MN HOUSE RESEARCH

Section 179 Expensing under the Federal and Minnesota Income Tax

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What is section 179 expensing?

Income tax laws generally require businesses to spread deductions of capital expenditures over the useful lives of the purchased property. Section 179 expensing, which takes its name from a section of the Internal Revenue Code (IRC), allows businesses to deduct the entire amount of the cost of qualifying property in the tax year the property is placed in service, rather than claiming depreciation deductions over a number of years. This allows the business to accelerate recognition of the expense from future tax years into the present year. The number of years over which property would otherwise be depreciated ranges from three to 15 years, depending on the type of property and its useful life as classified under the IRC.

What businesses can use section 179 and what property qualifies?

A business is allowed to use section 179 based on the amount of its qualifying capital expenditures in a taxable year. Purchases of most equipment and other personal property qualify, including many leasehold improvements by businesses renting their facilities. Some interior improvements to nonresidential real property also qualify. The amount of a taxpayer's section 179 deduction is limited to the taxpayer's taxable income, although the disallowed amounts may be carried over.

How much property qualifies for federal section 179 expensing?

Businesses may deduct up to $1 million in qualifying property placed into service in the tax year. This amount is phased out dollar for dollar once a business's qualifying property expenditure amount exceeds $2.5 million. The phase-out effectively prohibits businesses making more than $3.5 million in qualifying property in a tax year from using section 179 for that tax year.

What are the section 179 expensing allowances under the Minnesota income tax?

Prior to 2006, Minnesota conformed to the federal allowances, allowing businesses to claim the same amount for their Minnesota taxes as they did for their federal taxes. Since then, the legislature has elected not to conform to the higher federal allowances, but does allow the full amount of the deduction to be taken over multiple years.

In Minnesota, the amount of expenditures that may be deducted in the year the property was placed in service is determined based on two factors: the state's own cap and phase-out limits, and the section 179 addition.

Under the state's cap and phase-out limits, deductions are capped at $25,000, with a dollar-for-dollar phase-out once a business's total expenditures exceed $200,000.

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In addition to any amount deducted under the state's cap and phase-out limits, 20 percent of any remaining amount that is deducted under section 179, minus the amount deducted under the state's cap and phase-out limits, may also be deducted in the year the property is placed in service. The remaining 80 percent must then be added back to the business's Minnesota taxable income; 16 percent of this remaining amount is then deducted in each subsequent tax year for five years, until the full amount of the federal deduction has been used.

The following chart shows the difference between the amounts that may be deducted in the year the property is placed in service under section 179 compared to state expensing laws.

Section 179 Property Placed in Service in the Tax Year	Deduction Allowed Federally	Amount Allowed under the Minnesota Cap and Phase-out	Minnesota Add-back	Total Minnesota Deduction, Current Year
≤ $25,000	Full amount	Full amount	$0	Full amount
$25,000 to $200,000	Full amount	$25,000	80% of the amount in excess of $25,000	$25,000, plus 20% of the amount in excess of $25,000
$200,000 to $225,000	Full amount	$25,000 minus amount in excess of $200,000	80% of the federal amount in excess of amount allowed under the Minnesota cap	Amount allowed under the Minnesota cap, plus 20% of the amount in excess of that amount
$225,000 to $2,500,000	Full amount, up to $1,000,000	$0	80% of the federal amount	20% of the federal amount
$2,500,000 to $3,500,000	$1,000,000 minus amount in excess of $2,500,000	$0	80% of the federal amount	20% of the federal amount
> $3,500,000	$0	$0	$0	$0