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Subject: Basics of Bonus Depreciation and Section 179 Expensing Rules for Equipment Sales in 2012

Last year about this time, I provided the basic tax depreciation/expense rules that can help sales people in making new and used equipment sales before year end. Because of some changes, it is timely to revisit these rules. Basically, there has been a reduction in the "extra" amounts that can be written off in 2012 to reduce taxes.

There are two provisions we need to look at --

Section 179 expense deduction for new and used equipment. The Section 179 deduction for 2012 is $139,000 and the phase out threshold is $560,000. Here is an example how this works -- if a customer were to buy new and/or used equipment of $600,000 during 2012, the allowable Section 179 expense deduction would be $99,000 computed as follows: $600,000 of purchases minus the $560,000 threshold amount = $40,000 reduction of the $139,000 expense allowance to $99,000 for the Section 179 expense deduction in 2012.

Bonus depreciation for new equipment. Last year you could expense 100% of the purchase price of new equipment. In 2012 the extra bonus depreciation is limited to 50% of the purchase price of new equipment. Example – if a customer buys new equipment in 2012 for $600,000 he can take an extra $300,000 bonus depreciation deduction in 2012. After December 31, 2012 the bonus depreciation is scheduled to vanish.

Example of Combining Tax Provisions. Last year I provided the rules. This year I am adding an example on how these provisions work together in concert. The following shows that – after combining a) section 179 expense deduction, b) the bonus depreciation deduction and c) the regular MACRS depreciation deduction – a customer in 2012 would have a net after tax cost of about $446,000 on $600,000 of new equipment purchases. (Of course, the customer can write off the remaining basis of $214,704 over the next six years.)

Calculation of Section 179 Expense, Bonus Depreciation and Regular Depreciation for 2012		
Purchase Price of New Equipment	$600,000	
Section 179 Phase-out Threshold	$560,000	
Phase-out Excess	$40,000	
Section 179 Limit ($139,000-$40,000)	$99,000	
Allowable Section 179 Deduction		($99,000)
Basis Available for Bonus Depreciation	$501,000	
50% Bonus Depreciation		($250,500)
Basis Available for MACRS	$250,500	
Double-Declining Balance Method (Half Year Seven Year Property – 14.29%)		($35,796)
Residual Basis for Future Depreciation ($85,881 tax benefit in future years)	$214,704	
Total Expense and Depreciation Deductions on Purchase of $600,000 of new equipment for 2012		($385,296)
Tax Savings at 40% combined Federal and State		$153,658
After Tax Cost of $600,000 Equipment in 2012		$446,342

You should note that it is important to apply the Section 179 expense deduction, bonus depreciation deduction, and MACRS depreciation deduction in that order to arrive at the correct aggregate deduction of $385,296 for the $600,000 new equipment purchases in 2012. After looking at this computation, you can understand why I am in favor of tax simplification.