Section 179 Expensing under the Federal and Minnesota Income Tax

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What is section 179 expensing?

When businesses purchase tangible property, in general, they are not allowed to deduct the full cost of the property in the year it was placed in service. Instead, income tax laws require businesses to spread deductions of capital expenditures over the useful lives of the purchased property. The number of years over which property would normally be depreciated ranges from three to 15 years, depending on the type of property and its useful life as classified under the federal Internal Revenue Code (IRC).

Section 179, which takes its name from a section of the federal IRC, is an exception to the general rule that 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.

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 new and used equipment and other tangible, depreciable personal property qualify, including:

- machinery and equipment used in farming, manufacturing, mining, transportation, communications, electricity generation and gas and water distribution;
- single purpose agricultural or horticultural structures;
- computer software; and
- certain improvements to real property, including some interior improvements to real property, roofs, heating, ventilation and air conditioning systems, fire protection and alarms, and security systems.

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?

In 2017, Congress expanded the section 179 deduction in the federal Tax Cut and Jobs Act (TCJA). Businesses may now 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 expenditures in a tax year from using section 179 for that tax year. In 2019, the legislature retroactively conformed to these new federal limits, but did not allow 100 percent of the federal deduction to be taken in the year the property was placed in service until 2020, as described below.

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

For taxable years in 2006 through 2019, the legislature required the amount of the federal section 179 deduction to be taken as a state subtraction over a period of six years. For the first year, the amount subtracted was 20 percent of the federal amount, plus up to $25,000 (the latter amount was phased out dollar for dollar for section 179 expenditures over $200,000). For each of the next five years, only 16 percent of the remaining federal deduction was allowed as a state subtraction.

In 2020, the legislature eliminated the six-year period for taking the state section 179 subtraction, for property placed in service in 2020 and thereafter. This allows the amount of the federal deduction to be taken for state tax purposes in the same taxable year the deduction is allowed federally. Property placed in service prior to 2020, however, is still subject to the state subtraction schedule described above.

Also in 2020, the legislature retroactively eliminated the six-year period for taking the state section 179 subtraction for a certain type of property placed in service in taxable years beginning in 2018. This retroactive provision only applies to qualifying depreciable property, which is defined as any property (other than real property) acquired in a like-kind exchange, for which the exchanged property would have qualified for gain deferral under the pre-TCJA IRC's like-kind exchange rules.

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