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Bookkeeping & Consulting

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Breaking Down Basic Depreciation

Depreciation is an accounting method that spreads the cost of an asset over its useful life, rather than deducting the full expense in the year of purchase. This helps businesses match expenses with revenue and take advantage of tax benefits.

1. What Can Be Depreciated?

To qualify for depreciation, an asset must:

- ✓ Be **owned** by the business
- ✓ Be **used for business purposes**
- ✓ Have a **useful life of more than one year**
- ✓ Be something that **wears out, gets used up, or loses value over time**

Examples of Depreciable Assets:

- Buildings & Real Estate (not land)
- Machinery & Equipment
- Vehicles (if used for business)
- Office Furniture
- Computers & Software

2. How Depreciation Works

Instead of deducting the full cost of an asset immediately, you deduct a portion of it **each year** based on the IRS depreciation rules.

Example:

- A **\$10,000 office computer system** with a **5-year life**
- Instead of deducting \$10,000 in Year 1, you deduct **\$2,000 per year for 5 years**

3. Common Depreciation Methods

✦ A. Straight-Line Depreciation (Simplest Method)

- Spreads cost evenly over the asset's life



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- Formula: **(Cost - Salvage Value) ÷ Useful Life = Annual Depreciation**

Example:

- A \$10,000 piece of equipment with a **5-year life** and a **\$1,000 salvage value**
- $(\$10,000 - \$1,000) ÷ 5 = \mathbf{\$1,800}$ per year

✦ B. Double-Declining Balance (Accelerated Depreciation)

- Higher depreciation in early years, lower in later years
- Formula: **(2 ÷ Useful Life) × Remaining Book Value**

✦ C. Section 179 Deduction (Immediate Write-Off)

- Allows businesses to deduct **100% of qualifying asset purchases in Year 1**
- **Limits apply** (check IRS guidelines annually)

✦ D. Bonus Depreciation (Temporary Extra Deduction)

- **100% bonus depreciation** was available for assets placed in service **before 2023**
- **Starting in 2023**, bonus depreciation phases out:
 - **2023:** 80%
 - **2024:** 60%
 - **2025:** 40%
 - **2026:** 20%
 - **2027+:** No bonus depreciation

- **Section 179 vs. Bonus Depreciation: What's the Difference?**

Feature	Section 179	Bonus Depreciation
Deduction Limit	\$1,220,000 (2024)	No dollar limit
Phase-Out	Begins at \$3,050,000	No phase-out
Taxable Income Limit	Cannot exceed taxable income	Can create a loss
New vs. Used Assets	Both qualify	Both qualify
Applies to Vehicles?	Yes, with limits	Yes, with limits



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Feature	Section 179	Bonus Depreciation
Available Until?	Permanent	Phasing out (80% in 2024, 60% in 2025)

Business vehicles have additional restrictions:

- **Luxury Vehicle Depreciation Limits:**
 - Passenger vehicles used for business have **annual limits** on depreciation.
 - Maximum Section 179 deduction for **SUVs, trucks, and vans over 6,000 lbs GVWR: \$28,900 in 2024.**

4. When to Start Depreciating?

- Depreciation **begins** when the asset is **placed in service** (not when purchased).
- If an asset is used **partly for business and partly personal**, only the **business-use percentage** is depreciable.

5. When Does Depreciation Stop?

- When the asset is **fully depreciated** (its book value = salvage value).
- When you **sell or dispose** of the asset (may result in a gain or loss).

6. Reporting Depreciation on Taxes

Businesses report depreciation on:

- **Form 4562** (Depreciation & Amortization)
- **Schedule C** (for sole proprietors)
- **Balance Sheet** (for financial tracking)

Final Takeaways

- ✓ Depreciation **spreads asset costs over time** for tax benefits
- ✓ **Straight-line** is easiest, while **accelerated methods** give bigger upfront deductions
- ✓ **Section 179** and **Bonus Depreciation** allow for **immediate tax savings**
- ✓ Track assets and depreciation to **stay compliant and maximize deductions**