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Expensing and additional first-year depreciation in the 2010 Tax Relief Act

The recently enacted 2010 Tax Relief Act includes a wide-ranging assortment of tax changes affecting both individuals and business. On the business side, two of the most significant changes provide incentives for businesses to invest in machinery and equipment by allowing for faster cost recovery of business property. Here are the details.

Expansion and extension of additional first-year depreciation. Businesses are allowed to deduct the cost of capital expenditures over time according to depreciation schedules. In previous legislation, Congress allowed businesses to more rapidly deduct capital expenditures of most new tangible personal property, and certain other new property, placed in service in 2008, 2009, or 2010 (2011 for certain property), by permitting the first-year write-off of 50% of the cost. The new law extends and temporarily increases this additional first-year depreciation provision for investment in new business equipment. For investments placed in service after September 8, 2010 and through December 31, 2011 (through December 31, 2012 for certain longer-lived and transportation property), the new law provides for 100% additional first-year depreciation. In other words, the entire cost of qualifying property placed in service during that time frame can be written off, without limit. Note that even though the legislation did not take shape in Congress until mid-December of 2010, the effective date of this provision was made retroactive, to include qualifying property placed in service after September 8, 2010.

Fifty percent additional first-year depreciation will apply again in 2012.

The Act extends through 2012 the election to accelerate the AMT credit instead of claiming additional first-year depreciation.

The new law leaves in place the existing rules as to what kinds of property qualify for additional first-year depreciation. Generally, the property must be (1) depreciable property with a recovery period of 20 years or less; (2) water utility property; (3) computer software; or (4) qualified leasehold improvements. Also the original use of the property must commence with the taxpayer – used machinery doesn't qualify.

Enhanced small business expensing (Section 179 expensing). Generally, the cost of property placed in service in a trade or business can't be deducted in the year it's placed in service if the property will be useful beyond the year. Instead, the cost is "capitalized" and depreciation deductions are allowed for most property (other than land), but are spread out over a period of years. However, to help small businesses quickly recover the cost of capital outlays for qualifying personal property, small business taxpayers can elect to write off these expenditures in the year of acquisition instead of recovering the costs over time through depreciation. The expense election is made available, on a tax year by tax year basis, under Section 179 of the Internal Revenue Code, and is often referred to as the "Section 179 election" or the "Code Section 179 election." The new law makes three important changes to the Code Section 179 expense election.

First, the new law provides that for tax years beginning in 2012, a small business taxpayer will be allowed to write off up to \$125,000 (indexed for inflation) of capital expenditures subject to a phaseout (i.e., gradual reduction) once capital expenditures exceed \$500,000 (indexed for inflation). The new maximum expensing amount and phaseout level for tax years beginning in 2012 is actually lower than the levels in effect for tax years beginning in 2010 or

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2011 (maximum expensing amount of \$500,000, and a phaseout level of \$2,000,000). For tax years beginning after 2012, the maximum expensing amount will drop to \$25,000 and the phaseout level will drop to \$200,000.

Second, the rule which treats off-the-shelf computer software as qualifying property is extended through 2012.

Finally, the new law extends, through 2012, the provision permitting a taxpayer to amend or irrevocably revoke a Code Sec. 179 expense election for a tax year without IRS's consent.