

What Is Depreciation & How Does Depreciation Work?

By [Kathleen Murray](#) on July 11, 2019 | [Accounting](#), [Business Accounting](#), [What is](#) | [Comments \(1\)](#)

Depreciation is an income tax deduction that allows you to recover the cost of assets like cars, furniture, and equipment that you purchase and use in your business. It can also be reported for accounting purposes so that your financial statements accurately reflect your investment in fixed assets and allocate those costs over time.

How Depreciation Works

Machinery and other fixed assets wear out and lose value. Depreciation allows businesses to recognize this by writing off their costs over time. You can expense a portion of an asset's value each year it's used, or even deduct the entire amount at once. It depends on whether you're using depreciation for tax or accounting purposes.

Generally, any fixed asset—a long-term asset that can't easily be converted to cash—can be depreciated. This includes most of your plant, property, and equipment, with the exception of land. You can depreciate your warehouse and factory, but not the ground it's sitting on. You can also depreciate intangibles such as patents and software for tax purposes.

Depreciation is an important part of [small business accounting](#), and there are several methods you can use. In deciding which to use, you should consider the type of asset, future plans for your business, and how you will use the depreciation. There are two ways that you can use depreciation: as a tax deduction or as an expense that you record on your books for accounting purposes.

Let's look at these two reasons to use depreciation more detail:

1. Using Depreciation to Get a Tax Deduction

Taxes are what most people think of when they hear the word depreciation. For tax purposes, businesses can choose to deduct the entire cost of an asset all at once with bonus depreciation or the Section 179 deduction. Or they can divide the cost over several years using straight line depreciation or the Modified Accelerated Cost Recovery System (MACRS). For businesses with cars, [vehicle depreciation deductions](#) are typically made with MACRS, Section 179, or the special deduction allowance.

It's perfectly acceptable to use different depreciation methods for your taxes and your accounting records. Once you've decided on a method, however, you should remain consistent. If you're unsure, you might want to contact an accountant to determine the best approach.

The four primary methods the IRS lets you use to determine the allowable tax deduction for fixed assets are:

1. [MACRS](#) (Modified Accelerated Cost Recovery System): This is the primary method of depreciation that the IRS lets you use to determine the allowable tax deduction for fixed assets. In general, with MACRS, you can write off more depreciation in the early years of an asset and less in the later years.

2. [Straight line depreciation](#): If you have intangible assets that you need to depreciate, like patents or computer software, then you would use straight line depreciation and not MACRS to calculate your tax deduction.
3. [Section 179 deduction](#): If your asset qualifies for Section 179, then you can deduct up to \$1 million in fixed assets in the year of purchase. This lets you receive the entire tax deduction upfront; you don't have to spread out the cost over a number of years.
4. Bonus depreciation: Allows you to deduct 100% of the cost of assets placed in service during the years 2018 through 2022. It is similar to a 179 deduction, except there are fewer paperwork requirements and no \$1 million limit.

The following example provides more detail on how depreciation works for taxes:

Depreciation for Tax Purposes Example

Your company buys a tower crane costing \$1 million to help build office buildings over the next 10 years. You could depreciate the crane using the MACRS method, which would reduce your taxes in each of those years. Alternatively, you could deduct the entire cost of the crane using either bonus depreciation or the Section 179 deduction. This would provide a significant reduction in taxes your first year, but no further deduction after that.

To get an idea of the potential tax savings if you deduct the cost of your assets all at once, check out our [Section 179 calculator](#).

2. Reporting Depreciation for Accounting Purposes

If you use the [cash basis method](#) of accounting like many small businesses, then you don't need to depreciate fixed assets for your books. You would need to depreciate for tax purposes, however. That said, if you purchase multiple assets for your business or a very expensive asset, it can throw off your books if you don't use depreciation.

