

## Depreciation: Cost Recovery Methods and Options<sup>\*</sup>

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### Introduction

Depreciation on farm property placed in service after 1988 is limited to 150% declining balance (DB), rather than the 200% DB available for most non-farm property. Both methods change over to the straight-line method after the straight-line percentage becomes greater than the declining balance method, which describes where the percentages in the depreciation tables come from. Fortunately there are many sources for tables that have the percentage of depreciation for each year of the various classes and options. There are two straight-line (SL) options for the classes eligible for rapid recovery. The SL option may be taken over the MACRS class life or the MACRS ADS life. A fourth option is 150% declining balance over the asset depreciation range (ADR) midpoint life. Farmers and ranchers wanting to postpone depreciation deductions to a future year, when income is projected to be higher, may wish to use the ADS life of an asset because of its longer period in years. Accelerated cost-recovery methods for MACRS property are shown in the following table.

The changes in depreciation required for Alternative Minimum Tax (AMT) purposes are discussed in a separate article about AMT and depreciation. See the end of this paper for information on this and other depreciation topics.

**Note: Orchards, groves and vineyards** placed in service after 1988 are not eligible for rapid depreciation. They are in the 10 year class, and depreciation is limited to straight-line.

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## Accelerated Cost-Recovery Methods for MACRS

Class	Most Rapid MACRS Method Available
3, 5, 7, and 10 year farm assets	150% DB if placed in service after 1988 <sup>1</sup> 200% if placed in service 1987 through 1988 <sup>1</sup>
Nonfarm assets	200% DB
15- and 20-year	150% DB
27½ and 39 (31½) year	SL <i>only</i>

<sup>1</sup>See exception for orchards groves and vineyards above.

The MACRS rules do not provide standard percentage recovery figures for each year. However, the IRS and several of the tax services have made tables available, such as the table below.

### Annual Recovery (Percentage of Original Depreciable Basis)\*

(The 150% DB percentages are for 3, 5, 7, and 10 year class farm property placed in service after 1988.)

Recovery Year	3-Year Class		5-Year Class		7-Year Class		10-Year Class		15-Yr Class	20-Yr Class*
	200% DB	150% DB	200% DB	150% DB	200% DB	150% DB	200% DB	150% DB	150% DB	150% DB
1	33.33	25.00	20.00	15.00	14.29	10.71	10.00	7.50	5.00	3.75
2	44.45	37.50	32.00	25.50	24.49	19.13	18.00	13.88	9.50	7.22
3	14.81	25.00	19.20	17.85	17.49	15.03	14.40	11.79	8.55	6.68
4	7.41	12.50	11.52	16.66	12.49	12.25	11.52	10.02	7.70	6.18
5			11.52	16.66	8.93	12.25	9.22	8.74	6.93	5.71
6			5.76	8.33	8.92	12.25	7.37	8.74	6.23	5.29
7					8.93	12.25	6.55	8.74	5.90	4.89
8					4.46	6.13	6.55	8.74	5.90	4.52
9							6.56	8.74	5.91	4.46
10							6.55	8.74	5.90	4.46
11							3.28	4.37	5.91	4.46
12-15									5.90 <sup>†</sup>	4.46
16									2.95	4.46
17-20										4.46
21										2.24

\*Rounded to two decimals; see IRS Pub. 946 for more precise 20-year class rates.

<sup>†</sup>The percentage is 5.90 in years 12 and 14, 5.91 in years 13 and 15.

## Half-Year and Mid-Month Conventions

MACRS (other than 27½ and 39 year property) provides for a half-year convention in the year placed in service, regardless of the recovery option chosen. This means that a half-year of depreciation is taken in the first year (reflected in the table) and a half-year of the recovery amount is taken in the year of disposal (not reflected in the table unless disposal is in the final year of the cost-recovery period). No depreciation is allowed on property acquired and disposed

of in the same year. Property in the 27½ year and 39 year classes is subject to a mid-month convention in the year placed in service.

