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BAINBRIDGE BANTER, FEBRUARY 20, 2004

BUSINESS BANTER

Timely Tax Tips:

Focus on Business Deductions, Tricks and Traps

By Cynthia Hatfield

Everyone wants to know how the latest tax law changes will affect their bottom line. "How much will my tax due/refund be" is the most common question I receive from clients.

For businesses this year, the most significant change is the higher amount of deduction available for depreciation of certain qualified fixed assets placed in service during 2003 and 2004. The Jobs and Growth Tax Relief Reconciliation Act of 2003 increased the Section 179 expensing election for new personal property from $25,000 to $100,000. This deduction is limited by the amount of income your business earns and is only available operating businesses.

Another change to the depreciation tax law during 2003 is the increase in special depreciation allowance. This "bonus" depreciation is an additional depreciation on new personal property meeting certain criteria. The amount of the bonus depreciation is 30% of the cost of the assets placed in service prior to May 6th, and 50% of the cost if acquired after May 5th, 2003.

What impact does this law change have on your business? Well frankly it depends on the size of your business asset purchases. For instance, if your company is growing, and you purchased $150,000 dollars of equipment last year after May 5th, the good news is the first $100,000 can be written off to the extent you have income to offset the expense. The remaining $50,000 of assets may be depreciated using the bonus depreciation rate of 50% regardless of income. In addition, the remaining $25,000 of assets is depreciated at standard depreciation rates, yielding a deduction of about $3,600. So the total effect is to reduce income by $128,600 with only $150,000 cash outlay. This is a huge savings when compared standard depreciation deductions in effect prior to September 11, 2000 which might have approached $43,000.

What is the effect if your business was not profitable during 2003? Well, using the same example of $150,000 of equipment purchased after May 5th, you would not be eligible for the Section 179 deduction of $100,000. However, the total purchase price of the equipment would be subject to the 50% bonus depreciation plus regular depreciation of about $11,000, or a $86,000 reduction in income. Of course, the tax effect in either scenario will vary based upon the tax bracket of your business. The State of Ohio, however, does not allow these excess depreciation amounts, and requires the additional depreciation to be taken over a six year time frame.

What if your business did not acquire assets during 2003? The good news is that these benefits are also available during 2004. So if you are planning on business growth, or computer upgrades, or other general asset acquisitions in the next few years, it would make a lot of sense (especially with the current finance rates) to make the purchase now.

For the purposes of this article, I have simplified the concepts of depreciation of assets and the new tax laws somewhat for ease of readability. They are, of course, quite technical, and, if not applied correctly, can result in costly mistakes for your company. If you would like more in-depth information on this topic, or any other tax related matter, please contact me or your professional advisor.

If you have questions or comments regarding this article, please direct them to Bainbridge resident Cynthia Hatfield, CPA at chatfield@zinnerco.com, or call her at 216-831-0733.