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Economic Stimulus Act

Blytheco LLC
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This report highlights the depreciation changes in the Economic Stimulus Act of 2008 that affect taxpayers. It is informational only and not meant as accounting or tax advice. Exceptions and special provisions are not covered, so you should consult your accounting and tax professionals for advice specific to your situation.

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Introduction

Congress recently passed the Economic Stimulus Act of 2008 (HR 5140 - Pub. L. No. 110-185, 122 Stat. 613,) intended to fuel the United States economy through tax incentives aimed at encouraging businesses to increase investments in equipment, software, and other qualifying assets in 2008. This act was signed into law by the President on February 13, 2008, and applies to qualifying purchases placed in service by the end of 2008.

Tax code changes under the Act allow businesses to write off up to $250,000 of qualifying Section 179 property in 2008. In addition, businesses will be able to deduct an additional 50% of the cost of certain investments with an expected life of 20 years or less.

If you've had exposure to tax law changes throughout this decade, you'll recognize that the provisions of the Economic Stimulus Act are not “new.” For example, the increased Section 179 write-off existed prior to this year's Act and bonus depreciation was used as an economic stimulus tool following the September 11, 2001 terrorist attacks and Hurricane Katrina in 2005. However, prior to this year's Act, the expensing benefits intended to help small businesses make capital investments using Section 179, as well as bonus depreciation opportunities had, for the most part, expired.

With the return of bonus depreciation benefits, nearly double the Section 179 expensing limits, and increased investment limits, this year's Economic Stimulus Act is expected to encourage more businesses to accelerate capital investments into their 2008 budgets allowing them (and our economy!) to keep growing into the future. This document explains:

- Key components of the Act
- How these changes affect your business
- How to take full advantage of these benefits, including opportunities for:
    - Maximizing Section 179 expense increases by carefully choosing longer-life assets and placing them in service at the appropriate time
    - Using Bonus Depreciation to quickly recover the cost of equipment, software, and other qualifying asset purchases made in 2008
    - Managing complex tax code changes through the use of software

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Key Components of the Act

Boosted Expensing Applicable to More Businesses

Prior to this year's Economic Stimulus Act, Section 179 provided businesses with the ability to expense up to $128,000 of property placed into service during the 2008 tax year. Intended to help small businesses in particular, this expensing provision includes an "investment limit." This investment limit requires a dollar-for-dollar decrease in the amount that can be expensed when qualified property exceeds a certain ceiling. Prior to the new Economic Stimulus Act of 2008, that ceiling was $510,000. Under the new Economic Stimulus Act, Code Section 179 is modified to temporarily raise both the expensing amount and the investment limit. The $128,000 expensing amount is increased to $250,000 and the overall investment limit for qualified property is increased from $510,000 to $800,000 (at which point the expense amounts decrease dollar-for-dollar). This means that companies which previously didn't qualify for Section 179 expensing may, in fact, qualify this year.

Consider a company that planned to invest $700,000 in 2008. Under rules prior to the Act, the company would not be eligible to take advantage of the Section 179 expensing provisions. Due to the dollar-for-dollar decrease in the expensing amount that began at $510,000, the company would not be eligible for any expensing because their investment exceeded $638,000 ($128,000 + $510,000). In this case, the company's only option would be to capitalize the entire investment and take normal depreciation deductions over the lives of the assets.

Under the new Economic Stimulus Act, this company would be able to immediately write-off their full $700,000 investment in 2008. In fact, the company can choose to accelerate purchases planned for later years into 2008 reduce the risk of exceeding the investment limit in future years. In this example, the company has an additional $100,000 of immediate investment available before the limit even begins!

Some Rules and Caveats

- Qualifying property includes tangible property that is purchased for active use in the conduct of business. This can include anything that is an integral part of manufacturing, production, transportation, communication, electricity, gas, water, or sewage disposal services. Most commercially available software, which isn't typically considered "tangible," is also recognized as qualifying property (as specified in IRC Section 167).
- The property must be purchased, and placed in service during your company's 2008 tax year (which in some cases may be a fiscal year), and must be used more than 50% for business in order to qualify for expensing.
- A company may not apply the Section 179 deduction if there is no taxable income derived from the active conduct of a trade or business. Deductions can, however, be carried over to a later year in which the business has taxable income. Furthermore, write-offs cannot exceed taxable income. If a company has only $50,000 of taxable income, then their write-off limit is $50,000.
- If the cost of the property that qualifies for Section 179 exceeds $800,000, the amount a company can deduct is reduced by the amount the value of the property exceeds $800,000. For example, if a company purchases a piece of equipment for $900,000, the maximum deduction the company can take is $150,000. (First the amount over the investment limit is calculated: $900,000 - $800,000 = $100,000. Then the Section 179 expense is reduced by that amount: $250,000 - $100,000 =$150,000.) This means, that in 2008, any taxpayer spending between $800,000 and less than $1,050,000 in capital investment will be able to write-off a portion of the amount spent.

