

EXPANSION OF SECTION 179 EXPENSING

Section 179 of the tax code provides businesses with an election to recognize a current expense deduction for the entire cost of certain depreciable assets, subject to limitations, in the tax year such assets are placed into service. The newly-enacted Small Business Jobs Act of 2010 (“SBJA”) increases the amount of expense deductions a business may elect to recognize under section 179 for certain operating assets for tax years beginning in 2010 and 2011 and expands the election to apply to certain real property in such years.

INCREASE OF SECTION 179 EXPENSING

Pre-SBJA, section 179 permitted businesses to elect to deduct up to \$250,000 of the cost of personal depreciable property for tax years beginning in 2009 and 2010 as a current expense, with a sharp drop in deductible limit for tax years beginning in and after 2011 to \$25,000. These limits were subject to “phase outs” that reduce the maximum deductible dollar for dollar by such costs in excess of \$800,000 for the 2009 and 2010 tax years and \$200,000 for tax years beginning in and after 2011. These allowances and limits are adjusted for inflation each year by the IRS.

The SBJA increases the amount of expensing permitted under section 179 for tax years beginning in 2010 and 2011 to \$500,000 per year, increases the phaseout amount in those tax years to \$2,000,000, and delays the return of the \$25,000 deductible limit to tax years beginning in 2012.

The following table provides a pre- and post-SBJA comparison of the section 179 expense allowances and phaseout amounts for such allowances:

	Tax Years Beginning In			
	2009	2010	2011	2012 and After
Pre-SBJA (prior law)				
Total Deductible Expense Amount Allowed	\$250,000	\$250,000	\$25,000	\$25,000
Phaseout Amount	\$800,000	\$800,000	\$200,000	\$200,000
Post-SBJA (existing law)				
Total Deductible Expense Amount Allowed	\$250,000	\$500,000	\$500,000	\$25,000
Total Deductible Expense Amount Allowed attributable to "Qualified Real Property"	n/a	\$250,000	\$250,000	n/a
Phaseout Amount	\$800,000	\$2,000,000	\$2,000,000	\$200,000

EXPANSION OF SECTION 179 EXPENSING TO QUALIFIED RESTAURANT PROPERTY

Prior to the passage of the SBJA, business owners under section 179 could only elect to expense the cost of tangible personal business property (and certain computer software). The cost of acquiring real property for business use was not eligible as an expense deduction under section 179 and could only be recovered as depreciation deductions over multiple tax years. The

SBJA extends section 179 to apply to the cost for certain leasehold improvement property, certain restaurant property, and certain retail improvement property (collectively, “qualified real property”).

The SBJA, in particular, extends section 179 to provide a restaurant or eatery business the election to expense the cost for acquiring a building with more than 50 percent of the square footage devoted to the preparation of and seating for on-premise consumption of prepared meals (“qualified restaurant property”) for tax years beginning in 2010 and 2011 to the extent such buildings are put into service in those tax years. Outside of an election under section 179, the cost of a building must generally be depreciated over 39 years. Limitations and restrictions, however, do apply to the expensing of qualified restaurant property under section 179. Not more than \$250,000 of the \$500,000 limitation on the amount of qualifying section 179 costs that can be expensed in those tax years may be attributable to qualified real property. Furthermore, the amounts of section 179 expenses disallowed because they are in excess of the business’s taxable income for the tax year, which generally would be carried forward to the subsequent tax year, cannot be carried over to a tax year beginning after 2011 if those expenses are attributable to qualified real property.

EXAMPLES

The foregoing presents a general explanation of the changes made to section 179 under the SBJA and the examples present simple fact patterns to illustrate the basic aspects of these changes. Section 179 is a very technical provision to apply, based on an extensive set of regulations, and dependent on the specific facts of each taxpayer.

Example 1

Restaurant business purchases a building that is a “qualified restaurant property” for \$390,000 and places it into service in 2010. Business has no other section 179 qualifying expenditures. The business is a calendar year taxpayer and its total income (net all other tax deductible expenses) for 2010 is \$500,000. Only \$250,000 of the building’s cost is deductible as a current expense under section 179 because of the general limitation on qualified real property costs. Business elects to expense the \$250,000 of building costs under section 179 and its resulting taxable income for 2010 is \$250,000 (\$500,000 - \$250,000). The remaining \$140,000 cost of the building must be depreciated over 39 years starting in 2011.

Pre-SBJA, the restaurant would only be allowed to deduct the depreciation cost of the building over 39 years on a straight-line method (*i.e.*, \$10,000 of depreciation deduction per year), resulting in a taxable income of \$490,000 (\$500,000 - \$10,000) for 2010.

Example 2

Successful restaurant business purchases and places into service a new building that is “qualified restaurant property” costing \$1.8 million and other section 179 qualifying costs totaling \$300,000 in 2010. Business earns \$1 million in total income (net all other tax deductible expenses). Business elects to expense maximum \$250,000 of the \$2 million purchase price of the building under section 179. Because total section 179 qualifying assets placed into service in

2010 exceeds the phaseout amount by \$100,000 (\$2.1 million - \$2.0 million), the total allowable section 179 expense deduction is reduced by this amount to \$400,000 (\$500,000 - \$100,000). Only \$150,000 (\$400,000 - \$250,000) of the \$300,000 of other qualifying section 179 costs can be deducted in 2010. If the business elects to take the full amount of section 179 expense deductions allowable, (\$250,000 attributable to the building and \$150,000 attributable to the other qualifying assets), then its taxable income for 2010 is \$600,000 (\$1 million - \$400,000).