

381 words

Abstract: Many businesses are eligible for current tax write-offs for certain equipment purchases and building improvements. These write-offs can do wonders for cash flow, but whether to claim them isn't always an easy decision. In some cases, there are advantages to choosing the regular depreciation rules. This article looks at a couple of examples to show why it's critical to look at the big picture and develop a strategy that aligns with a company's overall tax planning objectives.

First-year bonus depreciation and Sec. 179 expensing: Beware of pitfalls

Eligible taxpayers can elect to use bonus depreciation or Section 179 expensing to deduct the full cost of eligible property in the year it's placed in service. Alternatively, they may spread depreciation deductions over several years or decades, depending on how the asset is classified under the tax code.

For 2023, bonus depreciation was 80%. It drops in 2024 to 60%, in 2025 to 40% and in 2026 to 20%. After that, it will be eliminated, unless Congress acts to extend it. While taking current deductions can significantly lower your company's taxable income, it isn't always the smartest move.

Here are two examples when it may be preferable to forgo bonus depreciation or Sec. 179 expensing:

1. You're planning to sell qualified improvement property (QIP). If you have significant building improvements that are eligible for bonus depreciation as QIP, writing it off currently may be a tax trap if you plan to sell the building soon. That's because your gain on the sale — up to the amount of bonus depreciation or Sec. 179 deductions you've claimed — will be treated as "recaptured" depreciation that's taxable at ordinary-income tax rates, up to 37%. But if you deduct the cost of QIP under regular depreciation rules (generally, over 15 years), any long-term gain attributable to the deductions will be taxable at a top rate of 25% if the building is sold.

2. You're eligible for the qualified business income (QBI) deduction. This deduction allows eligible business owners to deduct up to 20% of their QBI from certain pass-through entities, such as partnerships, limited liability companies or sole proprietorships. The deduction — available through 2025 — can't exceed 20% of an owner's taxable income, excluding net capital gains. (Other restrictions apply.)

Claiming bonus depreciation or Sec. 179 deductions reduces your taxable income, which may deprive you of an opportunity to maximize the QBI deduction. And since it's scheduled to expire in 2025, it makes sense to take advantage of it while you can.

Timing is everything

Keep in mind that only the timing of deductions is affected by the strategy you choose. You'll still have an opportunity to write off the full cost of eligible assets over a longer time period.

Your tax advisors can analyze your company's overall tax benefit picture and come up with an optimal strategy.