



Understanding Depreciation

Learn how it **impacts your taxes** as a **property owner**.

About Depreciation



In accounting, **depreciation** is the **process of spreading the cost of a tangible asset over its estimated useful life**.

The **value** of the following **gradually decrease over time due to wear and tear**.



Buildings

(commercial & residential rental properties)



Furniture & Fixtures



Machinery & Equipment



Improvements

(fences, sidewalks, etc.)



Vehicles



Depreciation allows you to **systematically account** for this **decline in value throughout the lifespan**.

In terms of taxation, **the IRS recognizes depreciation** and allows businesses to **deduct it as an expense on their tax returns**.



This means **depreciation can significantly reduce your taxable income**, which **translates to lower taxes**.

So, while your **asset might be losing value on paper**, **depreciation** helps make up for that when it's time to **file your taxes**.



How Depreciation Works

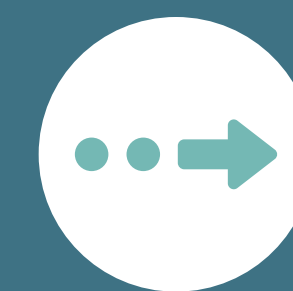
Every **depreciable asset** has a **"useful life"** as determined by the IRS.

This is the **estimated period** during which the asset is **expected** to be **usable for your business** or **income-generating activity**.



Methods of Depreciation

1) Straight-Line Depreciation Method - The simplest and most commonly used. It allocates the cost of an asset **EVENLY** over its useful life. The formula:



$$\text{Annual Depreciation} = \frac{\text{Cost of Asset} - \text{Salvage Value}}{\text{Useful Life}}$$

2) Accelerated Depreciation Methods

Accelerated depreciation methods **allocate more depreciation in the EARLY YEARS** of an **asset's life** and **less depreciation in later years**.



Declining Balance (DDB) DOUBLES the **straight-line depreciation rate** and is used to recognize that assets often lose value more rapidly in their initial years.



Sum-of-the-Years' Digits (SYD) involves **adding** the digits of an asset's useful life and **allocating** depreciation based on a fraction of those digits, with **more depreciation in the FIRST YEAR** followed by **gradually decreasing amounts**.

The Role of Depreciation in Taxation

Depreciation as a Non-Cash Tax Deduction

Depreciable Basis

Let's say you purchase a **commercial property for \$1 million**. A **portion of this cost**, excluding the value of the land, **is depreciable**.



Annual Deduction

Using IRS guidelines (typically **27.5 years for residential rental properties** or **39 years for commercial properties**), you determine the annual depreciation deduction.

Taxable Income Reduction

If your **annual depreciation deduction is \$25,000** and your business has **\$100,000 of income**,

only \$75,000 is subject to taxes

With Depreciation

Gross Income: \$200,000
Depreciation: \$125,000
Taxable Income: \$75,000
Tax rate: **22% (checking)**
Total tax due: \$16,500

Without Depreciation

Gross income: \$200,000

Taxable income: \$200,000
Tax rate: 32%
Total tax due: \$64,000

Total tax saved with \$125,000 of depreciation = \$47,500

For a free consultation call 800.236.6519 or visit www.engineeredtaxservices.com