

Depreciation

If you buy agricultural property such as machinery, computers, breeding livestock, equipment, etc. that has a useful life of more than one year, you spread the cost of it over several years for record keeping and tax purposes. This is called depreciation. Property is depreciable if it meets these tests:

1. It must be used in business or held for the production of income.
2. It must have a determinable useful life longer than one year, and
3. It must be something that wears out, decays, gets used up, becomes obsolete or loses value from natural causes.

The depreciation system currently in general use is the **Modified Accelerated Cost Recovery System (MACRS)**. MACRS has been used on property placed in service after 1986. Prior to then the ACRS (Accelerated Cost Recovery System) was used.

There are two components of MACRS - the **General Depreciation Schedule (GDS)** and the **Alternative Depreciation Schedule (ADS)**. GDS is popular because it has a shorter recovery period (number of years in the depreciation schedule). This allows for greater deductions on your income tax. However, if you want to show a greater net worth, ADS shows a higher value for the property. The type of property and property class help determine whether to use GDS or ADS. You use one or the other, not both.

Each item of property depreciated under MACRS is assigned a **property class**. The property class establishes the number of years over which depreciation is charged. This period of time is called the recovery period. All agricultural equipment must be placed in one of the following property classes:

3-year property, 5-year property, 7-year property, 10-year property, 15-year property or 20-year property

The table below shows the property class (using both GDS and ADS) of typical agricultural items. The general rule of thumb for any property not on this list is to classify it as 7-year property.

Farm Property Recovery Periods

ASSETS	GDS	ADS
Agricultural Structures (Single Purpose)	10	15
Automobiles & Pickup Trucks	5	5
Trucks (over 13,000 lbs)	5	6
Calculators & Copiers	5	6
Cattle (Dairy or Breeding)	5	7
Communications Equipment	7	10
Computers & Peripheral	5	5
Farm Buildings	20	25

Farm Machinery & Equipment	7	10
Fences (Agricultural)	7	10
Goats & Sheep (Breeding)	5	5
Grain bin	7	10
Hogs (Breeding)	3	3
Horses, Breeding & Working, Less than 12 years old	7	10
Horses, Breeding & Working, More than 12 years old,	3	10
Horses, Racing, More than 2 years old	3	12
Horticulture Structures (Single Purpose	10	15
Logging Equipment	5	6
Office Equipment & Furniture	7	10
Over the Road Tractor Units (Pulls Trailer)	3	4
Trees bearing fruits or nuts	10	20
Typewriter	5	6

There are four general methods used in figuring depreciation in agriculture:

- ◆ The 150% declining balance method using the GDS recovery period (150% DB-GDS).

(The item depreciates more in the first few years and depreciates less in the later years)

- ◆ The straight line method using the GDS recovery period (SL-GDS).

(The item depreciates at an uniform rate over its useful life)

- ◆ The 150% declining balance method using the ADS recovery periods (150% DB-ADS)

- ◆ The straight line method using the ADS recovery periods (SL-ADS)

There is a 200% double declining balance depreciation method but it is used for nonfarm property.

The following chart shows which method of depreciation can be used for different classes of property:

Depreciation Methods Chart

Property Class	Method that can be used
3, 5, 7, 10-Year	150% DB-GDS, 150% DB-ADS, SL-GDS, SL-ADS

15, 20-Year	150% DB-GDS, SL-GDS, SL-ADS
Trees or Vine Bearing Fruit or Nuts	SL-GDS, SL-ADS

A question that has persisted over the years in figuring depreciation is to determine how much depreciation to charge the first year when an item is bought part way through the year. To simplify this three different conventions are used:

Half year convention - All property placed in service is considered to be placed in service half way through the year. During the first year, half of the "normal" depreciation is taken. At the end of the depreciation period, the other half of the "normal" depreciation is taken.

Mid-quarter convention - If the amount of depreciation claimed on new items during the last 3 months of a year exceeds 40% of the total depreciation claimed during the year, then the mid-quarter convention is used. The amount of depreciation of each item is figured for one year then multiplied by 87.5% if it was placed in service during Jan. - March, 62.5% if it was placed in service during April - June, 37.5% for items placed in service during July-Sept, and 12.5% for items placed in service during Oct. - Dec.

Mid-month convention - All property is considered to be placed in service during the midpoint of the month. This requires some calculations.

Basis is a term used in figuring depreciation. For property you buy, your original basis is usually its cost to you. For all practical purposes basis is the same as cost.

To figure depreciation on an item you have to:

1. Determine whether to use GDS or ADS
2. Determine whether to use 150% Declining Balance or Straight Line
3. Determine what convention to use
4. Determine the property class (recovery period) of the item
5. Look up the percent of depreciation for the year in a depreciation schedule table
6. Multiply the amount of depreciation from the table by the basis (value) of the item

For more information about depreciation consult the following publications published by the Internal Revenue Service.

Publication 534 - Depreciation

Publication 225 - Farmer's Tax Guide

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