



February 2008

Business Incentives under the Economic Stimulus Package

To Our Clients and Friends:

As you probably know, on February 13, 2008 the President signed an economic stimulus package (the *Economic Stimulus Act of 2008*) which is intended to jump-start our economy, in part through tax incentives aimed at encouraging businesses to increase their investments in new equipment by the end of 2008. Under the Act, certain businesses will be able to write off up to \$250,000 of new or used qualifying expenditures in 2008 under what is called "Section 179". In addition, businesses will be able to deduct an additional 50% of the cost of certain additional new qualifying expenditures in 2008. Here are the most important details.

Boosted Section 179 expensing. Under pre-Act law, taxpayers could expense (i.e., deduct currently, as opposed to taking depreciation deductions over a period of years) up to \$128,000 of qualifying property for 2008. For 2008, this annual expensing limit was to be reduced (but not below zero) by the amount by which the cost of NEW OR USED qualifying property placed in service during 2008 exceeded \$510,000. These expensing rules are eased for qualifying empowerment zone property, renewal property, and GO Zone property. The amount of the expensing deduction is limited to the amount of taxable income from any of the taxpayer's active trades or businesses.

Under the Economic Stimulus Act, for tax years beginning in 2008, the \$128,000 expensing deduction limit is increased to \$250,000, and the overall investment limit is increased from \$510,000 to \$800,000.

As a result of this incentive, most small businesses, and even some medium-sized businesses with moderate capital equipment needs, will be able to obtain a full deduction for the cost of new or used business machinery and equipment purchased in 2008. What's more, there is no alternative minimum tax (AMT) adjustment with respect to property expensed under Section 179.

Bonus depreciation makes a comeback. Bonus first year depreciation was first allowed following the terrorist attacks of September 2001 but generally was no longer available for property acquired after 2004. (There are some exceptions, such as for qualified GO Zone property generally placed in service before 2008.)

The Act provides for accelerated depreciation by allowing a bonus first-year depreciation deduction of 50% of the adjusted basis of NEW qualified property placed in service after December 31, 2007, and, generally, before January 1, 2009. The basis of the property and the depreciation allowances in the year the property is placed in service and later years are appropriately adjusted (reduced) to reflect the additional first-year bonus depreciation deduction. The amount of the additional first-year depreciation deduction is not affected by a short taxable year. A taxpayer may elect out of additional first-year bonus depreciation for any class of property for any taxable year.

Bonus depreciation is allowed for AMT purposes as well as for regular tax purposes. But note that bonus depreciation is permitted only for: 1) property to which MACRS applies that has an applicable recovery period of 20 years or less, 2) water utility property, 3) non-custom-made computer software, and 4) qualified leasehold improvement property.

Original use of the property must begin with the taxpayer after December 31, 2007. Additionally, the placed-in-service cutoff date is extended for an additional year (i.e., before January 1, 2010) for certain property with a recovery period of ten years or longer and certain transportation and aircraft property.

Interaction of Section 179 expensing election, bonus depreciation and regular depreciation. The interaction of the Section 179 expensing election and the additional first-year “bonus” depreciation allowance with the otherwise applicable depreciation allowance can be illustrated as follows:

Assume that in 2008 a taxpayer purchases new depreciable property and places it in service. The property’s cost is \$350,000 (that is all that is spent, so it is less than the \$800,000 cap for Section 179 purposes) and it is 5-year property subject to the so called “half-year” convention. The amount of Section 179 expensing allowed is \$250,000 (the maximum). The amount of the bonus depreciation is \$50,000 (one half of the \$100,000 excess of the \$350,000 spent over the \$250,000 allowed under Section 179). The regular depreciation is \$10,000 (20% of the \$50,000 remainder). (The remaining \$40,000 of the cost of the property is deductible in future years under the rules applicable to 5-year property.) The total depreciation with respect to the property in the first year is then \$310,000 of the \$350,000 total for the assets placed into service in 2008.

Interaction of bonus depreciation and regular depreciation (No Section 179 expensing). Section 179 may not always be available to all taxpayers. The interaction of the additional first-year “bonus” depreciation allowance with the otherwise applicable depreciation allowance can be illustrated as follows:

Assume that in 2008 a taxpayer purchases new depreciable property and places it in service. The property’s cost is \$350,000 and it is 5-year property subject to the so called “half-year” convention, but Section 179 is not available because the company has a tax loss for the year. The amount of the bonus depreciation is \$175,000 (one half of the \$350,000 spent). The regular depreciation is \$35,000 (20% of the \$175,000 remainder). (The remaining \$140,000 of the cost of the property is deductible under the rules applicable to 5-year property.) The total depreciation with respect to the property in the first year is then \$210,000 of the \$350,000 total for the assets placed into service in 2008.

Other. The otherwise applicable 2008 “luxury auto” cap on first-year depreciation that is indexed for inflation and which will be announced later in the year will be increased by \$8,000 for vehicles that qualify.

We hope this information is helpful. If you would like more details about these aspects or any other aspect of the new law, please do not hesitate to call.

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