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- It is important to note that the expensing limits only apply to fiscal tax years that begin during 2008. Companies that have fiscal years that begin at other times during the calendar year (e.g. September 2007) will not benefit from the higher expense limits until the start of their next fiscal year (September 2008), and will be subject to the 2007 expensing amounts of $125,000/$500,000 applicable for the 2007 fiscal year begins.

Taking Advantage of 2008 Increased Write-Off Opportunity

Timing is everything! The Section 179 increases specified in the Economic Stimulus Act are available only for assets purchased and placed in service during the 2008 tax year. In 2009 and 2010, the limits drop back to $125,000 (indexed for inflation) and to $25,000 for 2011 and beyond, with no inflation adjustments. Here are a few things to consider as you place assets into service during the 2008 fiscal year:

- With careful planning, you can maximize your deductions by allocating the Section 179 expense opportunities to assets with longer recovery periods. In this way, the cost of all property is ultimately recovered over a shorter period of time.
- Code Section 167 makes “off-the-shelf” computer software eligible for Section 179 expensing. Although this provision has been around since 2002, it is scheduled to phase out after 2010. If your longer-recovery-period assets haven’t maxed out your increased Section 179 limits, consider writing off Sec. 167 software placed in service in 2008.
- If you are purchasing a significant portion of fixed assets in the fourth quarter of your fiscal year, taking Section 179 can reduce the depreciable basis of the assets and prevent exceeding the 40% test that would trigger the requirement to use the mid-quarter convention.

Welcome Back Bonus Depreciation

Next to fully writing off the entire cost of new property, the re-enacted bonus depreciation of 50% is a significant investment incentive, expected to inject over $40 billion into the U.S. economy in 2008. Because it has no investment limits, bonus depreciation can benefit almost every business operating within the United States, including larger businesses that may be ineligible for Section 179 expensing due to the investment limits.

As stated previously, bonus depreciation isn’t a new concept. You may remember a 30% first year bonus depreciation incentive under Code Section 168(k) of the Job Creation and Worker Assistance Act of 2002. The Jobs and Growth Tax Relief Reconciliation Act of 2003 increased this incentive to 50%. Since 2004, however, Section 168(k) bonus depreciation opportunities had all but expired for most businesses, with just a few exceptions for businesses located in areas like the Gulf Opportunity Zone and in the New York Liberty Zone. The provisions of bonus depreciation under the Economic Stimulus Act of 2008 are identical to previous versions, except the “placed in service” dates for newly acquired property must be within the 2008 calendar year beginning January 1, 2008 and ending December 31, 2008.

Essentially, bonus depreciation (also called “accelerated depreciation”) enables a company to immediately expense, as depreciation, a portion of the cost of an asset; thereby reducing the value, or adjusted basis, of property that must be capitalized. For example, if a company purchased $10,000 worth of commercial software, it can immediately expense $5,000 of the cost of the software as depreciation. The remaining depreciable basis of the software would immediately drop to $5,000. The $5,000 is capitalized and is eligible for regular depreciation deductions based on method and life. So, assuming this software is classified as 3-year Sec. 167 computer software, the company can take an additional $1,666.67 ($5,000 using straight-line depreciation over 3 years) worth of regular depreciation. This brings the total first year write-off of this investment to $6,666.67 for 2008, compared to only $3,333.33 prior to the new Stimulus Act! The remaining depreciable basis of $3,333.33 will expensed ratably over the remaining life of the investment.

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Some Rules and Caveats

- Bonus depreciation is permitted for:
  - Modified Accelerated Cost Recovery System or "MACRS" property with an applicable recovery period of 20 years or less
  - Commercial, off-the-shelf (non-customized) computer software that is depreciable over 3 years and that is not treated as intangible property under Section 197.
  - Water utility property
  - Qualified leasehold improvement property
- The property must be purchased, and placed in service during the 2008 calendar year, and must be used more than 50% for business in order to qualify for expensing in a taxable year. Note this applies to fiscal year filers who purchase assets before their 2007 fiscal year-end!
- Property subject to a binding written contract for its acquisition effective before 2008 is not eligible for bonus deprecation, even if it is placed in service during the 2008 calendar year.
- For property with a recovery period of more than 10 years, transportation property, and certain aircraft, an extension of the "placed in service" date of one year, through December 31, 2009, is possible if the estimated production period of the asset is more than one year and the cost is greater than $1,000,000. The contract must be entered between January 1, 2008, and December 31, 2008, and construction of the property by the manufacturer must begin during the same time period.
- There are some assets that do not qualify for the bonus depreciation, including depreciation on qualified GO Zone property, assets that are subject to depreciation under the Alternative Depreciation System (ADS), and assets that are acquired and disposed of in the same fiscal year. It is imperative to see if the bonus depreciation applies to the asset in question.

Section 167 Software Defined

Eligible computer software includes software that is readily available for purchase by the general public, is subject to a nonexclusive license, and has not been substantially modified. Software is deemed to be substantially unmodified if the cost of all modifications does not exceed the greater of 25% of the cost of the unmodified software (available to the general public) or $2,000.

