



Maximize equipment deductions in 2010

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The pace of needed **TECHNOLOGY EXPENDITURES** continues **unabated** in dentistry. The good news: these expenditures continue to have favored tax treatment. The bad news: the tax code makes realizing the deductions a complicated task. Here's help in navigating the complexity.

Two key tax provisions related to equipment are scheduled to lapse in 2010 without further action by Congress. This action may yet be forthcoming. For 2010, equipment expensing under Section 179 is scheduled to drop from \$250,000 allowed in 2009 to \$134,000 in 2010. Likewise, the 50% bonus first-year depreciation will lapse in 2010. This is a big change for dentistry. Still, the \$134,000 expensing is well above historical amounts allowed prior to the past few years. Equipment amounts in excess of the Section 179 limit may be depreciated over five years using accelerated methods of depreciation. All of this is still very appealing.

The ability to benefit from large equipment deductions in dentistry can be greatly limited by the dentist's choice of practice entity: sole proprietorship, S Corporation, or C Corporation. This is because there are two limitations at the entity level that can sabotage the allowed deductions. They are a **taxable income limitation** and a **basis limitation**. Let me share some examples of how these limitations can greatly reduce the allowable dental equipment deductions.

Sole proprietorship: Assume a dentist practices as a sole proprietor, either as a limited liability corporation or as an unincorporated entity. Assume further that, in 2010, the dental practice borrows \$100,000 and purchases equipment. The practice net income before equipment deductions is \$200,000. Let's apply the two limitations to determine how much taxable income the sole proprietor dentist has. First, the taxable income limitation requires that the practice have \$100,000 of taxable income in order to expense the equipment under Section 179. No problem there; the practice has \$200,000 of income. Second, the practice must have sufficient basis to achieve the deduction. In this case, the loan used to purchase the equipment counts as basis. The result: The dentist achieves the maximum deduction of \$100,000 for the equipment purchased and pays income tax on \$100,000 of taxable income (\$200,000 of income minus \$100,000 of equipment expense).

S Corporation: Assume the same facts as the sole proprietorship. Further assume that the dentist pays himself or herself a \$150,000 W-2 salary in the S Corporation. The

practice net income after salary would be \$50,000 (\$200,000 of practice net income minus \$150,000 of W-2 salary for the dentist). How do the income limitation and basis limitation interact with the equipment expensing in this case? In an S Corporation, the income limitation includes the dentist's salary of \$150,000 and the practice net income of \$50,000. So income is sufficient to deduct the full \$100,000 of Section 179 expensing. The problem in achieving the deduction is the basis limitation. The \$100,000 loan in the practice does not count as basis. Let's make one further assumption. Assume the dentist distributed the \$50,000 of practice income as an S Corporation distribution to himself or herself and no other basis issues exist. The result: The dentist cannot deduct any of the \$100,000 expensing for the equipment in the current year because insufficient basis exists. The dentist pays tax on \$200,000 of taxable income vs. \$100,000 for the sole proprietorship. The Section 179 expense is carried forward and not used in the current year.

C Corporation: If we assume the same facts as the S Corporation case, except for the \$50,000 distribution, the dentist would pay tax only on the \$150,000 of W-2 salary. But the dentist would lose \$50,000 of Section 179 expensing because of the taxable income limitation. The result: The dentist can only deduct \$50,000 of the equipment expensing and will pay tax on \$150,000 vs. \$100,000 for the sole proprietorship. The remaining Section 179 Expense is carried forward.

What you should do: First, if your practice's net income is typically less than \$300,000 per year, it is recommended that you practice as a sole proprietorship or a limited liability corporation (depending upon state law issues). Since dentistry requires ongoing equipment expenditures, the sole proprietorship offers the easiest method to achieve maximum deductions every year. Second, if you are already incorporated and have net income of more than \$300,000 per year, you are probably fine with the income limitation and basis limitation with some minor tax planning when making large equipment purchases. If practice net income is less, you must plan every large equipment purchase subject to the income limitation and basis limitation to avoid major losses of income tax deductions that would be otherwise available.

In summary, don't lose valuable equipment deductions that should be available to you. Plan annual expenditures to assure that you have maximized your tax deductions. **DE**

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