



## **PERSONAL INCOME TAX BULLETIN 2023-02**

### **Section 179 Property Deduction**

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**This Bulletin replaces and supersedes Informational Notice Personal Income Tax 2012-05.**

#### **PART I. GENERAL**

Pennsylvania Personal Income Tax ("PA PIT"), 72 P.S. §§ 7301, *et seq.*, allows taxpayers to treat the cost of property commonly referred to as Section 179 Property ("§ 179 Property") as a currently deductible expense ("§ 179 Deduction") to the extent described in this Bulletin. See 72 P.S. § 7303(a.3).

The § 179 Deduction is tied to the deduction permitted under Section 179 of the Internal Revenue Code of 1986, depending upon when the § 179 Property is placed in service, as explained in Part II below. Unless stated otherwise, PA PIT will follow the rules contained in IRC § 179. For example, the PA PIT definition of § 179 Property is the same as the definition for Federal Income Tax ("FIT") purposes.

A taxpayer may claim a § 179 Deduction for PA PIT purposes even if the taxpayer does not elect to currently expense the cost of the § 179 Property for FIT purposes.

The § 179 Deduction is a business expense. Consequently, it can only be used to offset gain from net profits, or Schedule C income, for PA PIT purposes. It cannot be used to offset gain from any other PA PIT income class.

#### **PART II. THE DEDUCTION**

The cost of § 179 Property that can be used as PA PIT § 179 Deduction, like the FIT deduction, is subject to two limitations—a dollar limitation and a business income limitation.



## Dollar Limitation

For § 179 Property placed in service before 2023, the PA PIT dollar limitation is based upon earlier of the IRC § 179 dollar limitation at the time the § 179 Property was placed in service or the IRC § 179 dollar limitation in effect in 2003. The applicable PA PIT dollar limitations for those years are as follows:

1997:	\$18,000
1998:	\$18,500
1999:	\$19,000
2000:	\$20,000
2001-02:	\$24,000
2003-22:	\$25,000

Act 53 of 2022 (Act 2022-53, P.L. 513, No. 53) amended the PA PIT law to increase the PA PIT dollar limitation to match the FIT dollar limitation. The amendment applies to § 179 Property placed in service in tax years beginning on or after January 1, 2023. In those instances, the PA PIT dollar limitation is \$1,000,000 subject to an annual inflation adjustment.

Like the FIT dollar limitation, the PA PIT dollar limitation is reduced dollar-for-dollar by the amount the taxpayer's § 179 Property placed in service during such taxable year exceeds \$2,500,000 subject to an annual inflation adjustment.

A taxpayer may elect to currently expense the cost of § 179 Property up to the dollar limitation indicated above based upon the year the § 179 Property was placed in service. A taxpayer is not required to expense any of the cost of its § 179 Property and may elect to expense less than the dollar limitation, but no more. The dollar limitation applies to the aggregate cost of all the taxpayer's § 179 Property for the taxable year. It does not apply to each § 179 Property.

The cost of any § 179 Property that the taxpayer does not elect to expense, either by choice or because of the dollar limitation, is treated as a capital expense and must be depreciated over the useful life of asset (less salvage value) following normal PA PIT depreciation rules.

Note: If the cost of § 179 Property that is elected to be currently expensed is different for FIT and PA PIT purposes, the § 179 Property will have a different adjusted basis for FIT and PA PIT purposes.

Consequently, the cost of any § 179 Property that must be depreciated will be subject to straight-line depreciation for PA PIT purposes.



### Business Income Limitation

Once a taxpayer elects the amount of the § 179 Property cost to currently expense for the current tax year, the taxpayer may deduct that amount subject to the business income limitation. For PA PIT purposes, the § 179 Deduction cannot be greater than the taxpayer's PA PIT net profits for the taxable year. (Note: A taxpayer's PA PIT business income limitation may be different than their FIT business income limitation.) **The § 179 Deduction is applied after all other business-related expenses and losses and cannot reduce the taxpayer's PA PIT taxable net profits below zero.** To the extent that the § 179 deduction exceeds the taxpayer's PA PIT net profits, the remaining deduction is carried over to the following tax year as explained in Part III, below.