There are four methods of depreciation that you can use for accounting purposes that meet Generally Accepted Accounting Principles (GAAP) guidelines:

1. [Straight line](#): This is the default method for most assets. It's a straightforward allocation of asset cost of the total number of years used. It's also allowed for tax purposes, which can simplify your accounting.
2. [Double declining balance](#): This is an accelerated method that takes bigger expenses in the first few years. It is good for assets like cars, which experience their biggest declines in value early on.
3. [Sum of the years digits](#): This is another accelerated method for assets that lose most of their value in their first years. It depreciates assets slightly slower than double declining balance.
4. [Units of production](#): This method, often used in manufacturing, is useful when it makes more sense to recognize depreciation of an asset based upon its usage or output rather than years in service.

In the example below, we walk you through how depreciation works for accounting purposes:

Example of How Depreciation Works for Accounting Purposes

To demonstrate how depreciation will impact your financial statements, let's go back to our \$1 million crane example. Below, we've provided revenue and expense totals on a sample profit and loss statement. Let's assume that before we purchased the crane, we have revenue of \$800,000 and expenses of \$125,000. That will give us a net profit of \$175,000.

If we depreciate the crane using the straight line method, we will divide the \$1 million evenly over 10 years to get a \$100,000 annual depreciation expense. Assuming revenues of \$800,000 and other expenses of \$125,000 in the first year, that will give us a profit of \$575,000.

If instead we use Section 179 or bonus depreciation to write off the entire cost of the crane, we end up posting a \$325,000 loss, as shown in the following table:

Comparing Depreciation Methods for Accounting Purposes

Profit and Loss Statement	With Straight Line Depreciation for Crane	With 100% Depreciation for Crane
Revenue	\$800,000	\$800,000
Depreciation on Crane	(\$100,000)	(\$1 million)
Other Business Expenses	(\$125,000)	(\$125,000)
Net Profit or (Loss)	\$575,000	(\$325,000)

From an actual cash position, nothing has changed. Whether you use straight line depreciation or write the total cost off immediately, you have still spent \$1 million on the crane. The first method gives you a profit of \$575,000. The second produces a loss of \$325,000, yet fails to account for the fact that you'll likely be using the crane for years to come.

Why does this matter? If you intend to qualify for a business loan or attract investors, you don't want to present financial statements that will give the impression that your business is not doing well (when it really is). This is one of the benefits of recording depreciation for fixed assets over a period of time, as we explain further in the next section.

Tax vs Book Depreciation Takeaway

As the crane example illustrates, the financial statements and tax returns of a business serve different purposes. For taxes, your goal may be to take the largest deduction you can upfront to reduce taxable income. For your books, you want to show a realistic and accurate bottom line for yourself, investors, and lenders.

As a result, it is acceptable to calculate depreciation for taxes differently from how you record depreciation for accounting purposes. This also means that it is possible for your books to differ from

what is reported on your tax return. As a result, many businesses keep two sets of books: tax-adjusted basis for tax purposes and book-adjusted basis for accounting purposes. [Small business accounting software](#) can help keep everything straight.

Let's take one final look at the differences between these two sets of books for depreciation purposes:

1. **Tax-adjusted basis:** The set of books you keep for tax purposes is used to calculate the deduction you can take for fixed assets on your tax return. As we discussed at the beginning of this article, depending on the type of asset, tax-adjusted basis is calculated by using the MACRS depreciation method, straight line depreciation, Section 179 depreciation, or bonus depreciation.
2. **Book-adjusted basis:** This set of books reflects what an asset is worth from a business' internal perspective. The book-adjusted basis is calculated using one of the four methods of depreciation mentioned previously, which we will go into greater detail later in this article (straight line, double declining balance, sum of the years digits, or units of production).

To reiterate, most businesses only care about the tax-adjusted basis and how they can use depreciation to enjoy a tax deduction. But if you purchase expensive assets or multiple assets in a year, then you may want to record depreciation for your books as well.

If you're worried about calculating depreciation on your own, using a bookkeeper like [Bench](#) could be a big help. Their team will calculate depreciation for you while working with your existing CPA. Packages start at \$95 per month; reach out today to get your free consultation.

[Visit Bench](#)

Requirements to Depreciate Assets

There are certain requirements an asset must meet before you can depreciate it. You must own it, use it in your business for more than one year, and it should have a measurable useful life that is longer than one year. The asset also must be depreciable for either tax or book purposes.

