



# An Introduction to Depreciation

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# Disclaimer

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- None of what is presented should be considered legal or tax advice
- This presentation is for educational purposes and may contain some generalizations
- Consult with trusted tax professionals on your individual situation

# What is depreciation?

- Agricultural producers purchase a variety of items for use in their business
- Many items are consumed within 12 months of purchase and are deducted as an expense
  - Seed, fertilizer, feed, etc.



# What is depreciation?

- Cost of property with a useful life greater than one year is generally recovered over a number of years
- Recovery occurs through an income tax deduction for depreciation



# What property is depreciated?

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- Generally, property that:
  - You own
  - Is used in your business or income generating activity
  - Has a determinable useful life
  - Expected to last longer than one year



# What do we need to know?

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- Date placed in service
- Basis of property
- Depreciation convention
- Recovery period
- Depreciation method
- Amount of §179 expense deduction
- Special Depreciation Allowance (bonus depreciation)

# Date placed in service

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- Property is placed in service when it is ready and available for a specific use
- It is not required that the property actually be used for that specific purpose by the date it is placed in service
- Example: Amaija purchased a planter on 12/12/24 which was delivered to her farm on 12/14/24. She first used it for planting on 4/1/25
  - Date placed in service is December 14, 2024



# Basis of property

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- Basis of personal property generally includes:
  - Cost of the property
  - Expenses for delivery, assembly, or installation
  - Sales tax paid at purchase
- Property basis includes any portion of purchase price paid with cash as well as any portion financed

# Basis of property

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- After 2017, when a purchase includes a trade-in, the basis of the new property is equal to:
  - The portion purchased with cash or financing, plus
  - The amount allowed for the property given up
- Example: Jace purchased a tractor with \$50,000 of cash and traded-in an older tractor valued at \$75,000. His basis in the new tractor is \$125,000 (\$50,000 trade difference plus \$75,000 trade allowance)
  - For tax purposes, Jace treats the trade-in as if it was sold for \$75,000

# Depreciation convention

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- Depreciation convention determines the portion of the year that depreciation is claimed in the year the property is placed in service
- Generally, either *half-year* or *mid-quarter* convention will apply to machinery, equipment, agricultural buildings, or livestock used for draft, breeding, or dairy purposes
- The *mid-month* convention applies to residential rental property and nonresidential real property

# Depreciation convention

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- In general, the *half-year* convention applies
- Except when more than 40% of the total depreciable bases of applicable property is placed in service in the last quarter of the year, *mid-quarter* convention applies
- Excluded from this calculation:
  - Nonresidential real property
  - Residential rental property
  - Property placed in service and disposed of in the same year
  - Amounts deducted using §179 expense deduction

# Depreciation convention

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- When the *half-year* convention applies, depreciation begins at the mid-point of the year (6 months of depreciation)
- When the *mid-quarter* convention applies depreciation begins at the mid-point of the quarter the property was placed in service
  - 1<sup>st</sup> quarter =  $\frac{7}{8}$  of the year or  $10\frac{1}{2}$  months
  - 2<sup>nd</sup> quarter =  $\frac{5}{8}$  of the year or  $7\frac{1}{2}$  months
  - 3<sup>rd</sup> quarter =  $\frac{3}{8}$  of the year or  $4\frac{1}{2}$  months
  - 4<sup>th</sup> quarter =  $\frac{1}{8}$  of the year or  $1\frac{1}{2}$  months

# Depreciation convention

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- Example: Pearce purchased a grain cart on July 10 for \$65,000 and corn header on October 20 for \$60,000. Because more than 40% of basis was placed in service the 4th quarter, the mid-quarter convention applies
  - $60,000 / (65,000 + 60,000) = 48\%$
  - 3/8 of a year of depreciation for the grain cart
  - 1/8 of a year of depreciation for the corn header

# Recovery period

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- The number of years that property is depreciated is the recovery period, with two options available:
  - General Depreciation System (GDS)
  - Alternative Depreciation System (ADS)
- In most cases, GDS is used but a taxpayer can elect to use ADS to increase the recovery period (in most cases) and decrease the amount of depreciation taken in the year the property is placed in service

# Recovery period

- Recovery period is determined by referencing *Table 7.1, Farm Property Recovery Periods* in *IRS Publication 225 – Farmers Tax Guide*