## **Mid-Quarter Convention**

If more than 40% of the year's depreciable assets (other than 27½ and 39 year property) are placed in service in the last quarter, **all** of the assets placed in service during that year must be depreciated using the mid-quarter convention. Assets placed in service during the first, second, third, and fourth quarters will receive 87.5%, 62.5%, 37.5%, and 12.5% of the year's depreciation, respectively. The amount expensed under IRC Section 179 is not considered in applying the 40% rule. In other words, the amount expensed under IRC Section 179 can be taken on property acquired in the last quarter, which may help avoid the mid-quarter convention rule. (See the end of this paper for information on how to find out more on IRC Section 179 and other useful topics.)

If the 40% mid-quarter convention rule is triggered, the depreciation on property acquired in the first and second quarters will be greater than the amount calculated under the MACRS half year convention rule. Taxpayers are not allowed to use the mid-quarter rules voluntarily. However, choosing the property to expense under Section 179, based upon the "in service date" could work to the advantage of a producer that would like to be subject to the rules. Expensing property put into service during the third quarter may trigger the 40% rule, so the depreciation for property put into service during the first and second quarter increases. Whether this increases total depreciation for the year would depend on the proportion of depreciable property placed in service in each quarter.

## **MACRS Alternative Depreciation**

The MACRS ADS is required for some property and is an option for any other property. ADS uses straight-line depreciation based on the alternative MACRS recovery period (ADR midpoint lives). Farmers who are subject to capitalization of preproductive expenses may elect to avoid capitalization; but if they do so, they must use the ADS life on all property. Any taxpayer required to use ADS is ineligible for bonus depreciation (which has various eligibility dates) but may still use the IRC Section 179 expense election.

## **MACRS property class rules**

For 3, 5, 7, and 10 year MACRS property, the same recovery option **must** be used for all the property acquired in a given year that belongs in the same MACRS class.

**Example 1:** G. Partick, a farmer, purchased a used tractor, used harvester, and used combine in 2010. All belong in the 7 year property class. Farmer Patrick may not recover the tractor over 7 years with rapid recovery (150% DB) and the other items over 7 or 10 years with SL. However, a taxpayer may choose a different recovery option for property in the same MACRS class acquired in a subsequent year. For example, Farmer Patrick could have chosen SL 7 year recovery for equipment purchased in 2008 and 150% DB for 7 years for equipment purchased in 2009 and could now select SL 10-year recovery for all machinery purchased in 2010.

A taxpayer may select different recovery options for different MACRS classes established for property put into service in the same year. For example, a taxpayer could select fast recovery on 5 year property, and SL over 7 years on 7 year property.

## IRS Publications

To access IRS Publications go to [www.irs.gov](http://www.irs.gov) and click on “Forms and Publications”. Then click on “Publication number” under “Download forms and publications by:”. Type the publication number in the find box to search for the publication. Publication may be viewed online by double clicking on the publication or downloaded.

**IRS Publication 946: How to Depreciate Property.** This publication specifically covers depreciation with great detail.

**IRS Publication 225, Farmer’s Tax Guide.** This publication addresses many of the issues for depreciation including separate sections for: Depreciation, Chapter 7; Basis of Assets, Chapter 6; and Dispositions of Property Used in Farming, Chapter 9.

## Additional Topics

This fact sheet was written as part of Rural Tax Education a national effort including Cooperative Extension programs at participating land-grant universities to provide income tax education materials to farmers, ranchers, and other agricultural producers. For a list of universities involved, other fact sheets and additional information related to agricultural income tax please see [RuralTax.org](http://RuralTax.org).

Fact sheets that might be of particular interest include:

- Depreciation: An Introduction
- Depreciation: Class Life
- Depreciation: Special Rules on Pickups, SUVs, Other Autos and Listed Property
- Depreciation: Election to Expense Qualifying Assets (Section 179 Deduction)
- Depreciation: Bonus or Additional First-Year Depreciation (AFYD)
- Depreciation: Other Topics
- Depreciation: Alternative Minimum Tax Considerations
- Depreciating Your Home Office

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