The five requirements to depreciate assets are:

1. The Asset Must Be Depreciable

There are some assets that the IRS says you can't depreciate, including land, inventory, and minor repairs you expense immediately. There are also assets that are now depreciable for book purposes according to Generally Accepted Accounting Principles (GAAP) that govern financial statements; these include vehicles, home office space, and buildings.

Here is a more complete list:

Summary Table of Fixed Assets

Assets That Can Be Depreciated

- [Vehicles](#): cars, taxis, buses, trucks

Assets That Cannot Be Depreciated

- Inventory

-
- Office equipment: computers, monitors, printers, copiers
 - Appliances, carpet, furniture used to furnish residential rental property
 - Office furniture: desks, filing cabinets
 - [Home office space](#): a room or a portion of your home that is used for business
 - Buildings: factory or warehouse
 - Major repairs: any kind of improvement that restores an asset and adds value (e.g., roof replacement on a building)
 - Intangible assets: patents, computer software
 - Land
 - Leased or rented property: office space, factory, warehouse
 - Minor repairs to an asset: repairs made for normal wear and tear like tire replacement or oil change on a car

2. You Must Own the Asset

You are the owner of property, whether you paid cash, assumed a mortgage, or took out a loan to buy it. If you purchased a vehicle to become an Uber driver, for example, you can still depreciate the car even if you will be making payments on it for five years. You can also depreciate leased property if it meets certain requirements. Refer to [IRS Pub 946](#) for details.

3. The Asset Must Be Used in Your Business

You cannot depreciate property used solely for personal reasons. However, you can depreciate property that is used for both business and personal reasons. The deduction you're allowed to take will be limited to the amount of time the asset is used for business purposes.

For example, when you're not driving your Uber clients in your new car, you run errands and take your kids to school. Your depreciation deduction for the car is based on the percentage of time you use it to drive Uber clients (business), not the time you spend running personal errands. A [mileage tracker](#) can help you keep business and personal trips separate.

4. The Asset Must Have a Determinable Useful Life

This means that the property must wear out, become obsolete, or lose its value in order to be depreciated. Certain types of property, like land, don't wear out and are therefore not eligible for depreciation.

5. The Useful Life of the Asset Must Be Greater Than One Year

The property must not become obsolete or lose all of its value within the first 12 months. If the asset will not last for more than one year, you can generally expense it at one time and you do not have to depreciate it.

How to Depreciate Repairs & Improvements

An improvement to a fixed asset can be depreciated, while a repair must be expensed in total. So it's important to distinguish between the two. To depreciate an improvement, you would set it up as a fixed asset and then depreciate it over its useful life.

Figuring out whether an expenditure is an improvement or a repair is often straightforward:

Example of How Depreciation Works for Repairs & Improvements

Let's say you have a minor leak in the roof of your warehouse. The cost to repair the leaky roof can be expensed 100%. However, if you have to completely replace the roof after a major leak, then the roof replacement is considered an improvement. That's because it restores the property and adds value. The new roof should be set up as a fixed asset and depreciated over its useful life.

As demonstrated above, figuring out whether something is an improvement or a repair is often straightforward. But sometimes making this determination is more difficult. If you aren't sure how to classify a modification to an asset, [IRS Publication 527](#) offers more guidance.

When Depreciation Starts & Ends

Knowing when depreciation starts and stops is important. It is a key component in calculating your allowable tax deduction. Depreciation starts when you place your property in service for use in your business. Depreciation stops when you have either fully recovered your cost or when you retire the asset from service, whichever happens first. We'll explain what all of this means with a few examples.

The three key depreciation beginning and ending points are when the:

1. Asset Is Placed in Service

You place property in service when it is available and ready for use in your business. Even if you are not using the property, it is in service when it is ready and available for its intended use.

