ALTB 04-03 Combing the 30%/50% Special Depreciation Allowance with the IRC §179 Expensing Allowance

Abstract
For taxpayers who make qualifying purchases, it is possible to use both the §179 expensing deduction and the special depreciation allowance (SDA). This article discusses some limitations and shows examples of how this can maximize tax depreciation, with a special focus on agricultural applications.

Related Articles
Readers will want to read the articles on the §179 expensing election and the special depreciation allowance before continuing, since the rules stated in the articles apply to the combined use. Clicking on the following links will take you to the articles regarding the §179 deduction and the 50% special depreciation allowance: the article on §179 deduction is available from http://www.farmdoc.uiuc.edu/legal/taxation/articles/ALTB_04-01/ALTB_04-01.pdf and the article on the 50% special depreciation allowance is available from http://www.farmdoc.uiuc.edu/legal/taxation/articles/ALTB_04-02/ALTB_04-02.pdf

Timing
The §179 deduction is claimed before taking the SDA.

Example 1 Sally purchases a $200,000 combine that qualifies for both the §179 deduction and the SDA. She must claim the §179 deduction first. Assuming she only qualifies for a maximum §179 deduction of $50,000, she will claim that deduction. This reduces the basis in the combine to $150,000. She can then claim a $75,000 SDA or 50% of $150,000. This allows Sally to take a $125,000 deduction on her $200,000 purchase.

Sally must understand why she is limited to the $50,000 §179 deduction. If it is because of the income limitation, she will not be able to claim the SDA. Each dollar of SDA reduces her profit, which reduces her §179 limit.

If Sally is limited in her §179 deduction because of excess purchases over $400,000, she will be able to claim both deductions. In addition, Sally will also be able to claim regular MACRS depreciation on the remaining basis of $75,000.

Caution
State law may differ from federal law. Therefore, Sally will want to check her state regulations before claiming either the §179 deduction or the SDA on her federal return. Many states have applied lower limits to these deductions.

Multiple Purchases
A taxpayer may have multiple asset purchases during the year. Some of these purchases may qualify for the 30% SDA, others for the 50% SDA and some may qualify for neither. However, most will qualify for the §179 expensing election. A taxpayer will want to compute the amount of tax deduction desired and then choose the assets and depreciation technique he wishes to use.

Example 2 Justine purchased the following assets in 2003. Justine’s net farm profit before calculating any §179 or SDA is $500,000.
<table>
<thead>
<tr>
<th>ASSET</th>
<th>Qualifying for IRC §179?</th>
<th>Qualifying for 30% SDA?</th>
<th>Qualifying for 50% SDA?</th>
</tr>
</thead>
<tbody>
<tr>
<td>New tractor acquired 5/7/2003 for $85,000</td>
<td>YES</td>
<td>YES</td>
<td>YES</td>
</tr>
<tr>
<td>Used wagon acquired 4/3/2003 for $800</td>
<td>YES</td>
<td>NO</td>
<td>NO</td>
</tr>
<tr>
<td>New trailer acquired 5/1/2003 for $2,000</td>
<td>YES</td>
<td>YES</td>
<td>NO</td>
</tr>
<tr>
<td>Farm machine shed acquired 7/10/2003 for $90,000</td>
<td>NO this is considered real property</td>
<td>YES</td>
<td>YES</td>
</tr>
<tr>
<td>New combine acquired 9/9/2003 for $200,000</td>
<td>YES</td>
<td>YES</td>
<td>YES</td>
</tr>
<tr>
<td>Commercial building acquired 11/6/2003 for $300,000</td>
<td>NO</td>
<td>NO</td>
<td>NO</td>
</tr>
</tbody>
</table>

Justine has $285,800 of purchases qualifying for §179. If she wishes to maximize her depreciation deduction, she will want to elect §179 on the wagon and the trailer since they will not qualify for the 50% SDA. In addition, she should claim an additional $97,200 of §179. She may elect to take the remaining §179 deduction on the combine, leaving it with a basis of $102,800.

When she aggregates the remaining combine basis with the cost of the tractor and the machine shed, she has $277,800 of assets that qualify for the 50% SDA deduction. Therefore, she has an SDA deduction of $138,900.

Justine reduced her net farm income by $241,700. She also has the regular MACRS depreciation on the remaining basis of the combine, tractor, machine shed and commercial building.

Justine needs to understand the consequence is her depreciation deduction in future years will be severely limited.

Justine may want to reduce her depreciation deduction if she does not have enough earned income (farm income, business income, and wages) to use all of the §179 deduction. In addition, Justine needs to understand how her state treats the §179 deductions and the SDA.

For example, Illinois requires the taxpayer to make a modification for SDA, but they allow the entire §179 amount. Indiana and Ohio require adjustments for both the SDA and §179 deduction.