
Tax Issues for Farmers: Depreciation Tools



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Depreciation Tools

- Based upon 2017 Tax Laws
- Options available
- Use in Income Tax Management



Depreciation

- What is depreciable? (Machinery, equipment, vehicles, certain livestock, buildings, and other farm assets with a useful life greater than one year.)
- Depreciation is used to deduct the cost of using a piece of property over its useful life.
- Generally cannot deduct 100 percent of the cost in the first year the asset is placed in service.



Depreciation Methods

- Modified Accelerated Cost Recovery System (MACRS)
 - 1. General Depreciation System (GDS): Accelerated or Straight Line option
 - 2. Alternate Depreciation System (ADS): Straight Line over a longer depreciable life
- Section 179 Deduction or Expensing Election:
recover all or a part of the cost in the year an asset is placed in service within certain limits.
- Additional First Year (Bonus) Depreciation
 - 50% Additional for 2016 and 2017
 - 40% Additional for 2018
 - 30% Additional for 2019



MACRS Depreciation Methods

- GDS: 200 % declining balance method applies to non-farm property.
- GDS: 150 % declining balance method applies to farm property.
- GDS: Straight line method
- ADS: Straight line method over a longer life
- Depreciate the assets to zero (fully deduct the cost of the asset).



Section 179 Deduction

- Property must be depreciable.
- Acquired for business use.
- Must be purchased.
- Asset can be new or used.
- Amount allowed cannot exceed dollar limits:
 - 2016 - \$500,000 of property placed in service with a total investment limit not to exceed \$2.01 million
 - 2017 - \$510,000 of property placed in service with a total investment limit not to exceed \$2.03 million

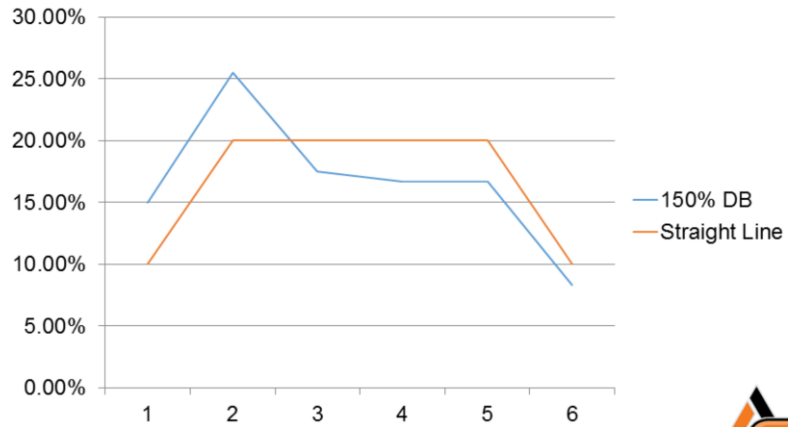


Section 179 Deduction (cont.)

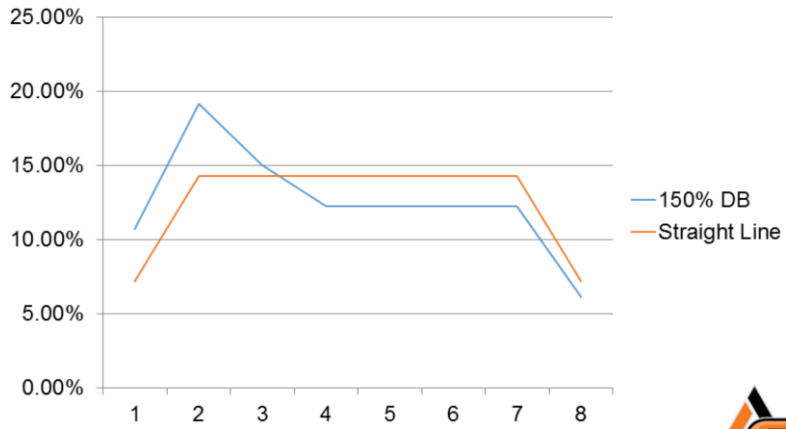
- If the investment limit is exceeded, then the amount allowed to be expensed is reduced.
- Cannot create a business loss and any unused amount can be carried forward to future tax years.
- W-2 wages can be offset by the Sec. 179 amount
- Works well in a year with abnormally high taxable income.



Depreciation for 5 Year Property



Depreciation for 7 Year Property



Depreciation for \$150,000 Tractor

Year	150% Declining Balance	Annual Depreciation Amount	Straight Line	Annual Depreciation Amount
1	10.71%	\$16,065	7.14%	\$10,710
2	19.13%	\$28,695	14.29%	\$21,435
3	15.03%	\$22,454	14.29%	\$21,435
4	12.25%	\$18,375	14.28%	\$21,420
5	12.25%	\$18,375	14.29%	\$21,435
6	12.25%	\$18,375	14.28%	\$21,420
7	12.25%	\$18,375	14.29%	\$21,435
8	6.13%	\$9,195	7.14%	\$10,710



Depreciation as an Income Tax Management Tool

- Useful tool to manage taxable income.
- If taxable income is expected to stay the same or increase, use straight line depreciation to maintain a larger deduction in the future.
- If taxable income is expected to decline, use declining balance depreciation to capture a larger deduction in the early, high income years.



Annual Depreciation Deduction for a \$40,000 Farm Asset

Year	150% DB	Straight Line	Sec. 179
1	6,000	4,000	40,000
2	10,200	8,000	0
3	7,140	8,000	0
4	6,664	8,000	0
5	6,664	8,000	0
6	3,332	4,000	0
Total	40,000	40,000	40,000



Income Tax Savings

	First Estimate	150% DB	Straight line	Section 179 Deduction
Taxable Income	75,300	75,300	75,300	75,300
Depreciation Deduction	N/A	6,000	4,000	42,250
Adjusted Taxable Income	75,300	69,300	71,300	33,050
Tax Due	10,544	9,491	9,791	4,046
Tax Savings	N/A	1,053	753	6,489



Conclusions

- Depreciation options are a simple and frequently used tool for managing taxable income.
- Be CAREFUL since improper use can lead to over investment in machinery and equipment which will often lead to cash flow problems in poor economic times (periods of low farm income).



Conclusion (cont)

- Be sure to consult with your tax advisor to determine your best tax management options
- It is much easier to avoid a problem compared to fixing a mistake.
- Visit RuralTax.org for various tax topics on depreciation.