Here is an example to demonstrate how this works:

Example of Starting Depreciation Based on Date Placed in Service

On March 30, you bought a duplex to use as residential rental property. You had to make several repairs to the property to get it ready for renters. On June 1, the repairs were complete, and the duplex was ready to rent. You begin to advertise it on Craigslist and in the local paper. The first tenants move in on July 1. However, the duplex is considered to be placed in service on June 1, when it was ready and available for rent.

2. Cost of the Asset Is Fully Recovered

Depreciation stops when you have fully recovered your cost in the asset or if you stop using it for business, whichever comes first. An asset is fully recovered when allowable depreciation deductions match the cost or investment you put into the item.

Here is an example to illustrate how to know when you've written down the asset:

Example of Stopping Depreciation Based on Full Asset Recovery

You purchased a computer for \$5,000 (including purchase price, delivery fees, and other associated costs). The computer has a useful life of five years and you will deduct \$1,000 per year as depreciation expense. In this scenario, the cost of the computer will be fully recovered in the fifth year. Therefore, the computer is no longer eligible for depreciation at the end of year five as indicated in the table below.

Full Recovery Depreciation Schedule for Fixed Asset With 5-Year Useful Life

Year	Depreciation Expense	Ending Balance (cost less depreciation expense)
1	\$1,000	\$4,000
2	\$1,000	\$3,000
3	\$1,000	\$2,000
4	\$1,000	\$1,000
5	\$1,000	\$0
Total	\$1,000	

3. Asset Is Retired From Service

An asset is retired from service when it is no longer used in your business. This means you have to stop depreciating it, even if you have not fully recovered the cost. This happens in cases where the property is sold, destroyed, or otherwise no longer being used in the business.

The following are ways an asset can be retired from service:

- You sell or exchange the property.
- You convert the property to personal use.
- You abandon the property.
- You transfer the property to a supplies or scrap account.
- The property is destroyed or damaged and is no longer usable.

Example of Stopping Depreciation Based on Asset Being Retired

Let's say you bought a computer for \$5,000 and it had a useful life of five years. You decide to use straight line depreciation, which gives you an annual expense of \$1,000. At the end of year three, you decide you're just going to use this computer for personal things. At this point, you have retired the

asset and would not be entitled to any future depreciation even though it still has a book value of \$2,000.

Summary of the 7 Depreciation Methods

The IRS allows four depreciation methods for tax purposes: [MACRS](#), straight line, bonus depreciation, and [Section 179](#). You can use the straight line method if you decide to also depreciate your assets for book purposes, but you can also use [sum of the years digits](#), double declining balance, or [units of production](#), depending on which makes sense for your books.

The summary table below provides a brief description of each depreciation method and whether it is used for book or tax purposes:

Summary Table of Depreciation Methods

Depreciation Method	Description	Books or Tax
Section 179	Allows deductions up to \$1 million in depreciation expense for fixed assets; use our Section 179 calculator to see if you qualify.	Tax
Bonus Depreciation	Allows you to deduct the entire cost of an asset in the first year of use and has no upper limit.	Tax
MACRS	Allows you to write off more depreciation in the earlier years of an asset's useful life; only used for income tax purposes.	Tax
Straight Line	Spreads the cost of the asset evenly over its useful life; primarily for intangibles when used for taxes.	Book and Tax
Sum of Years Digits (SYD)	Allows you to write off more depreciation expenses in earlier years and less depreciation in later years.	Book
Double Declining Balance (DDB)	Allows you to write off even more depreciation expenses in the earlier years than sum of the years digits.	Book
Units of Production (UOP)	Calculates depreciation based on usage (i.e., the number of units that a fixed asset produced in a year).	Book

How to Choose the Right Depreciation Method

Choosing the right depreciation method starts with identifying whether you are depreciating for tax or book purposes. But you also want to consider if the method results in the appropriate deduction and provides accurate financial statements for your unique business situation. The following examples show how these methods work for both tax and accounting purposes.

