News from the Hill

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New Tax Provisions Could be a Boon to Repair Stations

Congress has passed new tax laws designed to stimulate business purchasing, in an effort to stimulate the economy. While only time will tell if the tax provisions are successful in affecting the economy, there is one that is certain—there are significant tax advantages to investing in new tangible property for repair stations that have the resources to make use of the tax changes this year.

Increased Deduction for New Equipment

One of the great new elements of the new tax bill is that a small business may now expense up to $100,000 in otherwise depreciable equipment (tangible personal property). Under the old rules, that figure had been steadily climbing from $10,000 to $25,000 (it was $24,000 in 2002), so $100,000 is a major jump. This means if a repair station buys a $50,000 test set, it can deduct 100 percent of the value in the tax year in which it was purchased!

The $100,000 expensing limit is known as a section 179 deduction because that is the section in the tax code where it is found. It is meant to encourage investment in new equipment by small businesses. There are two benefits to AEA members in this clause. The first, obvious benefit is for AEA members who wish to invest in new equipment. The second is that this should encourage our small business customers to continue to invest in upgrades to their avionics.

There is a cap to this section 179 deduction. If a small business invests more than $400,000 in tangible personal property, the expensing benefit begins to phase out on a dollar for dollar basis. Thus, if a repair station invests in $425,000 in new tangible personal property in 2003, then its section 179 deduction drops to only $75,000 [$100,000—($425,000—$400,000)].

An interesting additional change in the law is that off-the-shelf software now qualifies for this increased expensing provisions of the section 179 deduction. Under prior law, no computer software qualified for the expensing provision because it was not "tangible" personal property. The new provisions are limited to off-the-shelf computer software. If you have any doubts about whether your software qualifies, you should consult your tax advisor.

Let's say a tour operator of one aircraft (under Part 135) wants to upgrade his avionics package. He has no other capital expenditures in 2003. Under the old law, if the new equipment would have cost $85,000, then the operator would have been able to expense $24,000 this year and the remaining $61,000 would have to be depreciated over a period of years. Under the new law, the operator can deduct the entire cost of the avionics package on his 2003 taxes as section 179 property.

Under the current law, these increased expensing benefits only apply to tax years 2003, 2004 and 2005, so start buying!

Depreciation of More than $100,000 in New Equipment

What if you invest more than $100,000 in new, depreciable equipment? The additional value in assets must be depreciated, which means that instead of getting the deduction immediately, you only get a portion of the deduction this year and the remainder in the years to come. The theory is that a new asset will help to generate revenue over a period of years and therefore the deductions associated with that purchase should be spread out over the (IRS-defined) useful life of the asset, offsetting the income generated by the equipment.

The taxpayer gets to list whatever he wants for his section 179 deduction, so choose your section 179 property wisely. You should select the property with the longest depreciation period as the section 179 property. This is so the total deductions are accelerated as much as possible.

Thus, if a small repair station buys $100,000 in computer equipment (five year property) and $100,000 in office furniture (seven year property), it would be best to treat the office furniture as the section 179 property, since that would best maximize and accelerate the tax deductions associated with the business'purchases.

Additional Depreciation

For new assets placed in service between May 6, 2003 and December 31, 2004, taxpayers now can enjoy an additional 50 percent bonus depreciation as additional first year depreciation. This is an increase from the 30 percent "bonus" depreciation rules previously in effect. This provision also increases the first year depreciation deduction for new passenger automobiles (vehicles under 6,000 pounds) used in a trade or business. As with the section 179 deduction, planning is advisable to determine if the benefits of the "bonus" depreciation apply when the purchase of the property is financed.

Note that this 50 percent depreciation rule is instead of the 30 percent "bonus" depreciation passed in 2002—it is not in addition to the bonus depreciation.

There are limits to this 50 percent deduction. The property must have a modified accelerated cost recovery (MACRS) period of 20 years or less. This means it does not apply to real estate but it would apply to certain leasehold improvements and land improvements. The 50 percent additional depreciation applies only to new equipment—not to used or refurbished equipment, so bear this in mind when making your purchases. If you acquire used equipment and then incur capital expenditures to have it overhauled, these expenditures should qualify for the 50 percent deduction, so tax concerns may impact decisions on who is responsible for an overhaul of equipment being purchased. For more details, be sure to discuss this with your tax professional.

The Feds Get Creative

In an interesting clause in the most recent tax bill, 25 percent of any corporate estimated tax payments due in September 2003 will not be due until October 1, 2003. Few AEA members will have the resources to make good financial use of the additional two weeks worth of use of the money. Why did the federal government do this, you might ask? This deferral has the effect of delaying the income attribution for the federal government until FY 2004, because the federal government's fiscal year ends on the last day of September. This revenue shift will have the appearance of diminishing FY 2003 apparent income for the federal government but increasing apparent income for FY 2004.

Estate Tax Repeal Update

The estate tax was not addressed in the most recent tax changes but it is being considered in other legislation. The estate tax is particularly important to AEA members that are family businesses.

The estate tax, also known as the "death tax," is imposed on property and assets that are passed on after (or in some cases before) a death. There is a substantial exemption—the first 1.2 million dollars of estate value are exempt from the tax. When a business is involved, though, this is often not enough. Appreciation in the value of land and structures, the value of inventory, tooling and equipment—all of these can add up to a business that is rich in assets but not sufficiently cash-rich to permit the family to pay the estate taxes on the business when a business principal dies. This can make it difficult to keep the family business in the family. Financial strategies such as life insurance policies can help make sure that the family has the money to pay the estate taxes, but these strategies can be expensive. When a family business has not done the right planning—or if it cannot afford to implement the right financial strategies—the death of the business principal can mean the death of the business as assets and entire businesses are sold to cover the estate taxes.

The estate tax is being slowly phased out until it reaches zero in the year 2010. In 2011, though, it reverts to its original form with a maximum tax rate of 55 percent. The reason for this reversion is that budget rules limit tax changes implemented through a budget rule (such as this one) to only 10 years. The original tax change was implemented through a budget rule because budget rules are not allowed to be filibustered in the Senate.

The House of Representatives has taken a significant step toward permanent repeal of the estate tax. By an impressive vote of 264 to 163, the House passed H.R. 8, the Death Tax Repeal Permanency Act. Forty-one democrats and 223 republicans voted for the legislation (only four republicans voted no), giving the legislation a great boost of momentum as it moves to the Senate. Successful passage in the Senate is still far from certain. This sort of legislation has passed the House before, only to be bogged down in the procedural mire of the Senate. Senate rules permit most measures to be filibustered, which would mean a 60 vote supermajority (instead of the normal 51 vote majority) would be needed just to get the matter to a formal vote. The measure still has a long way to go before the Senate votes to fully rescind the death tax, although the Senate may choose to offer a compromise that would extend the benefits of the estate tax sunset for several additional years.

There are enough changes in the tax code either recently passed or in the works to make your head spin even if you're a tax attorney, so be sure to get the advice of a competent tax accountant on how the new changes in the tax laws will affect your business, and how you can structure your transactions to best take advantage of the new laws. q

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