Taking Advantage of 2008 50% Bonus Depreciation

This bonus depreciation opportunity exists only for the 2008 calendar year. Because the effective date differs from the Section 179 expensing benefit, which is fiscal-year based, careful analysis should be made when placing assets into service this year in order to maximize the benefits of the Economic Stimulus Act. Consider these scenarios:

- Company XYZ has a fiscal year beginning in July. The 2007 tax year ends in June, 2008. They are planning to purchase a piece of equipment that costs $250,000. If they place this equipment in service in May during their 2007 tax year, they can expense only $125,000 of the cost because Section 179 increases enacted by the Economic Stimulus Act are available only for the 2008 tax year. However, the remainder of the cost, $125,000, can then be reduced using the 50% bonus depreciation benefit, but, ultimately, the company will pay a higher amount of taxes over the life of the equipment than if they had chosen to place the equipment in service in July during the 2008 tax year instead (wherein, they could have expensed the entire $250,000).

TIP: For qualified Section 179 assets in specific areas within the Gulf Opportunity (GO) or Enterprise Zones, the depreciation is higher.

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- For many companies, the fiscal year matches the calendar year. Companies have an option to expense as many longer-life assets as possible, applying bonus depreciation for assets with shorter recovery lives in order to maximize their tax benefits. Continuing the example above, Company XYZ places the $250,000 piece of equipment into service in July. Then they make $100,000 worth of software purchases in September. They will recover the cost of the software quicker than the cost of the equipment, which has a longer depreciable life under MACRS. In the longer run, they'll save tax dollars by expensing the entire $250,000 piece of equipment using the increased Section 179 write-off opportunity and then use the 50% bonus depreciation to reduce the basis of the software to $50,000.

"Luxury" Auto Depreciation

The final component of the Economic Stimulus of 2008 temporarily increases the cap on the depreciation for qualifying vehicles by $8,000, resulting in a maximum allowable depreciation of $10,960 automobiles, and $11,160 for vans and trucks. This depreciation cap increase applies to vehicles that are used predominantly for work use.

While the definition of "luxury" in the tax code may not be perceived as very luxurious – unloaded gross vehicle weight of 6,000 pounds and slightly more than $15,000 or more for automobiles and $15,000 or more, and a loaded gross vehicle weight rating of 6,000 pounds for trucks and vans – the "luxury" auto bonus depreciation provides yet another financial incentive for companies that purchase a vehicle between January 1, 2008, and December 31, 2008.

The maximum allowable depreciation schedule for qualifying vehicles placed in service by the taxpayer in the 2008 calendar year, is listed below:

	Autos			Trucks and Vans
1st Tax Year	$ 10,960		1st Tax Year	$ 11,160
2nd Tax Year	$ 4,800		2nd Tax Year	$ 5,100
3rd Tax Year	$ 2,850		3rd Tax Year	$ 3,050
Subsequent Tax Years	$ 1,775		Subsequent Tax Years	$ 1,875

Note: Maximum depreciation schedules exist for other types of vehicles.

TIP: Qualified non-personal use vehicles (i.e. a vehicle that by reason of its nature and design, is not likely to be used more than a minimum for personal purposes, due to modifications) is not subject to "Luxury" Auto Depreciation schedules and can be expensed under Section 179 rules.

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Managing Tax Change Complexity

Diligently keeping up with yearly changes to the tax code and determining how they affect your business can be a daunting task. The federal tax code has grown from approximately 400 pages in 1913 to over 66,000 pages in 2006. More than 5,000 pages were added between 2005 and 2006 alone!

Actually implementing all those tax code changes into your accounting processes can be even more daunting, especially if you're using spreadsheets or other manual procedures. As the examples in this paper illustrate, there are numerous scenarios for calculating the depreciation of your company's assets. Different types of assets can be depreciated in various ways over different periods of time. The decisions you make ultimately impact your company's bottom line.

Companies seeking ways to maximize their earnings must look to software solutions that are designed to swiftly and accurately implement the myriad of tax law changes occurring annually. Accounting solutions offered by Sage Software, have built-in business rules and processes that accurately and automatically factor in the latest tax law changes, ensure consistent GAAP practices, reduce errors, and enable sound financial tracking and reporting.

The Economic Stimulus Act of 2008 provides you with the perfect opportunity to put an accounting software solution in place. Not only can you immediately expense or write-down the cost of your software purchase, the return on your investment will be apparent in your tax and financial statements.

FAS Asset Accounting

Implementing a best of breed fixed asset accounting solution, such as Sage FAS, ensures your company is maximizing its tax savings and you're properly depreciating your fixed assets.

FAS Asset Accounting provides you with the flexibility needed to satisfy your specific requirements. It is a comprehensive solution that provides advanced fixed asset accounting and reporting features for businesses needing effective decision-making tools in integrated accounting environments. FAS Asset Accounting offers more than 50 depreciation methods, including MACRS 150% and 200% (formulas and tables), ACRS, Straight-Line, Modified Straight Line (formulas and tables), Declining Balance, Sum-of-the-Years-Digits, and user-defined depreciation methods. And with FAS SupportPlus, all version updates provide you with the most up-to-date IRS tax laws and GAAP rules, as well as all product enhancements.

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