New Tax Law Increases Direct Expense Deduction

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First-year Direct Expensing (Section 179) is an election in IRS code that allows businesses like farms to deduct the cost of capital purchases as a tax-deductible expense. Farmers can elect to treat the cost of up to $500,000 of qualifying property purchased during 2012 as an expense (rather than as a depreciable capital expenditure). Before the recent American Taxpayer Relief Act (ATRA) legislation passed, direct expensing was scheduled to be $139,000.

The election for using the direct expensing can be made after the tax year closes before filing your taxes. This allows a farmer some flexibility to manage deductions and taxable income after the end of the tax year.

Only certain kinds of capital purchases qualify for this direct expensing: farm machinery, breeding livestock, grain bins and other single-purpose agriculture or horticultural structures or similar tangible personal property used in the farm business. Field tile also qualifies for Section 179 expensing. General-purpose farm buildings, such as machinery sheds or hay barns, are not eligible. Land is not depreciable, so it is not eligible for Section 179 expensing.

The recently passed American Taxpayer Relief Act of 2012 increased direct expensing for certain depreciable assets to $500,000.

If you trade in a piece of machinery when purchasing new equipment, then only the amount paid to boot is eligible. The capital item must be purchased, and new or used property can be deducted as a Section 179 expense. If you inherited the property or purchased it from your spouse or parent or any lineal descendant, then it does not qualify.

There are several limitations that apply for direct expensing. If the farm business purchases and places into service more than $2 million worth of qualifying property, then the $500,000 limit is reduced dollar for dollar. For example, if a farm buys $2,125,000 worth of equipment, then the amount of First-year Direct Expensing (Section 179) allowed is limited to $375,000. If the business purchases $2,500,000 or more in 2012, then no direct expensing is allowed.

The amount is also limited to the combined taxable income before the deduction derived from the active conduct of all trades or businesses. Section 1231 gains and losses reported on form 4797, such as sales of breeding livestock and machinery, are taxable income, as well as wages. So, for example, if a farm bought $300,000 of farm machinery and the net farm income is $125,000, the First-year Direct Expensing is limited to $125,000. The amount disallowed by this business taxable income limitation can be carried forward against future capital purchases.

As always, it is a good idea to review any elections with your tax advisor.

Editor's Note: *This article was provided by the Michigan State University Extension.*