



## The Economic Stimulus Act's "Bonus Depreciation Tease"

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“Don’t let the tax tail wag the dog” is one of a tax adviser’s most frequently used sayings. It means taxpayers should not make a choice they would not make otherwise just for the tax benefits. For example, a taxpayer should not marry or divorce or purchase or sell a house simply to save taxes. Short-lived tax developments often create the urge to make a quick decision that is driven more by the desire to reduce tax than by thoughtful analysis.

A good example of such a development is the “bonus depreciation” included in the Economic Stimulus Act passed by Congress on February 13, 2008. The most publicized features of the law are the tax rebates of \$600 for singles, \$1,200 for married couples, and \$300 for children and the increase in the Section 179 immediate expensing amount from \$128,000 to \$250,000 for 2009. Less frequently mentioned is the 50% bonus depreciation that is available for purchases made in 2009. Bonus depreciation is primarily directed at large businesses that cannot take advantage of the immediate expensing provisions, but, for individuals, bonus depreciation has the subtle benefit that the first year luxury auto limitation is raised by \$8,000 from the projected \$2,960 for first year depreciation to \$10,960.

Example: John is in the 35% (28% plus 7% state) marginal income tax bracket. He purchased a \$50,000 vehicle that is used 100% for business. At the beginning of the seventh year, John sells the sport utility vehicle (SUV) for \$20,000. Here is the difference in treatment if (1) the vehicle was subject to the regular rate of depreciation for vehicles without the 2008 Economic Stimulus Act changes, (2) the vehicle is a non-SUV subject to the 2008 bonus depreciation rules, and (3) the vehicle is a SUV eligible for \$25,000 immediate expensing and the 2008 bonus depreciation.

Over the six-year period of ownership, the actual cash flows are the same regardless of the vehicle chosen or the depreciation rules that apply. From a time value of money perspective, the Economic Stimulus incentives for a non-SUV provide a present value benefit of \$779 (\$8,761 – 7,982) compared to the regular rules. If a SUV is purchased, the present value benefit is \$3,475 compared to the regular rules. This amount has two components, the \$779 (\$8,761 – 7,982) present value benefit from the additional \$8,000 of bonus depreciation and the \$2,696 (\$11,457 – 8,761) present value benefit from the \$25,000 immediate write off for SUVs.

Congress debated the repeal of this \$25,000 write off in 2007, but the provision did not pass. Congress may pass the provision in 2008.

Although the benefits for SUVs are tempting and may be short-lived, the \$3,475 of additional benefit does not seem to justify even the additional fuel cost from purchasing such a large vehicle. If the taxpayer drives 90,000 miles over six years (15,000 miles per year), the non-SUV gets 25 miles to the gallon, the SUV gets 10 miles to the gallon, and gas costs \$3 per gallon, the SUV fuel costs exceed the non-SUV fuel costs by \$16,200  $((90,000/10 - 90,000/25) \times 3)$ . This trade-off does not seem to make sense unless the taxpayer really wants to drive the SUV or needs the size and expense for business reasons.

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