

Capital Expenditure Incentives and Estate Planning Opportunities for 2011-2012

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The press has focused on the extension of the Bush Tax Cuts and the 2% payroll tax holiday effective only for 2011 for employees and self-employed individuals. If you want to read a detailed review of those provisions, visit our website at www.wdgbt.com. Almost all of the provisions relating to rate reduction, personal deductions, personal credits and the 100-plus extenders which are now needed every year to keep the complexity of the tax code in place were addressed in the bill. What you need is a scorecard for what was extended through 2011 versus what was extended through 2012. A couple notable exceptions to the extended items were the residential energy credit which was trimmed from a \$1,500 credit to a \$500 credit, the deduction for property taxes of non-itemizers, and the new home ownership credit which was eliminated except for new homes purchased in Washington, D.C.

The hope is that the combination of consumer demand partially spurred by the 2% payroll tax holiday, coupled with the business incentives to invest in equipment will spur the economy out of its doldrums and encourage job creation to reduce unemployment. As one lawmaker said, "The only way out of this mess is to grow our way out." Apparently, President Obama and enough members of Congress, both Republican and Democrat, agreed that it was worth the nearly trillion dollars of additional debt caused by the bill to pass the legislation. In addition to the trillion dollars of additional debt over the next two years, the law will set up a huge political battle two years from now. When the provisions of the laws expire, taxes will increase across the board unless another measure is passed to extend temporary provisions yet again. Making matters worse, if you are a deficit hawk there are even more new items to extend than ever before.

Capital Expenditure Incentives

In summary, businesses of all sizes can expedite the tax benefits of capital expenditures from September 8, 2010 through December 31, 2012. The two major provisions of the Act, which impact the acceleration of depreciation deductions, are bonus depreciation (which is temporarily 100% instead of 50%) and the expansion of Section 179 depreciation to larger amounts. Here are some practical examples of how these rules will apply in the waning days of 2010 through 2012.

- Bonus Depreciation automatically applies to **new** property only with a tax life of 20 years or less, which includes almost everything except for commercial and residential real estate. There is no limit on the amount of bonus depreciation and any losses created by bonus depreciation can be carried back or forward. Certain qualified leasehold improvements to commercial buildings also qualify if the lease is between unrelated parties and the building is over three years old, subject to some restrictions. The practical impact of these rules is that any business in America, large or small, can write-off the purchase of new equipment purchased from September 8, 2010 through December 31, 2011.
- There is an option not to use bonus depreciation. There are two major reasons to consider not using the benefit. One, if you don't use it, you may claim unused Research & Development tax credits and minimum tax credits. Two, you may currently be in a low tax bracket and desire to have the deductions at a later time if you think your tax bracket, or tax brackets in general, are going up in the future. Unlike the Section 179 deduction, which you can take on an asset by asset basis, the bonus provisions can only be on an asset class by class basis (typically 3,5,7, and 15 year).

- Bonus depreciation reverts to 50% in 2012 and goes away all together in 2013 unless extended. There are all sorts of rules regarding binding contracts in effect prior to the end of 2011 for certain equipment which takes a while to produce.
- For those of you considering solar panels you should be able to write-off the entire cost less one-half of the federal grant (another program which was extended) in year one in 2011.
- For those of you involved in leasing existing property, either as a landlord or tenant, you will want to pay careful attention to the qualified leasehold improvement rules which could net a 100% deduction in 2011 for expenses incurred by either the landlord or the tenant in conjunction with a lease.
- Property owners will want to think about the benefit of cost segregation analysis to determine which assets can be classified outside the 39-year (commercial property) or 27.5-year (residential property) constraints. The reward in many cases will be immediate expensing ability under the bonus rules.
- We turn now to the expansion of Section 179 which may be the tool of choice for qualifying businesses with moderate asset purchases (up to \$500,000 in 2010 and 2011 and \$125,000 in 2012). Two major advantages of Section 179 over bonus depreciation are that **used** equipment qualifies and 179 equipment can be chosen on an asset by asset basis. Disadvantages are the dollar limitations which are imposed based on all business interests owned, some additional limitations on use specifically if there are current losses, and an inability to carry back losses. Section 179 depreciation of up to \$250,000 applies to qualified leasehold improvements, qualified restaurant property, and qualified retail improvement property in 2010 and 2011 only.

