Daniel M. Isard

The Great December Shopping Spree

Buying what you don't need just to get a tax write-off is pure foolishness.

Dear Dan,
I enjoy December because of the chance to go shopping! I don't mean holiday shopping. I mean shopping for big-ticket items for my business. My accountant has me wait until December to buy them so I can write them off and dispose of my tax bill. I buy new cars even if the existing car is only two years old. I get new furnishings just to spruce up the place. I feel giddy and wicked doing it, but I think it's good tax planning! Why don't you ever tell people about this?
Signed, Shopping in Shippensberg

Dear rural Pennsylvania funeral home owner with a stupid accountant:

Let us begin by understanding some basic facts of life and taxes. Assume you are a C Corporation and you have a $100,000 profit. Let me further define profit as earnings after depreciation, interest expense and amortization. In that case, you pay $22,500 in taxes. That is a 22.5 percent tax rate. If you are a Sub S Corporation or an LLC or, heaven forbid, a sole proprietorship, that $100,000 is taxed at your personal tax bracket; worst-case scenario is that your tax is $39,000 or 39 percent.

The deal you and every business-owning American makes with the government is that you get to keep the amount of business earnings, after taxes. So, in the above cases, if you earned $100,000 of profit, you got to keep $77,500 or, at worst, $61,000 after taxes.

The formula for business taxation is revenue - expenses = profit. Expenses are subject to the U.S. tax code. One of these deductions is for equipment used in the course of trying to generate a profit. The equipment can be new or used when purchased. If the material is consumed in one year, it is going to be "expensed," meaning deducted in that year. If the material is going to be rendered through wear and tear or obsolescence, then the material is "depreciated." If the asset is an intangible asset, it is "amortized." The number of years that the asset is depreciated or amortized is set by the tax code. There are many tests to determine the period for depreciation. However, small businesses have Internal Revenue Code (IRC) Section 179 that comes to the rescue and allows a small business to write off some assets in one year rather than over several years. But this deduction is a tax incentive; it has nothing to do with the real value of the asset.

My dear Shippy, no business owner in the country is in a 100 percent tax bracket, so any deduction is a blend of the government taking less in taxes and you taking less in after-tax cash. Some countries literally have 60 percent tax rates! We in this country, before Kennedy, would tax some income at 75 percent!

High taxes stifle investment and initiative. Thus, buying something just for the ability to reduce taxes is akin to killing a fly in your house with a shotgun. Yes, it meets the objective, but looking at it objectively, it is very wasteful.

Now, let me further perfect the initiative of every business owner. It should not be to pay the least amount in taxes. It should be to manage your business, which involves making investments in your business that will increase its value, provide greater service to consumers and maintain your facilities. That being said, if something needs repair, you repair it. You repair it for the sake of not having a broken or dilapidated physical plant. You invest in autos when they need to be invested in – not to save on taxes.

The ability to deduct an investment in physical plant, furnishings, software, hardware or livery is covered by IRC Section 179. The tax code has four major purposes, and one of the most prevalent is the ability to spur the economy. Section 179 allows businesses to deduct investments made on behalf of their business on qualifying property and equipment more rapidly than the normal depreciation period. There are a few things to keep in mind.

Section 179 has been part of our tax code for many years and has been enhanced from time to time to promote small-business owners to invest in their businesses, which increases the amount of spending in our economy. Thirty years ago, the auto industry was hurting, so Section 179 was amended to allow a business owner to write off a car over two or three years, whereas the year before the amendment, it took five to seven years. The theory behind Section 179 is fully driven by economics. If the government gives you incentive to spend, you will spend. The cost to the government is the loss of taxes received due to giving you a deduction. On the other hand, the government avoids increases to plant bankruptcy rates, unemployment rates, the number of people on welfare and the potential for its tax base to dry up. It is a dangerous balancing act to be a government economist.

When Congress wanted to promote the economy a few years ago, it changed the amount of the deduction for depreciation under Section 179. So rather than buying something for $10,000 and writing it off over five years, the Section 179 amounts were changed to allow for a write-off of the full amount in one year. You are not getting more write-off value, you are just getting it on an accelerated basis.

There are limits. In 2015, that limit is $200,000. You can purchase new or used business equipment that also qualifies for the deduction. Most tangible property and software will qualify as well. The equipment can have a full-year write-off if you put it to use on or before December 31, 2015, for the 2015 calendar year tax return.

The qualifying purpose of the equipment must be business use. The equipment, vehicle(s) and/or software must be used for business purposes more than 50 percent of the time. If it's less than that, you cannot use Section 179. If it is used between 50 percent and full time for business, simply multiply the cost of the equipment, vehicle(s) and/or software by the percentage of business use to arrive at the monetary amount eligible for Section 179. The balance cannot be deducted or it might wind up on the owner's 1099.

I had a client who bought a $100,000 RV a few years ago. He was going to use this to "scatter" remains. Then he got audited. Asked the auditor: "So, how many times a year do you drive this thing?" My client replied, "Oh, about 20 times a year." The auditor asked, "How many of those trips involved a scattering?" My client responded, "Well, I am just getting the business started and so far only four trips." The auditor then reached into his briefcase and pulled out big stamp that said, "DENIED."

There is merit to having a tax professional consult with you before you purchase a $100,000 RV or show up for an audit on the deductibility of such an asset.

So, Shopping in Shippensberg, just buying assets that can lower your tax is not a good idea, WHICH IS WHY I NEVER WROTE PROMOTING THIS IDEA BEFORE (yes, this writer is shouting here). In fact, it's a STUPID IDEA!

I'm not saying that reinvesting in your company is a bad idea, but to buy furnishings before they are needed is a waste of money. Do you think you will get more calls because you have more furniture in your funeral home? Investing in a hearse? Who says, "I went to the funeral home because it had the new Slumberlounger hearse"? You don't want a broken-down automobile, but replacing a two-year-old auto is a waste of money unless you bought one of those stretch Yugos I saw at a convention a few years back.

If you do nothing, based on my initial premise, you wind up with cash money of between $61,000 and $77,500. What is so wrong with that? If you want to consider doing something, look into enhancing your qualified retirement plan. For most funeral home owners, putting an extra $20,000 into a retirement plan gives them one-half to two-thirds of the deposit, and with compounding, it will help enable their retirement. A Slumberlounger hearse can't help your retirement.

Another year-end use of profit that gives a giant return on investment is continuing education. Take a $10,000 trip that is not deductible, and it'll cost you about $15,000 ($5,000 for the income tax and $10,000 on hotel and travel). Go on a trip to learn how to enhance your business, and most of it will be deductible. My motto: "Try never to travel 'retail'; always travel 'wholesale' or 'after-tax.'"

So, Silly Shippensberger, if you have a good year, buy what must be bought to keep the quality of the service you are providing at its best. Send yourself to a seminar, maybe in Arizona, where you can learn something and be called a "loser" by the presenter. Then put more money into your retirement account. Don't be afraid to pay some taxes! What is left over is yours to keep. When you're 83 years old, you'll be happy that you put that money in the bank. Of course, you won't have the ability to take your friends for a drive in the 2015 Slumberlounger, but by then you probably won't have a license anyway. ✶

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