



## Special Report: Uncle Sam Wants You to Save on Taxes

Tips on making the Small Business Tax Cut work for you as 2008 comes to a close.

The government has beefed up tax benefits to small business for the fifth time in six years. The updated legislation allows small businesses, which have received big tax deductions for their technology purchases in recent years, to save more than ever.

In 2008, small businesses can deduct up to \$250,000 in new equipment purchases. This includes IT assets such as computer hardware, networking equipment and off-the-shelf software.

Now is the perfect time for small business owners to strategically plan their remaining purchases for the current year and take advantage of the Section 179 tax deduction and bonus depreciation. Accountants say many of their small business clients are taking advantage of it.

### Tax Relief Package

President George W. Bush signed an economic stimulus bill in February that doubles the amount small businesses can deduct for tax purposes. The deduction for the 2008 tax year increased from \$125,000 to \$250,000 and includes a 50 percent bonus depreciation.

It's not the first time the government has tried to ease the tax burden of small businesses by bolstering Section 179 of the tax code. It historically let companies immediately deduct \$25,000 a year in new equipment expenses, including technology purchases.

Lawmakers in 2003 quadrupled the deduction to \$100,000 a year and let companies deduct packaged software for the first time. Congress renewed the higher deduction and the software provision in 2004, 2006, 2007 and did so again in February.

The higher \$250,000 deduction will revert to \$128,000 (with a small increase from a Cost-of-Living Allowance) for the 2009 and 2010 tax years. And in 2011, the deduction will revert back to the original \$25,000 deduction, unless lawmakers extend the tax incentive.

The larger Section 179 deduction has proved extremely popular during the past five years. That is why lawmakers keep extending it.

### Cowan, Guteski & Co.

"It costs a lot to run an IT department," says Paul R. Barresi, IT manager at accounting firm Cowan, Guteski & Co., P.A. "If a server breaks down, we have to replace it. When we add new employees, we purchase more computers. So it's a huge benefit to be able to deduct our technology purchases all at once. This helps us save a lot on taxes."

The 60-employee firm, based in Toms River, N.J., has taken advantage of the Section 179 deduction the past three years. And it plans to do so again for the 2008 tax year.

The business spent about \$200,000 on IT in 2008, mostly on software, including off-the-shelf products, such as QuickBooks and subscription licensing on accounting and other line-of-business software. The firm also purchased five notebook computers and several desktop computers.

The amount Barresi spends on IT per year fluctuates. Last year, however, he also spent \$200,000 on five servers, rack enclosures, as well as computers, Microsoft Office upgrades and Microsoft Exchange Server seat licenses.

While the new equipment is necessary, it's easier for small businesses to invest in new technology knowing it's a tax break, Barresi says. "Anytime we can get money back, we'll take it."

### One-Time Deduction

Section 179 lets small businesses immediately take a one-time deduction for equipment purchases in one tax year versus having the costs deducted over the useful life of the equipment, which under a normal depreciation schedule is typically five or seven years.

Technology that can be deducted includes servers, computers, printers, networking equipment and off-the-shelf software. Deductions can also include machinery, furniture and some storage facilities.

When Congress initially increased the yearly deduction to \$100,000, it also doubled the amount businesses could spend yearly on equipment to qualify for the tax break. This jumped from \$200,000 to \$400,000 per year. For 2008, the spending limit, which was set to rise to \$510,000, jumps to \$800,000, thanks to the economic stimulus bill.

### Bonus Depreciation

In addition to the one-time deduction, buyers also get a 50 percent bonus depreciation. For example, if a company buys \$400,000 of new IT equipment in 2008, \$250,000 can immediately be deducted under Section 179.

Of the remaining \$150,000, the business can deduct half (\$75,000) the same year applying the bonus 50 percent depreciation, says Mark Luscombe, a principal federal tax analyst at CCH in Riverwoods, Ill. The remaining \$75,000 can be deducted through the normal depreciation schedule.

So, in that first year, a business can deduct portions of the remaining \$75,000. The amount deducted under the depreciation schedule will depend on the type of equipment and life of the assets, Luscombe says. See example below.

#### Example 2008:

Purchase **\$400,000** of new technology equipment

Deduction allowed for tax:

Section 179 expense (Indexed for inflation): **\$250,000**

Bonus depreciation:  $(\$400,000 - \$250,000) = \$150,000 \times 50\% = \mathbf{\$75,000}$

(HY,200%,DB)

Normal first-year depreciation =  $\$75,000 \times 20\% = \mathbf{\$15,000}$

(Depreciation calculated at 5 years)

Total first-year deduction and depreciation: **\$340,000**

### Annual Spending Limit

There's one caveat to using the Section 179 deduction. Businesses that spend more than the annual limit cannot take the full Section 179 deduction. Every dollar spent above the limit must be subtracted from the deductions.

For every dollar a business spends above the limit, the business owner must subtract a dollar from the deductions. For example, if a business spends \$820,000 in equipment purchases in 2008, or \$20,000 above the spending limit, then the business can only take a \$230,000 deduction from Section 179.

