New Tax Law Holds Great Benefit for Dentists

By Bob Creamer, CPA

In late September 2010, in order to help stimulate our sluggish economy, Congress passed a law to give tax breaks to small businesses by extending and increasing the Section 179 depreciation deduction. The Small Business Jobs Act of 2010, as the law is commonly called, also admitted a new category of property to qualify for the Section 179 deduction: qualified leasehold improvement property. In addition, the new law revived the Bonus Depreciation Deduction, which had lapsed at the end of 2009. Even later in December 2010, another law, the 2010 Tax Relief Act, further increased the Bonus Depreciation benefits to small businesses.

SECTION 179 ACCELERATED DEPRECIATION LIMITS INCREASED

In 2009, Section 179 was already at a significant $250,000 limit, which wasn’t subject to a phase-out threshold until purchases of qualified property reached $500,000. For tax years beginning in 2010 and 2011, the new law increased the maximum Section 179 deduction to $500,000, with the phase-out threshold raised to $2 million. These increases should fit most dentists, since most practices are not likely to spend over $2 million in one year on technology and equipment purchases. However, beginning in 2012, the expensing limit is scheduled to drop to $125,000 and further to $25,000 in 2013. We have a wonderful window of opportunity available this year if significant purchases or improvements need to be made.

QUALIFIED LEASEHOLD IMPROVEMENT PROPERTY

For 2011, Congress included a law directed towards the benefit of those contemplating the opportunity to make significant leasehold improvements. Under certain conditions, they will allow you to depreciate in a single year up to $250,000 of leasehold improvements. This $250,000 is taken as part of the allowable $500,000 total Section 179. Therefore, if a practice uses up the $250,000 in qualified leasehold improvements, then $250,000 remains to be used as Section 179 deductible expenses for technology and equipment purchases.

A three-year rule applies, which means that the improvements must have been placed in service more than three years after the date the building was first placed in service. In addition, the lessor must be a third party, which means the doctor cannot hold the building in one of his entities and then lease it back to his own dental practice. There is an ownership rule percentage that may apply in certain situations where the lessee is less than 50% owner of the leased property. Both of these rules have technical interpretations and restrictions which a Dental CPA should be consulted with to handle each situations on a case-by-case basis.

According to the IRS, it doesn’t matter if the building was leased out at one point and then sat vacant for years prior to the new lessee entering into a contract, since the provision refers to “first placed into service.” Example: A dentist enters into a lease agreement in a strip mall that sat vacant for the last three years. In this case, the doctor happens to be new to the facility and is making new improvements to the physical space prior to opening the doors. This situation would qualify for the deduction.

KEY CRITERIA OF “QUALIFIED LEASEHOLD IMPROVEMENT PROPERTY”

The qualified property must be depreciable and acquired for use in the active conduct of a trade or business. It also cannot be qualified leasehold improvement property to any subsequent owner. The improvements must be made under or pursuant to a lease, and the improved portion of the building must be occupied exclusively by the lessee, which means that the improvements to a common area do not qualify.

Examples of property that DO qualify:
• Electrical or plumbing system (including sprinkler system)
• Non-structural walls (i.e. operatory divider walls)
• Permanently installed lighting fixtures
• Ceilings and doors

Examples of property that DO NOT qualify:
• Enlargement of the building
• Any elevator or escalator
• Any structural component benefitting a common area
• Internal structural framework of the building (i.e. load-bearing walls)

RULES TO REMEMBER WHEN CLAIMING THE DEDUCTION

The improvements must be complete before they are deductible, per the usual “placed in service” rules. Therefore, improvements started in 2010, but finished in 2011, are only deductible in 2011. Once the $250,000 of qualified leasehold improvements has been claimed, any remainder is subject to regular depreciation. Remember, $250,000 is a limit within the maximum $500,000 Section 179 limit. Therefore, if $250,000 is claimed for qualified leasehold improvement property, only $250,000 remains to be used for other Section 179 property, such as dental equipment.

SPECIAL CARRYOVER RULES

Any amount of the qualified leasehold improvement deduction that was not used in 2010 may only carry over to 2011, and no further. No amount of qualified leasehold improvement property
deduction unused in 2011 may be carried over to subsequent years. Therefore, if there is an amount that is left unused after 2011, that amount will be considered placed in service on the first day of 2011 and will be subject to regular depreciation.

To illustrate, if a practice has $250,000 in eligible qualified leasehold improvement property expenses for 2011, but due to income limitations can only take the accelerated deduction for $100,000 of those expenses, the remaining $150,000 will begin regular depreciation starting with the first day of the 2011 tax year. The Section 179 deduction must be elected for the total amount, but the calculation will follow these rules.

**BONUS DEPRECIATION**

For tax years 2010 and 2011, Bonus Deduction for first year depreciation has been revived. Due to the passage of The 2010 Tax Relief Act, businesses can write off 100% of their equipment and technology purchases, effective for qualified property placed in service after September 8, 2010 and through December 31, 2011. So, for almost 4 months in 2010 and for all of 2011, this special bonus is allowed for technology and equipment purchases that meet the qualified criteria for Bonus Depreciation. As currently written into law, in 2012 the bonus drops back to just 50% rather than the full 100%.

Remember, that Bonus Depreciation is separate from the Section 179 and different expenses qualify for Section 179 that do not qualify for Bonus Depreciation. The most notable criteria difference is that qualifying purchases for Bonus Depreciation must be brand new and have “first use” with the taxpayer that year; whereas to qualify for Section 179, a purchase can be a used item (i.e. “new-to-you”, rather than brand new).

Note that Section 179 gets deducted first, and then any items remaining that qualify for Bonus Depreciation are deducted.

**Talk to your dental CPA for strategic planning.** The tax laws are complicated, with many exceptions to the rule. A dentist should always consult their Dental CPA when considering large dollar purchases in order to determine the most advantageous timing of the deductibility of the purchases. In addition, they should be an integral part of the development process when planning for future improvements or renovations to the practice. After all, it’s just good business!

Bob Creamer is a CPA and President of Creamer & Associates, PC, an accounting firm in Salem, Ore. In addition, he is an owner with partner Joanne Humphrey, CPA/PFS in Salem Asset Management, LLC. For the past 34 years, his firm has emphasized financial and retirement planning, dental transitions, practice enhancement, wealth creation, tax savings and related accounting and consulting services for maintaining an efficient and profitable dental practice. He is a founding member of the Academy of Dental CPAs. Bob can be reached at 800.248.1120 or bob@bestcpas.com.