In summary, careful consideration must be given on how to use these tools in tax planning for 2010 and beyond. Proper use can create additional cash flow or cause missed opportunities. The bigger question for the fiscal health of the country is whether these incentives will induce American businesses to make capital investments. In my experience, capital investments are made primarily when businesses think the equipment can provide additional efficiencies and profits. Tax deductions are an important, yet secondary, consideration.

Additionally, while providing sweeteners on the equipment side, Congress has done nothing to the real estate equation. Having to write-off real commercial real estate purchases and construction over 39 years, which can only be financed over 15-25 years, remains a major disconnect with the incentives provided in the legislation.

Estate Planning Changes, Opportunities and Pitfalls

No provision of the new law created more heartache for Democrats than the estate changes. After missing multiple opportunities to compromise on estate tax changes over the last decade, both sides blinked. Republicans settled for a temporary fix that, in effect, at least for now, ends the promise of the elimination of the estate tax. The Democrats are afraid that a precedent has been set with an exclusion that is too high and a rate that is too low. Given that estate tax rules were about to revert to 2001 levels and that approximately 13 times more estates would become taxable in 2011 (under the new rules only 3,600 estates are likely to be taxable in 2011) and given the dramatic changes in the gift tax structure, the Republicans and those moderately wealthy Americans who are willing to engage in estate planning over the next two years clearly won this battle. Here are the key takeaways:

- Have your estate plan reviewed by legal and tax professionals if your combined (you and your spouse) net worth is greater than \$1 million now or you anticipate it going over that amount in the near future. If you are involved in your parents' financial lives, advise them to do the same. Even if your will has language that you think takes advantage of current estate provisions, make sure the language doesn't create unintended consequences due to the new law.
- If a relative died in 2010 with an estate over \$1,000,000 reevaluate all of the estate's decisions to determine whether it wants to apply the new law's many benefits especially for smaller estates. I suspect George Steinbrenner's beneficiaries prefer the 2010 rules where there is no estate tax, but his estate may be the exception and not the rule.
- Hopefully you do not have a very rich relative in their final days. Congress has left in place the dichotomy of treatment for those dying in 2010 (no estate tax) versus a significant tax for the wealthy who die in 2011.



- The biggest change for 2011 and 2012 is that estates can generally pass \$5 million (instead of \$1 million) free of federal tax to their non-spouse and non-charitable beneficiaries. If there is a taxable estate, the rate is 35% (instead of up to 55%). In 2013 the exclusion and the rates revert to \$1,000,000 and 55%, respectively.
- There is also a provision that with proper planning if both husband and wife die during 2011 or 2012, which can pass up to \$10 million tax-free. This could provide a false sense of security when the exclusion reverts back to \$1,000,000.
- By far the greatest opportunity for planning is the change in the gift tax rules for 2011 and 2012. Prior to now the limit on gifts from someone were limited to \$1,000,000 during a person's lifetime regardless of the estate tax exclusion. For 2011 and 2012 there may be a one-time opportunity to transfer wealth between generations of up to \$5,000,000 for a single person or \$10,000,000 for a couple. While there are many reasons not to transfer one's wealth, the relative benefits of transferring \$5 million now versus the risk of only being able to transfer \$1 million later will weigh heavily on many, especially small business owners, farmers, and large holders of real estate.

Investment Income and Tax Driven Decision Making

- The extension of the tax cuts for 2011 and 2012 preserves the tax-free treatment of dividends and capital gains for those in the 15% bracket and extends the 15% rate for those in higher brackets. Dividends could have been taxed at rates approaching 40%, and will be in 2013 if the rates are not extended again, for some taxpayers.
- Qualified small business stock purchases between September 17, 2010 and December 31, 2011 held 5 years qualify for 0% capital gains. This only applies to new capital for C Corporations but could help attract capital to these companies with less than \$50 million in assets.

Hopefully this package of accelerated benefits for businesses and investors, combined with some of the enhanced lending incentives from the September act and consumer spending spurred by the payroll tax holiday, will be what the doctor ordered for the economy. We certainly hope so, or the medicine is going to get increasingly hard to swallow.



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