The table below compares how depreciation works for each method:

Sample Depreciation Expenses for \$1,000 Computer Using Different Depreciation Methods

Year	Bonus or Section 179	MACRS	Straight Line	DDB	SYD
Year 1	\$1,000	\$200	\$200	\$400	\$333
Year 2	-	\$320	\$200	\$240	\$267
Year 3	-	\$192	\$200	\$144	\$200
Year 4	-	\$115	\$200	\$86	\$133
Year 5	-	\$115	\$200	\$52	\$67
Year 6	-	\$58	-	-	-
Total	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000

Choosing a Depreciation Method for Tax Purposes

The depreciation method you choose for tax purposes—[MACRS, Section 179](#), bonus depreciation, or straight line—is going to ultimately determine your tax deduction. If you’re looking for investors or applying for a business loan, you want to minimize your expenses to increase your bottom line. However, if you expect a higher than normal profit, you should select the method that allows you to take the largest deduction to reduce your profit and overall tax bill.

For this example, we wouldn’t be able to use the straight line method to calculate our tax deduction since that’s reserved for intangible property like software and copyrights. In the chart above, MACRS yields a tax deduction of \$240 in the first year and \$384 in the second year. If you qualified for Section 179, then you could deduct the full \$1,000 cost of the computer in the first year.

On the face of it, writing off the entire \$1,000 cost off at once might seem to be the most beneficial for a small business, particularly if you’re looking to get the biggest tax write-off. But as Petro Lisowsky, a CPA and Professor of Accounting at Boston University notes, appearances can be deceiving.

“As a knee-jerk reaction, it sounds great to be able to write everything off. But doing that may not be optimal. In deciding whether to elect Section 179 or bonus depreciation, business owners need to think

about what they expect their future earnings to look like. You might want to save some deductions to offset your income in the future when you could be earning more and taxes could be higher.”

– Petro Lisowsky, CPA & Professor of Accounting, [Boston University](#)

While it is important for you to understand the different depreciation methods and how they work, I recommend that you save yourself some time and leave depreciation calculation to the experts.

Top [business tax software](#) can calculate your depreciation tax deduction for you.

Choosing a Depreciation Method for Book Purposes

When it comes to deciding which depreciation method you should use for book purposes, there are several factors that come into play. The type of industry your business falls into and how quickly the assets you purchase lose value are two factors you need to consider when choosing a method for book purposes.

For most small businesses that are not in manufacturing, straight line is the most widely used method for book purposes. This is because of how simple it is to calculate straight line depreciation. Once you calculate the depreciation for the first year of an asset, it is the same each year. In the above chart, depreciation for the first two years for the computer is \$200 per year and will remain at \$200 for the remaining three years.

If you manufacture a product, then go with [units of production](#). Under this method, depreciation is calculated based on the number of units produced by the machine or equipment used to make your product. It will therefore be the most accurate.

If you have assets that lose their value within the first couple of years after purchase, like a car or a laptop computer, then you may opt for double declining balance or the [sum of the years digits](#) method, since both of them will result in a higher depreciation expense earlier on in the life of the asset.

How to Claim a Tax Deduction for Depreciation

As we have discussed, you can use [MACRS](#), straight line, Section 179, or bonus depreciation to calculate your tax deduction. To claim it, you must complete [Form 4562](#) for each asset that you want to claim a deduction for. This form should be filed with your tax return.

Depreciation and Amortization
(Including Information on Listed Property)

Department of the Treasury
Internal Revenue Service (99)
Name(s) shown on return

► Go to www.irs.gov/Form4562 for instructions and the latest information.

Business or activity to which this form relates

Identifying number

Part I Election To Expense Certain Property Under Section 179

Note: If you have any listed property, complete Part V before you complete Part I.

