



Tax & Accounting

Depreciation Deduction: A Double-Edged Sword

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Most business owners recognize the value of depreciation. Simply put, it is a tax deduction for the wear and tear of business property.

What's more enticing is that it's a recurring deduction which doesn't require cash outlay. Whether the equipment is paid for upfront or financed, it provides businesses with a stream of tax deductions, lasting from three to seven years, depending on the type of asset. Real estate is in a separate category with depreciation spanning anywhere from 15 to 39 years.

If that's not a good enough reason to buy new equipment or upgrade a business vehicle, recent law changes and subsequent 2015 extenders created additional incentives:

- immediate write-off of purchased assets, up to \$500K per year (known as Section 179 deduction)
- bonus depreciation (50 percent of the cost is written off in the first year equipment is placed into service)

However, depreciation is not a freebie! One must not overlook the tax consequences when disposing of business assets. Upon sale, depreciation taken in prior years increases gain realized and is not afforded preferential capital gain treatment. Should the sale be structured on the installment basis (cash is received over time), tax on prior depreciation (recapture) becomes due in the year of sale, even if no cash is received.

There are still more positive aspects of the depreciation concept. For starters, businesses can take advantage of the time value of money; that is, deduction now is worth more than income later. Other ways to reduce or avoid the effects of the recapture trap include the following scenarios:

- Gifts of property are not subject to the recapture; instead, their potential tax implications carry over to the donee.
- Inherited property is not tainted by any recapture issues. Therefore, the recipient of the property can start with a clean slate, claiming fair market value of an asset on the date of death as his or her basis.



Other methods to reduce the bite of recapture effects would be to recognize ordinary income when the taxpayer or business is in a low tax bracket or when there are net operating losses available. One can postpone the recapture provisions by completing a like-kind exchange in which case the recapture is not triggered upon the exchange but rather is carried over to the replacement property.

With proper planning, depreciation recapture can be reduced, shifted, postponed or even eliminated.

With the 2016 Presidential election around the corner, tax professionals and business owners alike should pay close attention to potential changes to the rules concerning bonus depreciation, Section 179 deduction and the recapture rules discussed in this article. 📌



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