Whats The Deal With Full Expensing?

NTUF Issue Brief #170 - Visual Aid

Below is a general explanation of how to depreciate property under the Modified Accelerated Cost Recovery System (MACRS). Note that asset depreciation can be considerably more complicated for property acquired in a nontaxable transfer, depreciation in a short tax year, for general asset accounts, et cetera. Additionally, rules can be different for assets placed in service less recently.

Determine if your asset is eligible for a reduction in tax liability.

Determine whether to depreciate your asset under the General Depreciation System (GDS) or Alternative Depreciation System (ADS) using IRS Publication 946's guidance. If your asset is not required to be depreciated under ADS, you use GDS. However, you can also elect to use ADS for GDS-qualifying assets.

Using GDS

Determine the property class of your asset based on IRS Publication 946's guidance. Note that though property classes are defined by the "useful lives" of an asset, the property class is not the same as the recovery period.

Determine the recovery period based on the property class of your asset and the year the asset was placed into service. Property on an Indian reservation is subject to different recovery periods based on property class. Recovery periods can range from 3 to 39 years, or 2 to 22 years for Indian reservation property.

Using ADS

Determine the recovery period based on the type of asset described in IRS Publication 946. Recovery periods can range from 4 to 50 years.

Determine which averaging convention, which establishes when therecovery period begins and ends, applies.

If using the mid-month convention, one-half month of depreciation is allowed for the month the property is placed in service or disposed of.

If using the mid-quarter convention, 1½ months of depreciation is allowed for the quarter the property is placed in service or disposed of.

If neither of the other two conventions apply, use the half-year convention. Under this convention, one-half year of depreciation is allowed for the year the property is placed in service or disposed of.

Determine which depreciation method applies. In some cases, you can elect to choose a different depreciation method than the one which would normally apply. The depreciation method chosen affects only the reduction in tax liability an asset owner can receive in each year, not the total reduction in tax liability.

GDS Assets

The 200% declining balance method over a GDS recovery period. This method results in depreciation benefits being frontloaded towards early years, with greater reductions in tax liability in the early years than the straight line method, and lesser reductions in tax liability in later years than the straight line method.

The 150% declining balance method over a GDS recovery period. Similar to the 200% declining balance method, though tax liability is slightly lower in earlier years and slightly higher in later years.

The straight line method over a GDS recovery period. Reductions in tax liability are constant, with the exception of the first and last years.

ADS Assets

The straight line method over an ADS recovery period. Reductions in tax liability are constant, with the exception of the first and last years.

Calculate the yearly deduction in tax liability over the course of your asset's recovery period, then deduct that amount each year from tax liability.

Below is a general explanation of how deducting asset value from tax liability would work under full expensing.

Determine if your asset is eligible for a reduction in tax liability.

Calculate the yearly deduction in tax liability over the course of your asset's recovery period, then deduct that amount each year from tax liability.

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NTUF Issue Brief #170 - Andrew Wilford and Andrew Moylan

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