III. Tax Reform: Permanently Increase Section 179, The Direct Expensing Allowance

BACKGROUND

Section 179 of the tax code allows businesses to deduct, up front, a certain amount of equipment and asset purchases, such as computers, vehicles, machinery, and office furniture in the year of purchase instead of depreciating them over several years. When the total purchases in a year exceed a specific total amount or cap, the direct expensing allowance cannot be used.

Why is this important to small businesses and manufacturers?

Section 179 has always been one of SMC's priorities. This section of the tax code aids cash, flow reduces the cost of capital for small firms and is a simplification measure. It is one of the most important provisions in the tax code for smaller firms, particularly those manufacturers in more capital-intensive industries.

- **Manufacturing is very important to the Pennsylvania economy.** A total of 1,914,200 jobs in the state are supported by the manufacturing industry; it has one of the largest industry multiplier effects.
  Adapted from Governor Corbett's Manufacturing Advisory Council Report, August, 2012 and updated by Tom Palisin, Manufacturing Ombudsman, Pennsylvania Department of Community and Economic Development
- **According to the 2014 National Small Business Association (NSBA) Taxation Survey,** of the 11 choices of deductions or credits, Section 179 expensing had the highest usage at 34%.

PROBLEM

Congress has temporarily extended Section 179 multiple times in recent years.

The annual termination, change in limits and delay in extensions makes it difficult for businesses to plan, interferes with business efficiency improvements, and harms the economy both for buyers and sellers of capital goods.

- **Capital investments are curtailed:** Without action in 2014, the amounts in Section 179 reverted to pre-2001 levels of $25,000 in a write-off with a $200,000 purchase amount cap. After the cap is exceeded, businesses must use depreciation methods. The result is that businesses put off making decisions about investments once they reached the $200,000 cap.
- **Uncertainty makes business planning difficult and adds to the cost of compliance:** Any size business would have difficulty planning, but the problem is compounded for smaller businesses because they lack the resources for specialized staff.
  - There are more than 989,000 small businesses in Pennsylvania and most have LESS than 20 employees according to the U.S. Small Business Office of Advocacy. When a company has less than 20 employees, the owner and staff are filling multiple roles. In addition to uncertainty regarding the economy, the Affordable Care Act and the minimum wage, uncertainty about Section 179 becomes another unknown entity to juggle.
  - Tax compliance costs firms an average of $800 per employee and the cost for firms with fewer than 20 employees is almost double that.

U.S. Small Business Administration

SMC Member Illustration of the impact of changing rates on a small manufacturer:

> ”The 2011 Section 179 tax depreciation schedule was very helpful in enabling MLP Steel to reinvest into the business with its improved cash flow. MLP acquired new machinery during the recession at a discounted price resulting in increased productivity of various production lines. In some instance increases were in excess of 300%.…Under the present tax code for 2012, the Section 179 deduction limit is reduced to $139,000 and a bonus deduction of 50% with an equipment cap of $560,000. In 2013 the deduction limit may be reduced to $25,000 and the bonus deduction may be eliminated.
>
> MLP steel anticipates investing an estimated $800,000 to 1 million dollars in new equipment for our two manufacturing facilities. If the Section 179 depreciation schedule from 2011 was in effect, MLP would realize tax savings of $280,000. Unfortunately, the Section 179 tax schedule for 2012 will result in a deduction of $160,000, a difference of $120,000. The end result is a tax increase of approximately 43%, limiting MLP’s ability to reinvest in a new plant and machinery.”
>
> *Adapted from the testimony for the Iron and Steel Caucus on April 20, 2012*
> *by SMC member Jeff Pfeifer, President & CEO, MLP Steel, LLC.*

SOLUTION

SMC is asking for a permanent increase in Section 179 expensing for years beginning in 2014.

A permanent solution should be put in place that allows a $1 million write-off, phasing out for property exceeding $2 million with both thresholds indexed for inflation. This helps manufacturers and small businesses that purchase expensive equipment to remain competitive by:

- Aiding with cash flow.
- Providing certainty and predictability for business planning purposes.
- Simplifying and reducing the cost of compliance with the tax code.

Could you effectively and prudently manage your family budget and plan for the future when the rules are constantly changing?

Look at the following record of Section 179 legislative history since 2001. The expensing allowance and the purchase cap/phase-out threshold have been increased on a temporary basis multiple times.

- **2001–2002:** Direct expensing allowance was $25,000, with a purchase amount cap of $200,000.

- **2003, 2004, and 2005:** Direct expensing allowance was $100,000, with a purchase amount cap of $400,000.

- **2004:** Direct expensing allowance was $100,000, with a purchase amount cap of $400,000, extended through 2007.

- **2007:** Direct expensing allowance was $100,000, with a purchase amount cap of $400,000. The direct expensing allowance and purchase amount cap were increased to $125,000 and $500,000, respectively, for taxable years beginning in 2007 through 2010. The amounts were indexed for inflation in taxable years beginning after 2007 and before 2011. The direct expensing allowance amount for 2008 was indexed and scheduled to be $128,000, with a purchase amount cap of $510,000.

- **2008:** Direct expensing allowance was increased to $250,000, with a purchase amount cap of $800,000.

- **2009:** The temporary increases of 2008 were extended through 2009.

- **2010:** Direct expensing allowance was $250,000, with a purchase amount cap of $800,000. The temporary increase was set to expire at the end of 2010.

- **2010:** Direct expensing allowance was increased to $500,000, with a purchase amount cap of $2 million for the taxable years beginning in 2010 and 2011.

- **2010:** Direct expensing allowance in 2012 was $125,000. The $125,000 amount was reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeded $500,000. The $125,000 and $500,000 amounts were indexed for inflation. As a result, for 2012, the adjusted allowance was $139,000 and the phase-out was $560,000.

- **2013:** Direct expensing allowance was $500,000, with a purchase amount cap of $2,000,000 for 2012 and 2013. (In effect, a retroactive increase for 2012.) Neither number was indexed for inflation.

- **2014:** Direct expensing allowance falls all the way back to pre-2013 levels of $25,000, with a capital spending cap of $200,000 without inflation indexing.

Adapted from the Small Business Legislative Council Issue Papers

Legislative History of Section 179 Summary		
Year	**Direct Expensing Allowance**	**Purchase Amount Cap**
2001	$25,000	$200,000
2002	$25,000	$200,000
2003	$100,000	$400,000
2004	$100,000	$400,000
2005	$100,000	$400,000
2006	$100,000	$400,000
2007	$100,000	$400,000
2007	$125,000	$500,000
2008*	$128,000	$510,000
2008*	$250,000	$800,000
2009*	$250,000	$800,000
2010*	$250,000	$800,000
2010*	$500,000	$2,000,000
2011*	$500,000	$2,000,000
2012	$125,000	$500,000
2012*	$139,000	$560,000
2012	$500,000	$2,000,000
2013	$500,000	$2,000,000
2014	$25,000	$200,000
* Indexed for inflation		

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Please consider SMC Business Councils as a resource when you need facts, figures, information, and testimony from small employers. Visit www.smc.org to view SMC Business Councils 2014 Federal Position Papers.