1	Maximum amount (see instructions)	1	
2	Total cost of section 179 property placed in service (see instructions)	2	
3	Threshold cost of section 179 property before reduction in limitation (see instructions)	3	
4	Reduction in limitation. Subtract line 3 from line 2. If zero or less, enter -0-	4	
5	Dollar limitation for tax year. Subtract line 4 from line 1. If zero or less, enter -0-. If married filing separately, see instructions	5	
6	(a) Description of property	(b) Cost (business use only)	(c) Elected cost
7	Listed property. Enter the amount from line 29	7	
8	Total elected cost of section 179 property. Add amounts in column (c), lines 6 and 7	8	
9	Tentative deduction. Enter the smaller of line 5 or line 8	9	
10	Carryover of disallowed deduction from line 13 of your 2017 Form 4562	10	
11	Business income limitation. Enter the smaller of business income (not less than zero) or line 5. See instructions	11	
12	Section 179 expense deduction. Add lines 9 and 10, but don't enter more than line 11	12	
13	Carryover of disallowed deduction to 2019. Add lines 9 and 10, less line 12	13	

Note: Don't use Part II or Part III below for listed property. Instead, use Part V.

Part II Special Depreciation Allowance and Other Depreciation (Don't include listed property. See instructions.)

14	Special depreciation allowance for qualified property (other than listed property) placed in service during the tax year. See instructions	14
15	Property subject to section 168(f)(1) election	15
16	Other depreciation (including ACRS)	16

Part III MACRS Depreciation (Don't include listed property. See instructions.)

Section A

17	MACRS deductions for assets placed in service in tax years beginning before 2018	17
18	If you are electing to group any assets placed in service during the tax year into one or more general asset accounts, check here <input type="checkbox"/>	

Section B—Assets Placed in Service During 2018 Tax Year Using the General Depreciation System

(a) Classification of property	(b) Month and year placed in service	(c) Basis for depreciation (business/investment use only—see instructions)	(d) Recovery period	(e) Convention	(f) Method	(g) Depreciation deduction
19a	3-year property					
b	5-year property					
c	7-year property					
d	10-year property					
e	15-year property					
f	20-year property					
g	25-year property					
h	Residential rental property					
i	Nonresidential real property					

Section C—Assets Placed in Service During 2018 Tax Year Using the Alternative Depreciation System

20a	Class life					
b	12-year					
c	30-year					
d	40-year					

Part IV Summary (See instructions.)

21	Listed property. Enter amount from line 28	21
22	Total. Add amounts from line 12, lines 14 through 17, lines 19 and 20 in column (g), and line 21. Enter here and on the appropriate lines of your return. Partnerships and S corporations—see instructions	22
23	For assets shown above and placed in service during the current year, enter the portion of the basis attributable to section 263A costs	23

For Paperwork Reduction Act Notice, see separate instructions.

If you made a mistake in calculating depreciation on a prior year's tax return, you can file an amended tax return to make the correction. However, depending on the type of mistake, you may be required to file [Form 3115](#) in addition to an amended return.

Some examples of common errors: if you used the wrong MACRS table to calculate loss of value, if you depreciated an asset that should not have been depreciated (refer to the table above for what can and cannot be depreciated), or if you need to adjust the useful life of an asset.

How to Record Depreciation for Accounting Purposes

Recording depreciation for financial accounting purposes takes three steps. The first is to prepare a journal entry that is a debit to your depreciation expenses account. Next, you want to maintain records

demonstrating ownership for each fixed asset. Lastly, prepare a depreciation schedule to keep track of book and tax expenses.

The three steps to record depreciation for accounting purposes are:

1. Prepare the Depreciation Expense Journal Entry

To record depreciation for accounting purposes, you should create a journal entry. But first, make sure you have set up a depreciation expense account and an accumulated depreciation account on your [chart of accounts](#).

The journal entry will be a debit to the depreciation expenses account, which will increase total expenses on the profit and loss statement. The credit will be to the accumulated depreciation account. This account will appear on the balance sheet report to reduce the net value of all fixed assets.

Here is the journal entry that should be recorded using the straight line method for year 1 of our computer example above (\$200 divided by 12 months):

Account	Debit Entry	Credit Entry
Depreciation Expenses	\$16.67	
		Accumulated Depreciation
		\$16.67

2. Maintain Records on the Assets

In addition to recording depreciation, be sure to keep track of any receipts, titles, contracts, and other documents that prove you own the asset. These documents should include the purchase date and the amount that you paid for the asset.