### **PART III. CARRYOVER OF DISALLOWED DEDUCTION DUE TO BUSINESS INCOME LIMITATION**

Any amount of the § 179 Deduction that cannot be utilized in a taxable year due to the business income limitation is carried over indefinitely to subsequent tax years until exhausted ("Carryover Deduction").

If a taxpayer's Section 179 costs that the taxpayer elects to currently expense for the current tax year is less than the dollar limitation, the taxpayer adds any Carryover Deduction amount to the § 179 Property costs that the taxpayer elects to currently expense. The sum of the current year § 179 Property costs that a taxpayer elects to currently expense and the Carryover Deduction cannot exceed the dollar limitation for the current year. Any Carryover Deduction that cannot be used due to the dollar limitation is carried forward to subsequent years until it is used.

### **PART IV. PASS-THROUGH ENTITIES**

A partnerships or S corporation ("entity") that purchases § 179 Property may elect to currently expense the cost of the § 179 Property as explained above. This election is made at the entity level. A partner or shareholder is required to follow a partnership's or S Corporation's election to expense § 179 Property.

The § 179 Deduction to which a pass-through entity is entitled is calculated at the entity level based upon its § 179 Property placed in service for the year. The dollar limitation and the business income limitation are also calculated and applied at the entity level. An entity's § 179 Deduction, just like its income, is passed through to the entity's owners according to the owner's pro rata ownership interest.



The owner's share of the § 179 Deduction must be passed through as a separately stated item on the entity's PA PIT entity return (PA 20S/65) and owner information statements (PA K-1s and NRK-1s).

An entity's § 179 Deduction must be apportioned for its nonresident owners. The apportionment percentage is the same as the entity's taxable business income apportionment percentage for its nonresidents. So, if an entity has total taxable business income for PA PIT purposes of \$1,000,000 and \$300,000 of Pennsylvania source business income, then the apportionment percentage is 30%. Consequently, 30% of the § 179 Deduction is apportioned to the entity's non-residents.

If an entity has a Carryover Deduction, it does not pass through to the owners. It remains with the entity to be used in subsequent years. Only the owner's share of the § 179 Deduction passes through to the owner.

The dollar limitation and the business income limitation apply at both the entity level and the owner level. This is the same rule that applies for FIT purposes. Therefore, the sum of an owner's Section 179 costs that he elects to currently expense and the owner's share of all § 179 Deductions that are passed through to the owner cannot exceed the dollar limitation. To the extent that the sum of such costs and passed through § 179 Deduction exceeds the dollar limitation for the owner, that amount cannot be utilized in the current year and is lost. The remainder can be used as a deduction in the current taxable year subject to the owner's business income limitation. Any amount that exceeds the business income limit is a Carryover Deduction for the owner.

## **PART V. EXAMPLES**

For purposes of the following examples, it is assumed that the applicable dollar limitation is for § 179 Property placed in service on or after January 1, 2023, and without regard to the annual inflation adjustment.

### Example #1. General Section 179 Calculation

A PA PIT Taxpayer, who is a sole proprietor, purchases three § 179 Property assets and places them in service during the tax year (TY #1). Asset X has a cost of \$400,000. Asset Y has a cost of \$500,000. Asset Z has a cost of \$600,000. The total cost of all § 179 Property is \$1,500,000.

Taxpayer has gross profits of \$2,000,000 in TY#1.



Taxpayer can elect to expense up to but no more than \$1,000,000 of his § 179 Property cost for TY #1. Taxpayer is limited by the \$1,000,000 dollar limitation. The dollar limitation is not reduced because Taxpayer's § 179 Property costs are less than \$2,500,000.

