Looking for a Tax Deduction?

Is It Better to Purchase a Depreciating Asset or One That Appreciates in Value?

Using the 179 Deduction

As a business owner, you may elect to expense the cost of any IRC Section 179 property and deduct it in the year the property is placed in service. The Tax Cuts and Jobs Creation Act (TCJA) increased the maximum deduction from $500,000 to $1 million. It also increased the phase-out threshold from $2 million to $2.5 million. For taxable years beginning after 2018, these amounts of $1 million and $2.5 million will be adjusted for inflation.

The TCJA increases the bonus depreciation percentage from 50 percent to 100 percent for qualified property acquired and placed in service after September 27, 2017, and before January 1, 2023.

The Tax Cuts and Jobs Act (TCJA) extended and modified bonus depreciation, allowing businesses to immediately deduct 100 percent of the cost of eligible property in the year it is placed in service, through 2022. The amount of allowable bonus depreciation is then phased down over four years, and unless Congress takes further action, the bonus depreciation deduction disappears for property placed in service after 2026.

The scenario usually goes something like this: you're looking for a tax deduction, and your tax advisor suggests the purchase of a vehicle or equipment. The purchase will generate the tax deduction, and what is being purchased is usually a depreciating asset.

An Alternative Strategy: An Employer-Sponsored Retirement Plan

However, there may be an alternative strategy: an employer-sponsored retirement plan, an asset that will appreciate in value.[1] One catch: you have an employee. Will that negate the consideration for the retirement plan? No. As you can note from the hypothetical example on page 2, on an after-tax basis the retirement plan may not cost anything! After all, would you rather purchase something that will lose value or appreciate in value? Would you rather pay "Uncle Sam" or pay the employee? Let's consider the following.

Using the Section 179 Deduction is a great option if you need a vehicle or equipment, and through 2026 it will obtain the full tax deduction of the price of the equipment, with limits.[2]

The retirement plan is a good alternative if you're looking for a tax deduction[3] and looking for guaranteed retirement income.

EXAMPLE

Jeffrey, age 54, owns a successful business. Jeffrey has one employee, Carolina. Jeffrey is meeting with his tax advisor who informs him he would benefit from a tax deduction and suggests he purchase an SUV for the business. However, Jeffrey has been speaking with his insurance advisor who suggested a Fully Insured Pension Plan.[4]

Both concepts generate a tax deduction of $80,000. Both concepts will save Jeffrey taxes and free up cash flow for his business. The vehicle or equipment, more than likely, will depreciate over time; the retirement plan is guaranteed to appreciate.[1] As a percent of the cost and percent of the after-tax contribution, the retirement plan has an advantage, because Jeffrey is getting the largest portion of the contribution to the retirement plan.

IRC SECTION 179 ENHANCED 100% TAX WRITE-OFF			RETIREMENT PLAN	
	Old Rule	New Rule		
Overall Limit	$500,000	$1,000,000	Actuarially Calculated	
Limit for SUVs	$25,000	$25,000		
Bonus Depreciation	50%	100%		
Additional First Year Depreciation (28%)	$11,160	N/A		
Qualifying Vehicles	New	New and Pre-Owned		
Price	$80,000	$80,000	Contribution	$80,000
			Tax Deduction (40% Tax Bracket)	$32,000
Section 179 Deduction	$25,000	$25,000	After-Tax Cost	$48,000
Bonus Depreciation	$27,500	$55,000	Contribution for Owner	$69,000
Additional First Year Depreciation (28%)	$11,160	N/A	Net (Cost) Gain	$21,000
Total Depreciation	$63,660	$80,000		
Percent of Purchase Price	79.58%	100%	Owner's Contribution as a Percent of the After-Tax Cost	143.75%
Value in 2 Years		$15,999		$124,939
Value in 5 Years		$23,999		$335,357
Value in 10 Years		?		$712,341

No one strategy is right or wrong. Each strategy will depend on your specific goals and objectives after a thorough fact find. Each strategy should be discussed with your tax advisor.

[1] Based on the guarantees of the underlying insurance contracts and subject to the claims-paying ability of Security Mutual Life Insurance Company of New York.
[2] Phased out by 20% each year beginning in 2023 (80%); 2024 (60%); 2025 (40%); 2026 (20%); 2027 (0%).
[3] Contributions to a qualified defined benefit plan are mandatory.
[4] A fully insured plan must be funded by certain insurance contracts that qualify under IRC 412(e) funded with Security Mutual's Flexible Premium Annuity (FPA) and Whole Life Insurance with FPA Rider.

Contact your local Security Mutual life insurance advisor today to coordinate your financial plans and help achieve your goals and objectives.

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