Table 7-1. Farm Property Recovery Periods

Assets	Recovery Period in Years	
	GDS	ADS
Agricultural structures (single purpose) .....	10	15
Automobiles .....	5	5
Calculators and copiers .....	5	6
Cattle (dairy or breeding) .....	5	7
Communication equipment <sup>1</sup> .....	7	10
Computer and peripheral equipment .....	5	5
Drainage facilities .....	15	20
Farm buildings <sup>2</sup> .....	20	25
New farm machinery and equipment <sup>3</sup> .....	5	10
Used farm machinery and equipment .....	7	10
Fences (agricultural) .....	7	10
Goats and sheep (breeding) .....	5	5
Grain bin .....	7	10
Hogs (breeding) .....	3	3
Horses (age when placed in service)		
Breeding and working (12 years or less) .....	7	10
Breeding and working (more than 12 years) .....	3	10
Racing horses (more than 2 years) .....	3	12



# Recovery period

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- Even though the recovery period is a specified number of years, depreciation deductions occur over an additional income tax year because property is only depreciated for a portion of the year it is placed in service
- Example: Courtney purchased a used hay baler which would be depreciated for 7 years under GDS. If the half-year convention applies, she will claim:
  - Half year of depreciation for the year placed in service
  - Full year of depreciation in years 2 through 7
  - Half-year of depreciation in year 8

# Depreciation method

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- Depreciation method determines the timing of depreciation deductions
- For farm property placed in service after 2017 with a recovery period of 3-, 5-, 7-, or 10-years, the default depreciation method is GDS 200% declining balance
  - For this property, elections are available to use GDS 150% declining balance, GDS straight line, or ADS straight line

# Depreciation method

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- For farm property with a recovery period of 15- or 20-years the default depreciation method is GDS 150% declining balance
  - For this property, elections are available to use either GDS straight line or ADS straight line
- An election to change depreciation method applies to all property within a class life but does not impact the depreciation method for property with a different class life
- IRS Pub 946 – How to Depreciate Property Appendix A

# §179 Expense deduction

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- Election available to expense part or all of the cost of qualifying property in the year placed in service allowing considerable flexibility in tax planning
- Election is made separately for each property
- Qualifying property is generally:
  - Agricultural machinery and equipment
  - Livestock used for draft, breeding, or dairy purposes
  - Grain storage facilities
  - Single purpose agricultural and horticultural structures
  - Irrigation equipment and field drainage tile

# §179 Expense deduction

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- §179 is subject to a dollar limit (\$1,220,000 for 2024)
- §179 deduction is limited to business income including:
  - Wages earned as an employee,
  - Farm or non-farm business income (Schedule F or Schedule C)
  - Certain income from a pass-through entity
  - Gain from the sale of business property (excluding the sale of land)
- §179 deduction dollar limit is reduced by \$1 for every \$1 of investment over a limit (\$3,050,000 for 2024)

# Special depreciation allowance

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- Special depreciation allowance is commonly referred to as bonus depreciation
- Allows for a deduction of a percentage of property basis in the year the property is placed in service (60% in 2024 and 40% in 2025)
- Bonus applies to property with a GDS recovery period of 20-years or less, so nearly all depreciable agricultural property is eligible

# Special depreciation allowance

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- Bonus depreciation applies to qualifying property by default so a taxpayer must elect to not take
- Election to not take bonus depreciation applies to all property within a class life
- Separate election must be made for each class life
- §179 deduction is taken before special depreciation allowance
- Although useful, special depreciation allowance may provide less flexible than §179 deduction