For TY #1, Taxpayer elects to expense \$800,000 of the § 179 Property for TY #1 -- \$400,000 of Asset X (its entire cost) and \$400,000 of Asset Y (out of its total \$500,000 cost) and none of Asset Z's cost. The \$800,000 is Taxpayer's § 179 Deduction for TY #1.

Taxpayer's remaining \$700,000 § 179 Property cost (\$100,000 from Asset Y and \$600,000 from Asset Z) is treated as a capital expenditure. The remaining costs for Asset Y and Asset Z must be depreciated using PA PIT depreciation rules. For purposes of this example, the total yearly depreciation for Assets Y and Z is \$70,000.

Taxpayer has business expenses/losses for TY#1 of \$1,200,000. This includes the yearly depreciation on Assets Y and Z.

After deducting all applicable business expenses, including the first-year depreciation on the \$700,000 capital expenditure mentioned above, the Taxpayer's PA PIT net profits is \$800,000. Consequently, the § 179 Deduction will reduce Taxpayer's taxable net profits to \$0.

#### Example #2. Carryover Deduction

Same as Example #1, except that Taxpayer elects to expense \$1,000,000 of his § 179 Property costs in TY #1, which is the maximum he can elect under the dollar limitation. The \$1,000,000 is Taxpayer's § 179 Deduction for TY #1.

The election will change Taxpayer's remaining basis and depreciation in Assets Y and Z. Notwithstanding this change, for purposes of this example, it is assumed that Taxpayer's net profits for TY #1 will still be \$800,000.

Because Taxpayer's § 179 Deduction is greater than his PA PIT net profits for TY #1 (\$800,000), Taxpayer will have \$200,000 of unused § 179 Deduction. The unused portion is Taxpayer's Carryover Deduction that can be used in the next tax year (TY #2).



### Example #3. Section 179 Calculation with Carryover

Taxpayer from Example # 2 purchases a § 179 Property asset and places it in service during TY #2. The asset has a cost of \$900,000. Taxpayer has the \$200,000 Carryover Deduction from TY #1.

Taxpayer can elect to expense up to \$1,000,000 for TY #2. He can use all or a portion of his § 179 Property costs for TY #2 and his \$200,000 Carryover Deduction from TY #1 up to the \$1,000,000 limit.

For TY #2, the Taxpayer's PA PIT net profits is \$600,000. (For simplicity, the net profits are the same for each option).

Based upon those facts, Taxpayer has several options. Some possible options are listed below.

#### Option #1:

Taxpayer could elect to expense only \$600,000 of his TY #2 § 179 Property costs because it is under the \$1,000,000 dollar limit and his PA PIT net profits is only \$600,000. If Taxpayer makes this election, his § 179 Deduction is \$600,000 for TY #2 that he can use to reduce his PA PIT taxable business income to zero. The remaining \$300,000 cost of his TY #2 § 179 Property asset will be treated as a capital asset and must be depreciated over its useful life. Taxpayer did not use any of his \$200,000 Carryover Deduction from TY #1. So, that Carryover Deduction can be carried over to the next tax year.

#### Option #2:

Taxpayer could elect to expense the entire \$900,000 cost of his TY #2 § 179 Property because it is under the \$1,000,000 dollar limit. If Taxpayer makes this election, his § 179 Deduction is \$900,000 for TY #2. The deduction will reduce his PA PIT taxable business income to zero, and result in a \$300,000 unused Carryover Deduction for the next tax year.

Taxpayer did not use his \$200,000 Carryover Deduction from TY #1, and he can carry that amount over to the next tax year as well. For TY #3, Taxpayer will have a total Carryover Deduction of \$500,000.



### Option #3:

Taxpayer could choose to treat the entire cost of the TY #2 § 179 Property asset as a capital expenditure and depreciate the asset over its useful life.

Taxpayer could then elect to expense his \$200,000 Carryover Deduction from TY #1 as his § 179 Deduction for TY #2. The § 179 Deduction would reduce Taxpayer's PA PIT taxable business income for TY #2 to \$400,000. Taxpayer would not have a Carryover Deduction for TY #3.

