From the desk of Vladimir Turkeltaub, MS, CPA, EA

Too Good to Be True and Getting Even Better

I am talking about expensing large equipment purchases by small businesses. Usually it is hard to comprehend why a small business spends money to buy a piece of expensive equipment but cannot deduct it as an expense in the year it is purchased. The reason for this is what is known as capital expenditure. If the life-span of an item is more than a year it should be expensed over a reasonable period that corresponds to the life span of the item.

US congress and IRS gave small businesses a break and allowed yearly expense on purchased equipment of up to $25,000. For a small business, this meant that if you bought, let's say a computer for $2,500, you did not have to deduct only a part of it each year but could deduct the whole amount in the year when it became operational in the business. The total amount of purchased equipment that a business owner could handle that way was $25,000. There were other restrictions but I am sure you got the idea. This kind of deduction is known as Section 179 deduction that reflects IRS code section.

By speeding up the deduction US congress could stimulate the economy and promote purchases of the new equipment by small businesses and correspondingly lowering taxes on the businesses. It is evident that larger businesses would only marginally benefit from this tax break.

The Protecting Americans from Tax Hikes Act of 2015 (the PATH Act) permanently increased Section 179 deduction to $500,000 and it is also indexed this deduction for inflation in the future years. This deduction also has a phase-out threshold of $2,010,000 (phase-out deduction means that that the allowable amount of deduction is lowered if the total cost of purchased equipment for the tax period exceeds $2,010,000).

Section 179 deduction creates additional opportunities for the taxpayers and practitioners. We should not only consider the benefits of current year deduction but also take into consideration potential smaller deduction in the future years: the equipment needs are always limited and we always hope that the normal pattern for any business is to continue to grow.

Personally, I expected that as the economic conditions in the country improve congress would go back to significantly lower Section 179 allowance. Lucky for the businesses my expectations were proved wrong.

It is now rumored in Washington that the new administration is considering removing any limitation in expensing of equipment. For tax purposes, businesses will be able to deduct purchased equipment across the board in the year it was purchased. Moreover, the law will be retroactive from January 1, 2017.

I am closely monitoring the developments. Please stay tuned.