You will want to keep these documents in a separate file for each asset. The IRS requires that you retain such fixed asset supporting documentation for tax purposes. In the event of an audit, you would need to produce these records to back up the cost basis of the asset and show that you actually owned it.

3. Prepare a Depreciation Schedule

In addition to recording depreciation on the books, you need to create a depreciation schedule that includes detailed information about each fixed asset. If you have accounting software like [QuickBooks Online](#), then creating this schedule is a piece of cake. However, if you don't have accounting software, then I suggest you use a spreadsheet program.

Here is an example of what information your depreciation schedule should include:

Sample Depreciation Schedule for 7-Year Property

Date	Description	Cost	Useful Life	For Accounting		For Tax	
				Method	Depreciation Year 1	Method	Depreciation Year 1
January 1, 2019	Desk #1	\$5,000	7	S/L	\$714.29	Bonus	\$5,000
January 1, 2019	File cabinet #2	\$3,000	7	S/L	\$428.57	Bonus	\$3,000

How to Use QuickBooks to Track Depreciation

While [QuickBooks](#) does not calculate depreciation, you can still use it to track your fixed asset purchases, create depreciation schedules, and record your depreciation expense. If you're interested, there are fixed asset software programs that can help you to keep track all of your fixed assets and calculate their loss of value.

As we discussed in the previous section, the first thing you need to do is set up your fixed assets on your chart of accounts list. Below is a screenshot of the new account setup window in QuickBooks along with a brief description of the information you need to complete the setup. To learn how to set up the chart of accounts in QuickBooks, check out our video tutorial on [creating a chart of accounts](#).

Paul's Plumbing Co.				
ACCOUNT LIST				
ACCOUNT	TYPE	DETAIL TYPE	DESCRIPTION	BALANCE
Computer	Fixed Assets	Other fixed assets	Computer	1,200.00
Computer:Depreciation	Fixed Assets	Accumulated Depreciation		0.00
Computer:Original cost	Fixed Assets	Other fixed assets		1,200.00

Chart of accounts report filtered to show fixed assets in QuickBooks

Export this report to Excel, add the additional information that we discussed that should be included on your depreciation schedules, and save it.

If you are in the market for a new accounting software, be sure to check out our free [QuickBooks Online course](#). QuickBooks will allow you to easily create journal entries to record depreciation expense for all of your fixed assets. With [QuickBooks](#), you can also track detailed information for your fixed assets so that you can quickly create depreciation schedules.

Frequently Asked Questions (FAQs): What Is Depreciation

We've tried to thoroughly answer the questions about what depreciation is and how depreciation works. However, you might still have questions. We've answered some of the most common ones here.

Some frequently asked questions about depreciation include:

How does depreciation affect income?

Depreciation is an expense, so it will reduce income. For tax purposes, this means depreciating an asset will serve as a deduction, decreasing the amount of taxes you owe. For financial accounting purposes, depreciation reduces both net income and the value of the asset you carry on your books.

How many years do you depreciate equipment?

You should depreciate assets over their useful lives. If you bought a \$14,000 industrial oven that you expect to use for seven years, you would depreciate it for seven years. For tax purposes, the IRS stipulates the depreciation periods for certain types of equipment in [IRS Publication 946](#).

Why is depreciation calculated?

Fixed assets like vehicles, machinery, and equipment wear out and lose value over time. Depreciation is calculated to reflect this by allocating the cost of the asset over the time it is used. Depreciating assets allows you to better match revenues and expenses and create financial statements that more accurately reflect actual business activity.

What types of assets are subject to depreciation?

Generally, any fixed asset that you use in your business, with the exception of land, can be depreciated. This will include buildings, machinery, equipment, furniture, and other assets involved in producing

goods or services for sale. You are also allowed to depreciate intangible assets such as patents and software for tax purposes.

Bottom Line

Before reading this article, you probably knew that you could take depreciation as a tax deduction, but maybe you were not familiar with how depreciation works for book purposes. By now, you should have a better understanding of what property is depreciable, which depreciation methods to use for your books, and which are acceptable for tax purposes. You should also understand the impact that depreciation expense has on your financial statements.