### Example #4. Pass-Through Entity § 179 Deduction Calculation

An Entity purchases three § 179 Property assets and places them in service during the tax year (TY #1). Asset X has a cost of \$500,000. Asset Y has a cost of \$900,000. Asset Z has a cost of \$1,500,000. The total cost of all the assets is \$2,900,000.

For TY #1, Entity's PA PIT net profits is \$2,000,000. Entity's PA PIT net profits are derived from multiple states. The PA source net profits is \$1,200,000. Entity has three owners with the following residency status and ownership percentages: Owner D (PA Resident - 25%, Owner E (PA Resident) - 35%, and Owner F (Nonresident) - 40%.

Entity's § 179 Deduction must be calculated at the entity level. Because Entity's total costs for its § 179 Property for TY #1 is greater than \$2,500,000, Entity's dollar limitation is reduced dollar-for-dollar by the amount the costs exceed \$2,500,000 for a reduction of \$400,000 ( $\$2,900,000 - \$2,500,000 = \$400,000$ ). So, Entity's dollar limitation is \$600,000 (the \$1 million limitation less the \$400,000 reduction).

Entity elects to expense up to its dollar limitation. It elects to expense the \$500,000 cost of Asset X and \$100,000 of Asset Y. Its § 179 Deduction for TY #1 is \$600,000. Entity must treat the remaining \$800,000 cost of Asset Y and the entire \$1,500,000 cost of Asset Z as capital expenses and depreciate those costs over the assets' useful lives.

Entity's § 179 Deduction does not exceed its business income, so the Entity has no Carryover Deduction. (Note: If Entity's § 179 Deduction did exceed its net profits, it would have had a Carryover Deduction for the following year. The Carryover Deduction would stay on Entity's books and would not be passed through to its owners.)



Entity will have to report \$2,000,000 of PA PIT net profits and \$600,000 of § 179 Deduction on its entity return. The net profits and § 179 Deduction is passed through to the owners as follows:

	<b>Net Profits</b>	<b>§ 179 Deduction</b>	<b>Pennsylvania K-1 Net Business Income</b>
Owner D	\$500,000	\$150,000	\$350,000 (RK-1)
Owner E	\$700,000	\$210,000	\$490,000 (RK-1)
Owner F	\$480,000 (PA source)	\$144,000 (PA source portion)	\$336,000 (NRK-1)

Example #5. Pass-Through Entity Owner § 179 Deduction Calculation

Taxpayer, an individual, is an owner in multiple entities that have § 179 Property costs and § 179 Deductions. Taxpayer's pass-through PA PIT net profits and § 179 Deduction from each entity are as follows:

	<b>Net Profits</b>	<b>§ 179 Deduction</b>	<b>Pennsylvania K-1 Net Business Income</b>
Entity 1	\$200,000	\$100,000	\$100,000
Entity 2	\$400,000	\$200,000	\$200,000
Entity 3	\$500,000	\$400,000	\$100,000
Entity 4	\$700,000	\$500,000	\$200,000
Total:	\$1,800,000	\$1,200,000	\$600,000

Taxpayer has no other PA PIT net profits or Section 179 costs of his own.

Taxpayer's § 179 Deduction is also limited by the dollar limitation and business income limitation. Taxpayer's pass-through § 179 Deduction exceeds the \$1,000,000 dollar limitation. So, Taxpayer is limited to \$1,000,000 of the pass-through § 179 Deduction from Entities #1-4. The excess \$200,000 is lost. Taxpayer can use the \$1,000,000 § 179 Deduction to reduce his PA PIT taxable net profits to \$800,000 (\$1,800,000 net profits less \$1,000,000 § 179 Deduction). Taxpayer will need to increase his total Net Business Income as reported on Pennsylvania K-1s by the \$200,000 disallowed excess §179 Deduction and report \$800,000 as Net Income or Loss from the Operation of a Business, Profession or Farm on Form PA-40, Pennsylvania Income Tax Return.