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Economic Stimulus Law Is Great News for Equipment Purchasers by Christian A. Klein, Esq.

Imagine if Congress and the President were to enact a law that rewarded you for buying new equipment by cutting your tax bill.

You can stop dreaming. It's a reality.

In March the President signed the Job Creation and Worker Assistance Act into law. It created a temporary 30 percent depreciation bonus that in many ways acts as a rebate on new equipment purchases.

The depreciation bonus provision of the new law has tremendous implications for companies in the capital-intensive construction industry. It can reduce your tax liability for this year and improve your cash flow. All you have to do is buy equipment.

Put simply, the depreciation bonus means that you can now depreciate or "write off" more of the cost of new machines for the tax year in which you buy them. Here's how it works:

Let's say that you purchase a new excavator that costs $100,000. Under the pre-existing depreciation structure, you'd be able to write off 20 percent (i.e., $20,000) of the cost for the year in which you make the purchase.

Under the new law, you can now write off 30 percent immediately and you can also write off the 20 percent of the remaining 70 percent of undepreciated value that you were entitled to deduct under pre-existing law. For a $100,000 machine with a six-year depreciation life that means you can depreciate $44,000 in the first year for a tax savings of $9,600!

There are few details about the new depreciation law that are important to understand:

Used vs. new equipment. First, the depreciation bonus doesn't apply to used equipment. The President and Congress believed that if new equipment sales were stimulated, manufacturing activity would increase, jobs would be created, the productivity of companies purchasing new equipment would be enhanced, and the economy would recover more quickly. The applicability of the law was therefore limited to new machines.

Short term vs. long term tax savings. Although the depreciation bonus will help many construction industry companies recover from the economic slowdown more rapidly, the new law is not a panacea for your every problem. The fact is that with the depreciation bonus you'll still ultimately wind up paying the same amount in taxes. Your tax liability in later years will be slightly increased to make up for your near-term tax savings. The advantage is that your short-term tax liability will be reduced and your cash flow for the year in which you purchase the equipment will therefore be improved.

You don't have to use it. Although many equipment purchasers will want to use the depreciation bonus to improve their near-term cash flow, rest assured that the law allows you to opt-out and depreciate your new equipment according to traditional depreciation rules if you choose to do so.

Held harmless from the AMT. Lawmakers recognized that the value of the depreciation bonus would be substantially reduced if Alternative Minimum Tax (AMT) issues weren't addressed. The new law therefore specifically allows the deduction for purposes of computing AMT and provides that there is no adjustment to the allowable amount of depreciation for purposes of computing alternative minimum taxable income with respect to the property from which the depreciation bonus is allowed.

The clock is ticking. Finally, it’s important to understand that the depreciation bonus won’t be around forever. It’s intended to be a short-term economic stimulator, so there’s a time limit. Under the new law, the original use of the equipment must commence with the person purchasing the equipment on or after September 11, 2001 and before September 11, 2004. The equipment must be put in service before January 1, 2005.

That’s the depreciation bonus in a nutshell. In enacting the stimulus law, Congress and the president have done their part to get the economy moving again. Now it’s up to equipment purchasers to grab the ball and run with it.

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