Should Your Farm Use the Section 179 Deduction this Year?

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Harvest season is winding down, which means it is time to start thinking about year-end tax planning for 2016. If you are reading this, you likely already know that 2016 was somewhat of a down year for field crop production in Michigan. **Farm Bureau** reports corn yield is down 7 bushels from last year to 155 bushels per acre. Similarly, soybean yield is projected to be down 2 bushels per acre, to 47 bushels per acre. Dry beans suffered the largest decline in yield, projecting a nearly 250 pound per acre decrease from last year. Still, if you have carryover grain or livestock inventory, your income may be higher than last year.

This article is the first of a two-part series and discusses the deduction available under Code Section 179. Part 2 addresses ways the bonus depreciation rules and other farm-specific deductions can be paired with Section 179 for effective and powerful year-end tax planning.

WHAT IS SECTION 179?

The general rule under the Internal Revenue Code (the "Code") requires taxpayers to capitalize asset purchases and depreciate the assets pursuant to the applicable depreciation schedule. Under Code Section 179, taxpayers may instead deduct the cost of tangible personal property placed into service during the year. The most common asset expensed under Section 179 is "Section 1245 property," which includes machinery and equipment purchases. Importantly, there is no requirement that the purchased property be new—Section 179 applies to both new and used property. Section 179 is also available for purchased breeding livestock.

The use of Section 179 is subject to two limits. First, the limit on the available deduction is $500,000 ($510,000 in 2017). Accordingly, if you purchase $600,000 in equipment, you may deduct $500,000 under Section 179 and you must depreciate the remaining $100,000. The second limit reduces the available deduction by the amount your total property purchases exceed an "investment ceiling." For 2016, this investment ceiling is $2,010,000 ($2,030,000 in 2017). Accordingly, if

you purchase $2,110,000 of equipment during the year, the $500,000 deduction is reduced by $100,000 ($2,110,000 - $2,010,000).

SHOULD YOU USE THE SECTION 179 DEDUCTION?

The first step in determining whether generating year end deductions is right for you is to obtain an accurate picture of your anticipated income tax liability before the end of the year. You should try to determine your anticipated tax liability by the first week of December to give yourself ample time to plan any purchases. The benefit of Section 179 is that the deduction is not prorated by when equipment is placed into service. Accordingly, the full $500,000 deduction is available, even if you do not place equipment into service until December 31. The standard depreciation rules penalize taxpayers for placing equipment into service at the end of the year. Section 179 avoids this undesirable result and allows farmers to do last-minute tax planning.

Second, you do not want to purchase new equipment solely for the sake of reducing your current income tax liability. If you need new equipment and do not need financing to purchase that equipment, Section 179 is a useful tool that not only allows you to expense the entire purchase this year, but also avoids borrowing costs you would incur if you financed the purchase. On the other hand, if you borrowed money to purchase new equipment, you may want to consider using standard or bonus depreciation instead of fully expensing the purchase under Section 179. By taking a full deduction this year, you foreclose the possibility of taking deductions in subsequent years. This means that you must generate enough cash flow to cover your loan payments in subsequent years.

There are some instances where Section 179 may be useful even in a down year. The deduction available to Section 179 is limited to the amount of your taxable income, and any deduction exceeding net income is carried over into the subsequent year. Accordingly, if you absolutely must purchase equipment in a down year, it may be beneficial to take the Section 179 deduction if you anticipate the need for a carried over deduction in 2017.

Section 179 is not the only advantageous Code provision available to farmers for year-end tax planning. Part 2 of this series will discuss other Code provisions that may be paired with Section 179 to maximize your year-end deductions. For more information on how Section 179 can benefit your specific farm, contact Mike Zahrt at mzahrt@fosterswift.com.