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### **November 2004 - Tax Savings for You in the New October 2004 Laws (Part 3)**

As you may know, President Bush signed both “The Working Families Tax Relief Act of 2004” and “The American Jobs Creation Act of 2004” into law in October after they were both overwhelmingly approved by both parties in both houses of Congress. Between these two laws there are tax savings for almost everyone.

Part 1 of this series of articles discussed several family tax law changes, including the child tax credit, marriage penalty relief, continuation of the 10% tax bracket for more people, alternate minimum tax relief, additional child tax credit eligibility for military families, and continuation of the educator expense deduction and the electric vehicle credit. Part 2 continued with a number of business tax benefits, offset by a cutback in the expensing provision for SUVs and a crackdown on tax shelters and delinquent taxpayers.

I have received many questions this past week on the new SUV rules as well as how depreciation rules in general help you save taxes. These new tax laws make this a good time to update you on this topic.

### **Background**

Basic tax rules allow you to deduct business expenses from your taxable income as you pay them. Depreciation is one of the main exceptions to this rule. The idea behind depreciation is that when you buy vehicles, equipment, furniture, or fixtures that you will use in your business for several years, the resulting tax deduction should be spread over the years the item is used rather than claimed all at once when it is purchased.

Gradually over the years, Congress has added various tax incentives to entice small businesses to buy equipment, hoping to stimulate the economy. First, broad categories of equipment were established with allowance to take depreciation deductions over fewer years than the actual useful life. For example, most vehicles are depreciated in full in 5 years, even though they will likely be useful longer than that and have some resale value at the end of their useful life. Most machinery is depreciated in full in 7 years, again a shorter period than the normal useful life. The tax benefit of a shorter depreciation period is that you can claim a larger deduction each year, until the item is depreciated to zero.

### **Rapid Depreciation Rules**

Later, Congress added Section 179 to the tax code, which allows most small businesses to choose to write off the entire cost of equipment in the year it is purchased, up to a limit of \$25,000 per year. The equipment can be new or used, but generally cannot be permanently attached to real property or purchased from a related party. Items or portions of items used for investment purposes rather than business purposes do not qualify for the Section 179 election.

After September 11, 2001, special temporary rules were put in place to further stimulate equipment sales and speed up the economic recovery from the catastrophic events of that day. The Section 179 limit was increased to \$100,000 for 2003, 2004, and 2005. Then in October 2004, the \$100,000 limit was extended for two more years to cover 2006 and 2007.

Bonus depreciation was added as another option after September 11 as well. You can choose between a one-time bonus deduction of 30% or 50% of the purchase price, and then take regular depreciation over several years on the balance. There is no annual limit for bonus depreciation, but the items must be new, not used.

### **Special Depreciation Rules for Passenger Vehicles**

Tax law in general attempts to collect the most from those perceived to have high income. Tax is assessed at increasing percentage rates as income rises and most deductions and credits gradually become unavailable as income rises. Some years ago, Congress noted that many people were opting to purchase and take tax write-offs for “luxury automobiles” since these people felt they were spending money that was mostly going to be paid in taxes anyway. The result was annual limits on depreciation allowable for passenger vehicles. These limits are adjusted for inflation each year, but still apply to almost all new vehicles that are available. There are nine different categories of vehicles for this purpose, which I won’t attempt to fully explain here except to give an example that more depreciation is allowed for electric vehicles than for conventional ones. In general, if a vehicle purchased for business use in 2004 costs more than \$16,000, its depreciation deduction will be limited. In some cases, this drops as low as \$14,800.

### **Commercial Vehicles Are Allowed Full Depreciation**

When Congress established depreciation limits on passenger vehicles, it specifically wished to continue to encourage businesses that need commercial vehicles to purchase them by allowing full use of all rapid depreciation methods. It decided to define a commercial vehicle as anything over 6000 pounds gross vehicle weight. This resulted in a surge in SUV sales, since most of them are over 6000 pounds.

Part 2 of this series mentioned that this exclusion for SUVs only has been changed for vehicles purchased after October 22, 2004. All rapid depreciation methods, including both the Section 179 expense election and 30%/50% bonus depreciation continue to be available for SUVs. However the Section 179 election is now limited to \$25,000 per year. Note that this is still more generous than that allowed other passenger vehicles. It is also worth noting that vehicles over 6000 pounds that seat over 9 passengers, as well as those with at least a 6-foot cargo area that is physically separate from the passenger area, continue to be considered commercial vehicles and eligible for the full \$100,000 Section 179 yearly limit.

### **New Rule for Charitable Contributions of Vehicles**

A new limit has been placed on vehicles, boats, and airplanes donated to charity after December 31, 2004. You will still need to get a receipt from the charity. This receipt will need to show how much the charity sold the vehicle for if they did not use it or do major repairs before selling it. This is because if the charity sold the vehicle for less than blue book value, your contribution tax deduction is limited to the amount the charity received when it sells it. The October tax law changes also establish a new and sizeable penalty on charities that “knowingly furnishes a false or fraudulent acknowledgment”.

### **Important Note!**

**The information in this article is intended to inform you of some of the financial opportunities provided in the tax laws or elsewhere. These laws are very complex and thus this article is not intended to give you specific advice for your personal situation. If you need such advice, please contact a qualified professional!** Please call or e-mail me ([doug@accuteksolutions.com](mailto:doug@accuteksolutions.com)) for an initial consultation to discuss your personal situation and how the tax laws might benefit you. Your first 30-minute visit is free to let you sample what we can do for you at no cost or obligation. We also invite you to submit questions you’d like to have answered in a future article!

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