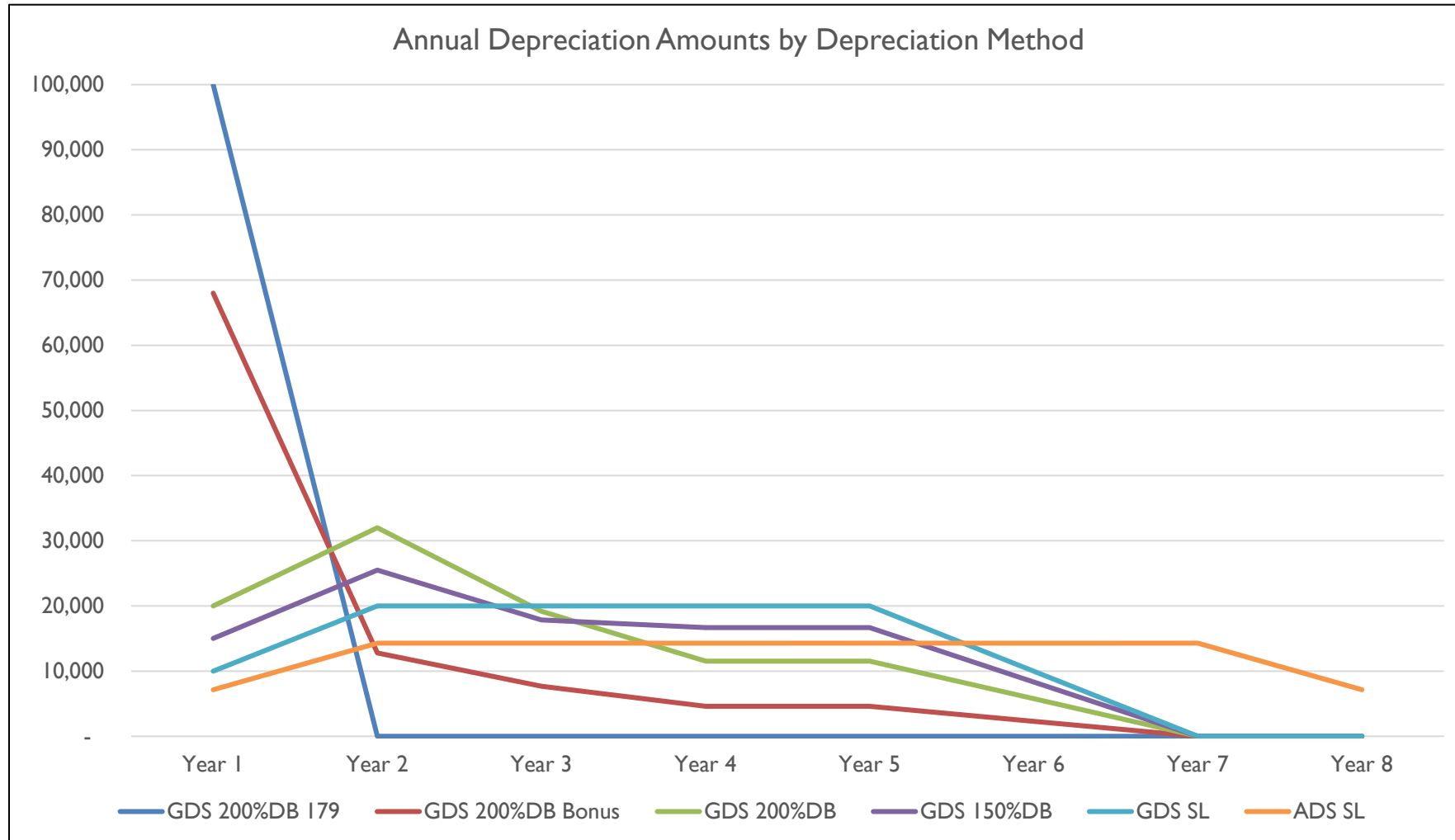
# Depreciation differences

- Example: Justin purchased a new tractor for \$100,000. He discusses potential depreciation options with his income tax preparer who provides the following table of options:

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8
<b>§179 Deduction</b>	100,000							
<b>60% Bonus + GDS 200DB</b>	68,000	12,800	7,680	4,608	4,608	2,304		
<b>GDS 200DB</b>	20,000	32,000	19,200	11,520	11,520	5,760		
<b>GDS 150DB</b>	15,000	25,500	17,850	16,660	16,660	8,330		
<b>GDS SL</b>	10,000	20,000	20,000	20,000	20,000	10,000		
<b>ADS SL</b>	7,140	14,290	14,290	14,280	14,290	14,280	14,290	7,140



# Depreciation differences



# Planning thoughts....

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- Elections related to depreciation are made at the time of tax preparation time, providing flexibility after-the-fact
- Accelerated depreciation (§179 or bonus depreciation) will reduce depreciation deductions available in future years so evaluate the benefit of the deduction now versus in the future
- Some states do not follow federal rules for §179 deduction or bonus depreciation
- Annual limits on depreciation for certain cars, pickups, or SUVs adds complexity

# Resources

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IRS Publication 225 – Farmers Tax Guide

<https://www.irs.gov/pub/irs-pdf/p225.pdf>

IRS Publication 946 – How to Depreciate Property

<https://www.irs.gov/pub/irs-pdf/p946.pdf>

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[ruraltax.org](http://ruraltax.org)

# Questions?

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# Contact Information

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