The rest of the equipment costs can be deducted through the normal depreciation schedule. This is usually five-to-seven years. See example below.

#### Example 2008:

Purchase **\$820,000** of new technology equipment

Deduction allowed for tax:

Section 179 expense (Indexed for inflation less the overspending - loss of \$20,000): **\$230,000**

Bonus depreciation  $(\$820,000 - \$230,000) = \$590,000 \times 50\% = \mathbf{\$295,000}$

(HY,200%,DB)

Normal first-year depreciation  $(\$295,000 \times 20\%) = \mathbf{\$59,000}$

(Depreciation calculated at 5 years)

Total first-year deduction and depreciation: **\$584,000**

### Potential Pitfalls

To qualify for a Section 179 deduction, the business usage of an asset must be more than 50 percent. If the usage is greater than 50 percent but less than 100 percent, the taxpayer may claim the Section 179 deduction on the percentage of the cost of the asset that is used for business.

If a company takes the Section 179 deduction and business usage falls below 50 percent or if the equipment is sold during the useful life of the asset, then the business owner must put back a portion of the deduction as income. This tax rule is called a "recapture" on the amount of deductions taken on equipment.

Take, for example, a company that buys a server for \$10,000. The business uses it 100 percent for business and expenses the entire cost the first year, but then only uses it 25 percent for business the next year. The company then will have to recapture the original deduction — minus the normal depreciation that would have been allowed — as income.

For example, under a five-year depreciation schedule, the depreciation allowed for the first year (100 percent business usage) is \$2,000. The second year of depreciation (25

## Section 179 Expensing for Small Businesses

**Deductions:** Up to \$250,000 in 2008 for technology, off-the-shelf software, machinery, furniture and most storage facilities.

**Spending Limit:** To qualify for the entire deduction, capital spending must not exceed \$800,000 in 2008. Every dollar spent above the limit must be subtracted from the Section 179 deduction.

**Expiration Date:** The deduction will fall back to about \$128,000 (with a small increase for inflation) in 2009. It will revert to \$25,000 in 2011 unless Congress renews it again.

## Small Business Tax Deduction Glossary

**Section 179 Expensing:** Section 179 refers to the portion of the Internal Revenue Code that allows small businesses to deduct the cost of property from their income taxes.

**Deduction:** Amount small businesses can subtract from their income, so they can lower their taxes.

**Depreciation:** A deduction that allows businesses to write off the cost of computers, software and other technology over the useful lives of the assets.

**Modified Accelerated Cost Recovery System (MACRS):** The method used to determine asset depreciation. Under MACRS, small businesses typically write off computers and office equipment over a five- to seven-year period.

**Recapture:** A business that previously took a Section 179 deduction must add back a portion of the deduction as income if the business sells the equipment during its useful life or if business usage falls below 50 percent.

Source: Internal Revenue Service. For more information, visit the Internal Revenue Service Web site ([www.irs.gov](http://www.irs.gov)) and search for the IRS Publication 946, "How to Depreciate Property," or contact your tax professional.

percent business usage) is \$500. Combined, the allowable deduction under the normal depreciation schedule is \$2,500. That means the remaining \$7,500 that was originally deducted under Section 179 must be added back into the business owner's income.

The same is true if a business owner sells the equipment for a profit. If you sell an item for \$6,000 and have taken \$5,000 in allowable deductions, the owner must pay additional tax from the gains made from the sale.

### Tax Deduction Tips

"During the last few months of the year, business owners should determine if they need new equipment so they can take advantage of the tax break", says James Cravens Sr., founder and partner of accounting firm Cravens & Cravens, LLP in Du Quoin, Ill.

Businesses should consult with their accountants. They can run the numbers and explain in detail how the business could benefit, he says. But don't make a purchase for the sake of making a purchase, as "the costs are not subsidized," Cravens Sr. says.

Although Cowan, Gunteski & Co. will take advantage of the tax deduction, its technology purchases were driven by business needs, Barresi says. "My firm has invested heavily in technology to improve collaboration and communication

and to increase reliability, data security and application performance, which makes my users work more efficiently."

If companies review their needs and risk going over the Section 179 deduction and spending limits, they can split their purchases over two tax years, he says. For example, buy half the equipment in November and December, and then the remaining half in January or February.

Despite the immediate benefits, however, not every company should take advantage of the deduction in every case, says James Cravens Jr., a partner at Cravens & Cravens. Again, consult with an accountant to discuss different tax scenarios and to determine the best tax strategy, he says.

For example, companies that had a bad revenue year and are in the 15 percent tax bracket but anticipate greater income the next year should forgo a Section 179 deduction and write equipment off under the normal depreciation schedule, Cravens Jr. says. Under that scenario, business owners will get a bigger tax benefit when they're earning more in future years.

A provision in the law lets small businesses amend their tax returns from previous years retroactively to either take advantage of a Section 179 deduction or revoke its use. "You can go back and amend your return to maximize the tax benefit," Cravens Sr. says.

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