

Tax Information for Small Businesses

CONSTRUCTION - Depreciation IRC Section 167(a), 168 & 179a

What is Depreciation?

- Property used for business
- Property expected to last more than one year
- Represents wear, decay, usage, obsolescence, or loss of value due to natural causes

What can be Depreciated?

Real Property:

Any building or structure built on land; plants or trees grown on land; and attachments or improvements to land

Personal Property:

Cars, trucks, machinery, furniture, equipment, and all other tangible items which are not real property

What cannot be Depreciated?

- Property placed in service and disposed of in the same year
- Inventory
- Land
- Repairs and replacements that do not increase the value of your property; make it more useful; or lengthen its useful life

How to Figure Depreciation

- Basis
- Class Life
- Placed in Service Date
- Convention
- Method

Definitions

- **COST BASIS:** Usually the purchase price, including sales tax, freight, and installation charges.
- **ADJUSTED BASIS:** Increase cost basis by improvements. Decrease basis by depreciation deductions.

Compute Basis

Example:

Adam bought a dump truck from a local contractor. He paid \$2,000 cash, borrowed \$3,000 from the bank, and agreed to dig the foundation for the contractor's lake cabin (worth \$1,000). The cost basis for the dump truck is \$5,000.

Class Life

- 3-year Property
 - Tractor units used over the road.
- 5-year Property
 - Any construction property that does not have a class life.
 - Automobiles, taxis, buses & trucks.
 - Computers & peripheral equipment.
 - Office machinery, such as typewriters, calculators, & copiers.
 - Property used in research & experiments.
- 7-year Property
 - Office furniture & fixtures
- 15-year Property
 - Land improvements, such as shrubbery, fences, roads, & bridges.
 - Service stations, but not the pumps.
- 39-year
 - Nonresidential real property.

Placed In Service Date

Depreciation is taken when the property is ready and available for use in your trade or business, even if the property is idle or currently not in use.

Conventions

Half-Year:

- Treat property placed in service during the year as if it started at the midpoint of the year
- This convention is used for most property

Mid-Month:

- Treat property placed in service during a month as if it started at the middle of the month
- This convention is used for real property

Mid-Quarter Convention:

- Treat personal property placed in service during a quarter as if it started at the middle of the quarter

- Must be used when more than 40 percent of all personal property placed in service during the year was placed in service in the last three months of the year

Computing Your Depreciation Deduction

Multiply the basis of the asset by predetermined percentages set by the class life, convention, and method.

General Depreciation System (GDS); 200% Declining Balance (DB); Half-Year Convention (HY)

Year 1

3-Year: 33.33%

5-Year: 20.00%

7-Year: 14.29%

Year 2

3-Year: 44.45%

5-Year: 32.00%

7-Year: 24.49%

Year 3

3-Year: 14.81%

5-Year: 19.20%

7-Year: 17.49%

Year 4

3-Year: 7.41%

5-Year: 11.52%

7-Year: 12.49%

Year 5

3-Year: n/a

5-Year: 11.52%

7-Year: 8.93%

Year 6

3-Year: n/a

5-Year: 5.76%

7-Year: 8.92%

Year 7

3-Year: n/a

5-Year: n/a

7-Year: 8.93%

Year 8

3-Year: n/a

5-Year: n/a

7-Year: 4.46%

Example

Shawn bought a used pickup for \$15,000 in March 1998. His depreciation deduction for each year is computed by multiplying Cost with GDS. The example is as follows:

1998: Cost of \$15,000 multiplied by 20.00% is equal to a depreciation of \$3,000

1999: Cost of \$15,000 multiplied by 32.00% is equal to a depreciation of \$4,800

2000: Cost of \$15,000 multiplied by 19.20% is equal to a depreciation of \$2,880

2001: Cost of \$15,000 multiplied by 11.52% is equal to a depreciation of \$1,728

2002: Cost of \$15,000 multiplied by 11.52% is equal to a depreciation of \$1,728

2003: Cost of \$15,000 multiplied by 5.76% is equal to a depreciation of \$864

The total depreciation equals to \$15,000.

Listed Property

- Any four-wheeled passenger vehicle used primarily for public streets, roads, and highways that weighs 6,000 lbs or less unloaded
- Entertainment, recreation, or amusement property (Includes photographic, phonographic, communication, and video-recording equipment)
- Computer and related peripheral equipment
- Any cellular telephone

Section 179 Election

Allows you to elect to deduct all or part of the cost of certain qualifying property in the year you place it in service.

Section 179 Property

Includes: Property purchased new (if a trade-in is used, only the cash amount can be used)

Does Not Include: Leased, real, or rented property; Listed property whose business use for the year is 50% or less of the total use

Deduction Limitations

Maximum Dollar Limit:

- For 2003 to 2005, it is \$100,000. After 2005, it is scheduled to go down to \$25,000.

Investment Limit:

- If the total cost of the Section 179 property exceeds \$400,000 (the “threshold figure”), the amount of excess reduces the maximum dollar limit dollar for dollar. The threshold figure returns to \$200,000 after 2005.

Taxable Income Limit:

- The amount you deduct each year cannot exceed the taxable income from all active trade or business conducted during the year.
- Wages and salaries paid as an employee are included.

New Law

- Additional 50 percent special depreciation deduction on property's depreciable basis taken after Section 179 deduction.
- Newly purchased property with class life of 20 years or less.
- Acquisition Date: Purchased after 5/5/2001, but before 1/1/2005
- Placed in Service Date: Must be used in your business after 5/5/2003 and before 1/1/2005
- Original Use: Began with you after 5/5/2003

Computation Example

- Property purchased 5/17/2003.
- Original cost is \$200,000.
- Section 179 deduction taken is \$100,000.
- What is the special depreciation deduction?

Answer

Cost: \$200,000

Less Section 179 deduction (100,000)

Multiply remaining depreciable basis by 50%: \$100,000 multiplied by 50%

Special Depreciation Allowance: \$50,000

Regular Depreciation Basis: \$50,000

Thank You!