



Is Bonus Depreciation just a Temporary Loan? Not so with a Like-Kind Exchange

by Kevin R. Schmitt, CPA, CFP®, Partner
Honkamp Krueger & Co., P.C.



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Did your CPA get you an extra deduction when they took advantage of "bonus" depreciation in 2008? Did they also tell you you'd eventually need to pay it back? After a two year hiatus, Congress resurrected "bonus" depreciation as a stimulative response to the country's continuing economic downturn.

This immediate, one time bonus deduction probably cut a big chunk out of your 2008 tax bill. However, the only problem with getting the extra deduction this year is paying it back in a future year when you sell the property and need to recapture bonus depreciation as additional taxable gain. In effect, bonus depreciation in the current year often results in a larger tax bill down the line if you sell bonus property within a few years of purchase.

Fortunately, all is not lost. What if you could defer bonus depreciation recapture and the related additional taxes when you sell your property?

Ask your tax professional about a like-kind exchange (LKE)

Most people only know of LKE in regard to exchanges of real estate. However, the same rules were also created to allow business owners, small and large alike, to defer paying taxes on sales of business property as long as they reinvest sales proceeds in like-kind property. Effectively, this means as long as you continue to replace used or worn property with like-kind property any taxes due on the sale of that property will be deferred basically until you sell the business. Note: even if you didn't take bonus depreciation on new property in 2008 you can still save by doing an LKE.

A simple example

Let's assume you have one piece of property for which you originally paid \$10,000. Let's also assume after six years the property is fully depreciated and you sell it for \$1,000. Typically, you'll have to report a \$1,000 gain to the IRS. If you pay 40 percent of your income in taxes you will only be left with \$600 to replace that piece of property. Without a like-kind exchange you lose 40 percent of your buying power to taxes. Unfortunately, the cost of our property has gone up in the past six years, and it now costs \$12,000 to purchase a like-kind replacement. Don't you wish you had \$1,000 to reinvest instead of \$600?

Saving \$400 on a single transaction may not be that big of a deal to you, but what if your company is buying and selling these assets on a regular basis on a far larger scale? In our

simple example, selling 50 pieces a year could result in a \$20,000 tax savings. In that case, LKE puts \$20,000 back into your business to help you grow faster and, in the end, it might just be that competitive advantage you're looking for.

What kind of property is eligible?

The quick answer is any asset used in your trade or business. Whether your business purchases materials handling equipment to use in everyday operations or it purchases golf carts to lease to customers, both types of operations qualify for like-kind exchange. Other businesses that are likely to benefit from LKE are construction, vehicle leasing, transportation and freight operations including trucking fleets of tractor trailers, or any other business that relies on significant investments in business assets that must be upgraded or replaced on a regular basis. If you depreciate assets, more than likely your business would benefit from LKE.

What exactly does like-kind property mean?

Typically like-kind is interpreted broadly. You don't have to replace a 2004 Ford F-150 with another 2004 F-150. You could buy a 2008 Chevy 2500 or Toyota Tundra or, under a recent IRS pronouncement, you could even buy a passenger automobile like a Ford 500 used in your business. In the construction industry, all construction equipment is like-kind to all other types of construction equipment. The same goes for golf carts and material handling equipment.

The idea behind LKE is simple. The government does not want to penalize you for replacing or improving parts of your business to simply enhance or maintain your ability to earn additional taxable income (and of course, pay additional taxes). If you eventually cash out your business, the IRS will want to tax you on the final sale, but in the interim, the IRS thinks you should be able to use the proceeds from asset sales to grow your business, not pay taxes.

If you traditionally pay taxes on your income, and you have a significant population of assets that you use in your trade or business and regularly buy and sell, then LKE might give you the competitive advantage that you need to survive in today's challenging economy.

This may sound all too simple and too good to be true, so talk to your CPA to discuss your specific circumstances and find out if this tax savings strategy might be right for you.

If you would like more information on this topic, please contact Kevin Schmitt at 888-556-0123 or kschmitt@honkamp.com.

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