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The President's Advisory Panel on Federal Tax Reform
1440 New York Avenue NW
Suite 2100
Washington DC 20220

Re: Request for Comments #2
Proposal to Reform a Particular Aspect: Depreciation of Business Assets
Submitted by Individual (Tax Professional, Enrolled Agent)
Contact Information: Above

Description of Proposal. Redesign the current depreciation system toward SIMPLICATION, while improving fairness, maintaining the President's "bonus" depreciation plan as a part, when needed, of regular depreciation procedures. It offers the flexibility of simple temporary additions to depreciation when need for economic growth and maintains competitiveness. Compliance is simplified and administrative costs for both businesses and the Internal Revenue Service should be substantially reduced.

While there may be some year to year revenue shifts, the proposal is revenue neutral over asset life. There may be some revenue increases due to a reduction in the potential for "cheating".

This proposal:

SIMPLIFIES by ELIMINATING three of the four conventions and two of the three methods used in computing depreciation. The need for the eliminated items is accomplished by utilizing a first year depreciation system much like that used under Section 179 and recent "bonus" depreciation methods.

ADDS FLEXIBILITY for adjustments needed in slow economic times while simplifying depreciation in subsequent years.

ELIMINATES depreciation limits on vehicles while maintaining expensing limits for high cost vehicles.

REDUCES potential for "cheating" on personal use of other listed property.

Staff may feel free to contact me (contact information above) and the material may be released to the public.

Submitted by:

H Edward White EA

Depreciation rules of today began in 1986, the last time depreciation received major changes. At that time Congress was concerned that businesses were buying capital equipment late in the tax year and gaining a full year of depreciation, hence complications like half year and mid-quarter conventions were utilized, meaning that the largest depreciation came in the second year for all three methods under GDS: DDB, 150DB and SL. As Congress gained experience, they found that small businesses needed to write-off capital items in the 1st year, and Section 179 was born. When the economy moved into recession, enabling all businesses to maximize 1st year depreciation was an economic stimulant. Now we have rules that maximize 1st year depreciation with depreciation schedules that delay it. If we could combine these rules into one set of rules, we might make life simpler for large as well as small business, and certainly for the nation's tax preparers

RECOMMENDATIONS

GDS and ADS

1. Establish a 1st year depreciation for all property and life classes (e.g. 20% to 25%). Limit it to property purchased before approximately October 1 of the calendar tax year, and take one-half of the allowance for 4th quarter purchases. The President and the Congress could decide to establish larger "bonus" depreciation when economic conditions so justified. Bonus should be for the year of enactment plus the following year, beyond which would require another vote in the year before the extension year. The "bonus" could be an additional 10% or as much as 40%. Real property construction should receive no regular bonus, but given up to 20% in a recession year. (What's the matter with a $20 million deduction for a $100 million project in slow construction times?) Give residential rentals not just businesses, bonus depreciation. (See Class Life below.)

2. After the 1st year allowable depreciation is computed, determine the non-depreciated balance, or "subsequent year basis". Use SL with full year convention only. We already have 1st year accelerated depreciation and we already know the capital item was in use January 1. The class life has NOT been extended a year; depreciation on 5-year property extends over 6 years now.

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Eliminate DDB and 150DB methods as well as half-year and mid-quarter conventions! Most small businesses are better off using SL; they need depreciation in subsequent years when they are likely to be more profitable. It should not be a restraint for large corporations when they get a larger 1st year depreciation. Try to keep the 20% to 25% for all classes and property life except real property, but make "bonuses" available to them when economic conditions warrant.

3. ELIMINATE ADS! The Congress has already largely done this It might need to be kept for Corporate Real Property (non-residential) and other large assets like aircraft, locomotives, etc.

4. Class Life is reasonable in most cases. There was no need to reduce rental home kitchen furnishings to 5 years. Take it back up to 7 years but give them 1st year depreciation even in normal economic times. Try to limit the number of life spans: 3, 5, 7, 10, 15 and 20 years should be sufficient for all but real property; make them 25 and 35 years.

<u>Listed Property - Automobiles</u>

While there are lengthy definitions of when an automobile is listed property, it boils down to: An automobile used for ancillary (not for hire) purposes in business use. Use is for the conveyance of business person(s) and their equipment for business purposes. If materials like those used in re-pairs need to be hauled, the vehicle is primary use, like for hire; definition is not changed from present.

The recommendation is that you simply not allow the depreciation or expensing of listed vehicles, THEY MAY ONLY BE EXPENSED BY USING MILEAGE. For Leased Vehicles it is not that you MAY use mileage, you MUST. This solves a big definition problem for SUVs. If it is ancillary use you must use mileage, even if it has a loaded weight of over 6000 pounds.

Yes, Corporations, too. If they buy a Rolls-Royce for the Chairman, same mileage rate as any other vehicle. This method of expensing totally eliminates vehicle limits on depreciation. For vehicles that are like automobiles, e.g SUVs and pick-up trucks (vehicles under 14,000 pounds)

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that qualify as non-listed, limit them to 90% of depreciation and expenses; these will nearly always have some personal use. Mileage only for listed vehicles and expense limit of 90% on qualified auto-type vehicles should eliminate most of the cheating without hurting legitimate business use deductions. If the vehicle is not owned by the business user, IRS currently breaks out mileage by depreciation and other expenses, but it is buried in the annual publication. When the mileage rate is published print the non-owner rate right along with it.

Listed Property - Other

1. Computers and Entertainment Equipment. These are only treated as listed when they have business use in a non-business environment. Treat these the same as non-mileage vehicles: maximum allowable depreciation and expense is 90% of total cost. Everyone who is honest will admit that they occassionally use the internet for a personal message or to read a movie review.

2. Cellular 'Phones. Treat them the same as other listed property with literally certain personal use: Cap their business use at 90% of total expense.

SECTION 179

This has been around for awhile and does help small business. It can be simplified by eliminating the carryforward. If the small business owner cannot use it all in the year of purchase there is still SL depreciation for the balance. It will be available in the next tax year if additional assets are purchased.

A word about carryforwards in general. They are additional work to track and, while important for some expense or loss items they should not be used where the tax advantage is deminimus.

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