



NAEDA Special Report

Revised tax bill still provides benefits

The Working Family Tax Relief Act of 2004 (WFTRA) and The American Jobs Creation Act of 2004 (AJCA) were signed into law during 2004. Some provisions of these new laws were further amended by The Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA) and the Small Business and Work Opportunity Tax Act of 2007 (SBWOTA). This latest Act changes aspects of taxation of Subchapter S Corporations and rules regarding depreciation and deduction of business property. The new rules have numerous provisions that affect equipment dealers and their customers.

■ Some of the key provisions are as follows

Section 179 – Business Expense

The SBWOTA extends the Section 179 expense limit through tax years beginning before 2011 and expands the limit to \$125,000 (adjusted for inflation). This amount is increased for Gulf Opportunity Zone property.

The opportunity to apply the Section 179 expense to certain SUVs used for business (that weigh more than 6,000 pounds, but not more than 14,000 pounds) is limited to \$25,000 of the cost of the SUV.

Qualified Leasehold Improvements

The AJCA provides that leasehold improvements on nonresidential property placed in service after October 22, 2004, but prior to 2006, may be recovered over a 15-year period using straight-line depreciation instead of being depreciated over 39 years.

Manufacturers' Deduction

Beginning in 2005 and phased in through 2009, businesses that manufacture goods in the U.S. can claim a new deduction under new Section 199 of the code. This manufacturers' deduction applies not only to taxpayers who are engaged in traditional domestic manufacturing activities, but all taxpayers performing construction, engineering, and architectural services and taxpayers who are producing electricity, natural gas or potable water.

Taxpayers who produce agricultural products can also qualify for this deduction if they perform storage, handling or other processing services within the U.S. Eligible taxpayers may claim a deduction ranging from 3 percent in 2005 to eventually 9 percent when the deduction is fully phased in after 2009 (based upon the lesser of their qualified production activities income or their taxable income for the year). The amount of the tax deduction is limited to 50 percent of W-2 wages allocable to the business' domestic production gross receipts.

S Corporation Law Changes

The AJCA has adopted a number of new provisions designed to reform and simplify S Corporation rules that include:

- Allowing members of a family to elect to be treated as one shareholder.
- Increasing the number of permissible S Corporation shareholders to 100 from 75.

The SBWOTA eased provisions that could cause unplanned termination of S Corporation status for corporations that used to be taxed as C Corporations. Current tax laws state that an S Corporation can lose its favorable tax treatment in certain situations where it has passive investment income for three consecutive years. The new rules removed from the definition of "passive investment income" capital gains derived from the sale of stock or securities.

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■ How the new tax bills benefit equipment dealers

The Section 179 business expense deduction rules are extremely important to equipment dealers because these new laws will encourage more equipment purchases by customers in the next few years. Dealers should take an active role in promoting these changes and use them as a valuable marketing tool. The Section 179 business expense deduction and bonus depreciation rules also can be used by a dealership in the purchase of its own (a) machinery, tools or other property used in the dealer's business or (b) inventory held for leasing purposes.

Section 179 Business Expense Deduction

Section 179 of the tax code permits businesses to expense the costs of certain property that would otherwise be depreciated over several years. The new law increases the annual limit of these deductions and extends the new rules through 2010.

What is Section 179 property?

- A farm tractor purchased by a farmer is a good example of Section 179 property. The technical definition of Section 179 property is tangible personal property with a life exceeding one year that is used for trade or business.
- Real estate is not Section 179 property.
- The old rule allowed a business to immediately expense \$100,000 of Section 179 property. **The new rule increases this amount to \$125,000 (as adjusted for inflation) for the 2007 – 2010 tax years.**
- The Section 179 business expense deduction can only be used by small businesses. The old rule classified small businesses as those with capital asset purchases (i.e., depreciable property) of \$400,000 or less per year. The new rule increases this amount to \$500,000 **(as adjusted for inflation) per year for the 2007 – 2010 tax years.**
 - * Businesses with over \$500,000 but less than \$625,000 of capital asset purchases; i.e., depreciable property, can also use Section 179 but the \$125,000 expense cap is reduced on a

dollar for dollar basis once capital asset purchases exceed \$500,000, e.g., a business with \$550,000 of capital asset purchases can only expense \$50,000 of such purchases.

- The changes to Section 179 are applicable after December 31, 2006, so any purchases made after that date qualify. Note that the tax benefits of these changes only apply to purchases by December 31, 2010.

■ Reduction in Taxes on Capital Gains and Dividends set to expire

Decrease in Capital Gains Rates

Top capital gains rates are reduced to 15 percent from 20 percent. Capital gains taxes are assessed on gains on the sale of capital assets (e.g., stock). The new rates went into effect May 6, 2003, and will remain in effect through December 31, 2010. However, there are some limitations:

- All sales prior to May 6, 2003, are subject to the previous capital gains rates.
- A 25 percent capital gains rate remains for long-term real estate gains attributable to depreciation recapture.
- Unless Congress takes further action, the old rates will return after December 31, 2010.

Dividends

Qualified dividends received by shareholders from C Corporations will now be taxed at the capital gain rates instead of the shareholder's ordinary income tax rate. However, there are some limitations to the new rules:

- Dividends received from tax-deferred retirement plans do not qualify for the new rates.
- Unless Congress takes further action, the old rates will return after December 31, 2010.

Disclaimer: This summary and overview is provided as a general guide to equipment dealers. However, it does not contain all of the details of the new legislation. Each dealer should consult his/her tax advisor to determine how the new law specifically impacts his/her dealership and what procedures are necessary to benefit from the new tax laws. This information contained herein does not and is not intended to constitute legal advice, but should be used only in connection with consultation with an attorney in regard to a particular factual situation. Further, it pertains only to laws of the United States. Certain laws may vary from state to state and may vary depending on the business conducted by a particular employer.