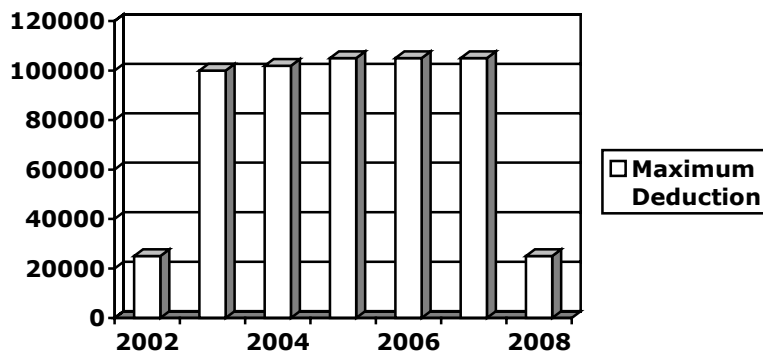


## DEPRECIATION: MAXIMIZING ITS BENEFITS

### Section 179 Depreciation

Depreciation is an important element in reducing the taxable income of a business. Although the temporary bonus depreciation is no longer applicable, accelerated depreciation under Section 179 remains available. Section 179 allows you to deduct the entire cost of a qualified asset in the year it was acquired. In 2006, a business can deduct \$108,000. This limit will also be adjusted for inflation in 2007. Unfortunately, in 2008 the limit of this deduction will revert to \$25,000.

In Pennsylvania, the maximum allowable deduction for personal income taxes (Schedule C, Partnership returns, & S corporations) is \$25,000.



### Limitations on the cost of Property

The maximum allowable deduction is reduced by the amount over a limit on the cost of the property. Before 2003, this limit was \$200,000. In 2006, it will be \$430,000. If the cost of your qualifying Section 179 property is more than \$430,000, you must deduct the amount over \$430,000 from the deduction limit. For example, if the cost of the property to be depreciated was \$482,000, it would be \$52,000 over the limit. The deduction limit of \$108,000 would be reduced by \$52,000 to \$56,000. If the cost is \$538,000 or more, you cannot take a Section 179 deduction.

To qualify for Section 179 depreciation

- It must be eligible property.
- It must be acquired for business use (used more than 50% business).
- It must have been acquired by purchase.
- It can be used property, as well as new property.

### What Property is Qualifying?

Qualifying property is

- Tangible personal property including machinery and equipment.
- Other tangible property (except for buildings and their structural components) that is an integral part of manufacturing, production or extraction.
- A research facility used in connection with manufacturing, production or extraction.
- A facility used in connection with manufacturing, production or extraction for the bulk storage of fungible commodities.
- Off the shelf computer software if it is readily available for purchase by the general public, is subject to a non-exclusive license and has not been substantially modified. Databases that are not in the public domain, do not qualify.

### **Eligible Property Must Have a Business Use**

To be eligible the property must have been acquired for business use. Certain property does not qualify. These include investment property, rental property and property that produces royalties.

If the property is used both for business and non-business purposes, its business use must exceed 50% of its total use. The deduction is calculated by multiplying the percentage of business use by the cost. For example, if the property cost \$100,000 and 75% of its use is for business purposes, \$75,000 of the cost is eligible for depreciation.

### **Eligible Property Must be Purchased**

Property is not considered to be acquired by purchase if:

- It is acquired by one member of a controlled group from another member of the group.
- It is a gift or inheritance
- It is acquired from a related person.

### **What is not Eligible Property?**

Land and improvements such as buildings and other permanent structures and their components are real property, not personal property and are not qualified as Section 179 property.

Generally, you cannot claim a Section 179 deduction on leased property unless it is property that you manufacture or purchase and lease to someone else.

The term of the lease must be less than 50% of the property's useful life.  
The deductions that you are allowed on the property cannot be more than 15% of the rental income from the property.

If you buy qualifying property with cash and a trade-in, only the cash portion of the purchase is eligible to be used for the Section 179 deduction.

## **Other Limitations**

Although the total amount that you can deduct for Section 179 in 2006 is \$108,000, this amount can be allocated among several qualifying items and you do not have to claim the full \$108,000.

The total Section 179 deduction cannot exceed the taxable income from the business. Any cost not deductible because of the income limitation can be carried over into the following year. Taxable income must be calculated without regard to:

- The Section 179 deduction
- The self-employment tax deduction
- Any net operating loss carry back or carry forward
- Any unreimbursed employee business expenses

If the business use of the property drops below 50% in any year, you must recapture the deductions made on that property. The recapture is treated as income, but the recapture amount is added to the basis of that property for future depreciation.

*---Joseph C. Paparone II, CPA*

*Editor's note ---Joe is a Partner in the Grove City Office. A significant and growing portion of his practice is the manufacturing sector.*