

## UNDERSTANDING THE TAX BENEFITS OF YOUR INVENTORY (NEW BONUS DEPRECIATION AND SECTION 179 RULES)

### SUMMARY

The IRS places restrictions on the amount of depreciation taxpayers can deduct for passenger automobiles used in a trade or business. These restrictions, however, do not apply to light trucks and vans that have a gross *loaded* weight or cars with a gross *curb* (unloaded) weight of over 6,000 pounds.

**All of the examples in this article assume that the vehicle is used 100% for business purposes. If the business usage is less than 100%, the resulting tax benefit will be reduced and possibly eliminated. Tax benefits can be derived from the acceleration of depreciation deductions and the deferral of income taxes. Each customer should be encouraged to consult their tax advisor as to the value of the accelerated depreciation to their specific situation.**

### UNDERSTANDING THE TAX BENEFITS - GWV MORE THAN 6,000 LBS.

Certain new and used vehicles weighing over 6,000 pounds have attractive tax advantages for business owners. The tax laws allow certain taxpayers to deduct 100% of the purchase price as first year bonus depreciation on qualifying assets (only certain new assets qualify) purchased for use in a trade or business after September 8, 2010 and before January 1, 2012. The tax law also allows taxpayers to expense (section 179) up to \$500,000 of qualifying assets (new and used assets qualify) in the year they are purchased. However, section 179 deductions are phased out once qualifying property and equipment additions exceed \$2,000,000. The deduction is completely phased out when total qualifying additions equal \$2,500,000.

This means the average taxpayer can purchase qualifying new and used vehicles for use in his or her trade or business and potentially realize the tax benefits immediately:

#### Example 1

Purchase price of new or used vehicle	\$50,000
First year section 179 expense	(50,000)
Remaining purchase price depreciated over 5 years	\$ <u>-0-</u>

Assuming an effective tax rate of 35%, the current year tax benefits would be \$17,500.

#### Example 2

Purchase price of new vehicles	\$1,000,000
Purchase price of used vehicles	<u>1,000,000</u>
Total Purchase Price	2,000,000
First year section 179 expense *	( <u>500,000</u> )
	1,500,000
First year bonus depreciation (100%, new vehicles only)	( <u>1,000,000</u> )
	500,000
First year MACRS depreciation (20%)	( <u>100,000</u> )
Remaining purchase price depreciated over 5 years	\$ <u>400,000</u>
 Total first year expense	 \$ <u>1,600,000</u>

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\* This deduction will begin to phase out if qualifying property and equipment additions exceed \$2,000,000.

Assuming an effective tax rate of 35%, the current year tax benefits would be \$560,000.

The key to communicating these tax benefits is for your sales people to understand which vehicles qualify for this favorable tax treatment. Once they have identified the vehicles and a prospect, they can “feature and benefit” the tax law. Websites such as [www.carsdirect.com/research](http://www.carsdirect.com/research) and [www.intellichoice.com](http://www.intellichoice.com) are good resources for determining the weight of a particular vehicle. Nearly all cars are subject to the depreciation limitations because they weigh less than 6,000 pounds. The only exceptions appear to be those equipped with armor protection packages or limousine type vehicles that are not otherwise exempt from the limitations.

**UNDERSTANDING THE TAX BENEFITS - GVW LESS THAN 6,000 LBS.**

Even if you cannot sell your customer a new vehicle weighing more than 6,000 pounds, there are still income tax benefits to buying a new vehicle under the tax law. For vehicles acquired after September 8, 2010, the depreciation deduction for trucks (including SUVs) and vans weighing less than 6,000 pounds that qualify for bonus depreciation will equal \$11,060 in the first year, \$4,900 in the second year, \$2,950 in the third year and \$1,775 in the fourth year and every year thereafter until they are fully depreciated. The depreciation deduction for cars weighing less than 6,000 pounds that qualify for bonus depreciation is \$11,160 in the first year.

Example

Purchase price of new truck or van	\$25,000
First year depreciation	<u>(11,160)</u>
Remaining purchase price depreciated according to passenger vehicle table	<u>\$13,840</u>

Assuming an effective tax rate of 35%, the current year tax benefits would be \$3,906.

**IMPORTANT NOTE:** These rules do not apply to certain “modified” light trucks and vans that cannot be used for personal use. For example, a light duty van that has only a front bench for seating, permanent shelving that fills most of the cargo area, “constantly carries” merchandise or equipment, and has been painted with advertising or the company’s logo will generally qualify as “modified” for this purpose. These vehicles will qualify for tax treatment as if they weighed in excess of 6,000 pounds.

**CONCLUSION**

Explaining the features and benefits of the tax law can help improve sales of vehicles weighing in excess of 6,000 pounds. Please contact me if you have questions or if you would like me to come to your dealership to review the tax benefits of these vehicles in more detail.