20 years or less; (2) be certain business computer software; (3) be a water utility property; or (4) be a qualified leasehold improvement. The deduction doesn't have caps or general dollar deduction limits, but it is limited to the original user of the property—that is, first use of the property.

Bonus depreciation also eliminates the calculation of an AMT adjustment with respect to the asset. This applies to the first year (in which bonus depreciation is claimed) and the remaining years of the asset's life. If a taxpayer elects out of bonus depreciation, then the normal AMT adjustment will apply for all years of the asset's life. In choosing whether or not to elect out of bonus depreciation, taxpayers need to look at both the direct 50% expense amount and the benefit of not making an AMT adjustment for the asset.

Since both Sections 179 and 168(k) pertain to immediate expensing of what would normally be MACRS depreciation, there are rules governing the interaction of the special provisions and the regular system. The taxpayer is allowed to use all three on the same asset! For example, a profitable business purchasing a qualifying $500,000 MACRS seven-year asset could deduct the maximum Section 179 deduction of $250,000, then take 50% of the balance as a Section 168(k) deduction, then apply the normal MACRS procedure to the remaining balance, as shown in Table 2.

Table 2. Comprehensive Example for MACRS Seven-year Property

Qualifying Assets	$500,000
Maximum Section 179 deduction (2008)	(250,000)
Balance	250,000
Section 168(k) Bonus Depreciation	(125,000)
Balance	125,000
MACRS depreciation, seven-year life, mid-year convention, percentage rate 14.29%	(17,863) rounded
Undepreciated Balance, End of first year for $500,000 seven-year asset	107,137
Total depreciation deducted in year of purchase, $500,000 seven-year asset	392,863

In a curious quirk, the technical choice of the use of these provisions differs. A taxpayer must actively elect to use Section 179. The use of Section 168(k) is assumed, however, and a taxpayer must actively elect out of the treatment should he or she not want the bonus depreciation.

Both of these temporary provisions offer attractive, if brief, tax saving opportunities for businesses. As shown in our second example, well over half of an asset's purchase price may be deductible this year. Business managers need to seriously evaluate their capital budgets with an eye toward moving purchases into 2008 instead of 2009 in order to take advantage of these incentives. Likewise, if the purchases are more than $800,000 and the excess purchases are expected to be less than the 2009 Section 179 asset cap, the business manager may want to delay some of the purchases planned for the last quarter of 2008 until the first quarter of 2009 in order to use the normal Section 179 amount for 2009 if this is more beneficial than the bonus depreciation, thereby maximizing the use of these two tax provisions. ■

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