



**Internal Revenue Service**

**Small Business and Self-Employed  
Taxpayer Education and Communication**



# Tax Information for Small Businesses



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# CONSTRUCTION Depreciation IRC Section 167(a), 168 & 179a





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# What is Depreciation?

- Property used for business
- Property expected to last more than one year
- Represents wear, decay, usage, obsolescence, or loss of value due to natural causes



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# What can be Depreciated?

- Real Property:
  - Any building or structure built on land; plants or trees grown on land; and attachments or improvements to land
- Personal Property:
  - Cars, trucks, machinery, furniture, equipment, and all other tangible items which are not real property



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# What cannot be Depreciated?

- Property placed in service and disposed of in the same year
- Inventory
- Land
- Repairs and replacements that do not increase the value of your property; make it more useful; or lengthen its useful life

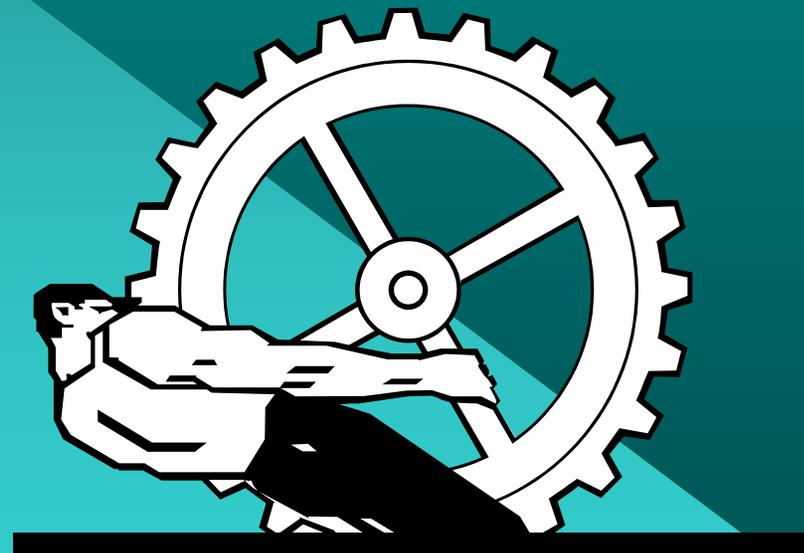


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# How to Figure Depreciation

- Basis
- Class Life
- Placed in Service Date
- Convention
- Method





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## Definitions

- **COST BASIS:** Usually the purchase price, including sales tax, freight, and installation charges.
- **ADJUSTED BASIS:** Increase cost basis by improvements. Decrease basis by depreciation deductions.



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# Compute Basis

## Example:

Adam bought a dump truck from a local contractor. He paid \$2,000 cash, borrowed \$3,000 from the bank, and agreed to dig the foundation for the contractor's lake cabin (worth \$1,000). The cost basis for the dump truck would be \$5,000.



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## Class Life

- 3-year Property
  - Tractor units used over the road.
- 5-year Property
  - Any construction property that does not have a class life.
  - Automobiles, taxis, buses & trucks.
  - Computers & peripheral equipment.
  - Office machinery, such as typewriters, calculators, & copiers.
  - Property used in research & experiments.
- 7-year Property
  - Office furniture & fixtures
- 15-year Property
  - Land improvements, such as shrubbery, fences, roads, & bridges.
  - Service stations, but not the pumps.
- 39-year
  - Nonresidential real property.



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# Placed In Service Date

- Depreciation is taken when the property is ready and available for use in your trade or business, even if the property is idle or currently not in use.



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## Conventions

### Half-Year:

- Treat property placed in service during the year as if it started at the midpoint of the year
- This convention is used for most property

### Mid-Month:

- Treat property placed in service during a month as if it started at the middle of the month
- This convention is used for real property



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# Conventions (cont'd)

## Mid-Quarter Convention:

- Treat personal property placed in service during a quarter as if it started at the middle of the quarter
- Must be used when more than 40 percent of all personal property placed in service during the year was placed in service in the last three months of the year



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# Computing Your Depreciation Deduction

- Multiply the basis of the asset by predetermined percentages set by the class life, convention, and method.



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## General Depreciation System (GDS); 200% Declining Balance (DB); Half-Year Convention (HY)

<u>Year</u>	<u>3-Year</u>	<u>5-Year</u>	<u>7-Year</u>
1	33.33%	20.00%	14.29%
2	44.45%	32.00%	24.49%
3	14.81%	19.20%	17.49%
4	7.41%	11.52%	12.49%
5		11.52%	8.93%
6		5.76%	8.92%
7			8.93%
8			4.46%



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## Example

Year	Cost x GDS	Depreciation
1998	\$15,000 x 20.00%	\$3,000
1999	\$15,000 x 32.00%	\$4,800
2000	\$15,000 x 19.20%	\$2,880
2001	\$15,000 x 11.52%	\$1,728
2002	\$15,000 x 11.52%	\$1,728
2003	\$15,000 x 5.76%	\$ 864
Total		\$15,000



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# Listed Property

- Most four-wheeled passenger vehicle used primarily for public streets, roads, and highways that weighs 6,000 lbs or less unloaded
- Entertainment, recreation, or amusement property (Includes photographic, phonographic, communication, and video-recording equipment)
- Computer and related peripheral equipment
- Any cellular telephone



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# Section 179 Election

- Allows you to elect to deduct all or part of the cost of certain qualifying property in the year you place it in service.



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# Section 179 Property

## Includes:

Property purchased new (if a trade-in is used, only the cash amount can be used)

## Does Not Include:

Leased, real, or rented property

Listed property whose business use for the year is 50% or less of the total use



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# Deduction Limitations

## Maximum Dollar Limit:

- For 2003 to 2005, it is \$100,000. After 2005, it is scheduled to go down to \$25,000.

## Investment Limit:

- If the total cost of the Section 179 property exceeds \$400,000 (the “threshold figure”), the amount of excess reduces the maximum dollar limit dollar for dollar. The threshold figure returns to \$200,000 after 2005.



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# Deduction Limitations (cont'd)

## Taxable Income Limit:

- The amount you deduct each year cannot exceed the taxable income from all active trade or business conducted during the year.
- Wages and salaries received as an employee are included.



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## New Law

- Additional 50 percent special depreciation deduction on property's depreciable basis taken after Section 179 deduction.
- Newly purchased property with class life of 20 years or less.
- Acquisition Date: Purchased after 5/5/2003, but before 1/1/2005
- Placed in Service Date: Must be used in your business after 5/5/2003 and before 1/1/2005
- Original Use: Began with you after 5/5/2003



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# Computation Example

- Property purchased 5/17/2003.
- Original cost is \$200,000.
- Section 179 deduction taken is \$100,000.
- What is the special depreciation deduction?





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## Answer

<b>Cost</b>	<b>\$200,000</b>
less Section 179 deduction	(100,000)
multiply remaining depreciable basis by 50 percent.	\$100,000 X 50%
Special Depreciation Allowance	\$ 50,000
Regular Depreciation Basis	\$ 50,000



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# Thank You!