

13. *Expansion of limitation on expensing of certain passenger automobiles (sec. 474 of the bill and sec. 179 of the Code)*

PRESENT LAW

A taxpayer is allowed to recover, through annual depreciation deductions, the cost of certain property used in a trade or business or for the production of income. The amount of the depreciation deduction allowed with respect to tangible property for a taxable year is determined under the modified accelerated cost recovery system ('MACRS'). Under MACRS, passenger automobiles generally are recovered over five years. However, section 280F limits the annual depreciation deduction with respect to certain passenger automobiles. 383

[Footnote]

[Footnote 383: The limitation is commonly referred to as the 'luxury automobile depreciation limitation.' For passenger automobiles (subject to such limitation) placed in service in 2002, the maximum amount of allowable depreciation is \$7,660 for the year in which the vehicle was placed in service, \$4,900 for the second year, \$2,950 for the third year, and \$1,775 for the fourth and later years. This limitation applies to the combined depreciation deduction provided under present law for depreciation, including section 179 expensing and the temporary 30 percent additional first year depreciation allowance. For luxury automobiles eligible for the 50% additional first depreciation allowance, the first year limitation is increased by an additional \$3,050.]

For purposes of the depreciation limitation, passenger automobiles are defined broadly to include any 4-wheeled vehicles that are manufactured primarily for use on public streets, roads, and highways and which are rated at 6,000 pounds unloaded gross vehicle weight or less. 384

[Footnote] In the case of a truck or a van, the depreciation limitation applies to vehicles that are rated at 6,000 pounds gross vehicle weight or less. Sports utility vehicles are treated as a truck for the purpose of applying the section 280F limitation.

[Footnote 384: Sec. 280F(d)(5). Exceptions are provided for any ambulance, hearse, or any vehicle used by the taxpayer directly in the trade or business of transporting persons or property for compensation or hire.]

In lieu of depreciation, a taxpayer with a sufficiently small amount of annual investment may elect to expense such investment (sec. 179). The Jobs and Growth Tax Relief Reconciliation Act (JGTRRA) of 2003 385

[Footnote] increased the amount a taxpayer may deduct, for taxable years beginning in 2003 through 2005, to \$100,000 of the cost of qualifying property placed in service for the taxable year. 386

[Footnote] In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. The \$100,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds \$400,000. Prior to the enactment of JGTRRA (and for

taxable years beginning in 2006 and thereafter) a taxpayer with a sufficiently small amount of annual investment may elect to deduct up to \$25,000 of the cost of qualifying property placed in service for the taxable year. The \$25,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds \$200,000. Passenger automobiles subject to section 280F are eligible for section 179 expensing only to the extent of the applicable limits contained in section 280F.

[Footnote 385: Pub. Law No. 108-27, sec. 202 (2003).]

[Footnote 386: Additional section 179 incentives are provided with respect to a qualified property used by a business in the New York Liberty Zone (sec. 1400L(f)), an empowerment zone (sec. 1397A), or a renewal community (sec. 1400J).]

REASONS FOR CHANGE

The Committee believes that section 179 expensing provides two important benefits for small business. First, it lowers the cost of capital for property used in a trade or business. With a lower cost of capital, the Committee believes small business will invest in more equipment and employ more workers. Second, it eliminates depreciation recordkeeping requirements with respect to expensed property. However, the Committee understands that some taxpayers are using section 179 to lower the cost of purchasing certain types of vehicles (1) that are not subject to the luxury automobile limitations imposed by Congress and (2) for which the specific features of such vehicle are not necessary for purposes of conducting the taxpayer's business. The Committee is concerned about such market distortions and does not believe that the United States taxpayers should subsidize a portion of such purchase. The Committee's provision places new restrictions on the ability of certain vehicles to qualify for the expensing provisions of section 179.

EXPLANATION OF PROVISION

The provision limits the ability of taxpayers to claim deductions under section 179 for certain vehicles not subject to section 280F to \$25,000. The provision applies to sport utility vehicles rated at 14,000 pounds gross vehicle weight or less (in place of the present law 6,000 pound rating). For this purpose, a sport utility vehicle is defined to exclude any vehicle that: (1) does not have a primary load device or container attached; (2) has a seating capacity of more than 12 individuals; (3) is designed for more than nine individuals in seating rearward of the driver's seat; (4) is equipped with an open cargo area, or a covered box not readily accessible from the passenger compartment, of at least 72.0 inches in interior length; or (5) has an integral enclosure, fully enclosing the driver compartment and load carrying device, does not have seating rearward of the driver's seat, and has no body section protruding more than 30 inches ahead of the leading edge of the windshield.

The following example illustrates the operation of the provision.

Example- Assume that during 2004, a calendar year taxpayer acquires and places in service a sport utility vehicle subject to the provision that costs \$70,000. In addition, assume that the property otherwise qualifies for the expensing election under section 179. Under the provision, the taxpayer is first allowed a \$25,000 deduction under section 179. The taxpayer is also

allowed an additional first-year depreciation deduction (sec. 168(k)) of \$22,500 based on \$45,000 (\$70,000 original cost less the section 179 deduction of \$25,000) of adjusted basis. Finally, the remaining adjusted basis of \$22,500 (\$45,000 adjusted basis less \$22,500 additional first-year depreciation) is eligible for an additional depreciation deduction of \$4,500 under the general depreciation rules (automobiles are five-year recovery property). The remaining \$18,000 of cost (\$70,000 original cost less \$52,000 deductible currently) would be recovered in 2005 and subsequent years pursuant to the general depreciation rules.

EFFECTIVE DATE

The proposal is effective for property placed in service after the date of enactment.