

| Year | 3-Year | 5-Year | 7-Year |
|------|--------|--------|--------|
| 1 | 33.0% | 20.00% | 14.29% |
| 2 | 44.45% | 32.00% | 24.49% |
| 3 | 14.81% | 19.20% | 17.49% |
| 4 | 7.41% | 11.52% | 12.49% |
| 5 | | 11.52% | 8.93% |
| 6 | | 5.76% | 8.93% |
| 7 | | | 8.93% |
| 8 | | | 4.46% |

Suppose your business just purchased a \$100,000 asset that has a 3-year useful life, and falls into 3-year class of assets. Using the SL method, the depreciation expense each year for the next 3 years would be:

| Year | Recovery Rate | Unadjusted Basis | Depreciation Expense | Accumulated Depreciation |
|------|---------------|------------------|----------------------|--------------------------|
| 1 | .1667 | \$100,000 | \$16,670 | \$16,670 |
| 2 | .3333 | \$100,000 | \$33,330 | \$50,000 |
| 3 | .3333 | \$100,000 | \$33,330 | \$88,330 |
| 4 | .1667 | \$100,000 | \$16,670 | \$100,000 |

Note that the book value or basis of the asset (acquisition cost – accumulated depreciation) would be \$0 after it has been fully depreciated at the end of 4 years. Because of the half-year convention, it takes 4 years to depreciate the asset, even though it falls into the 3-year classification.

Depreciation expense for the same asset using the MACRS method would be calculated as:

| Year | Recovery Rate | Unadjusted Basis | Depreciation Expense | Accumulated Depreciation |
|------|---------------|------------------|----------------------|--------------------------|
| 1 | .3333 | \$100,000 | \$33,333 | \$33,333 |
| 2 | .4445 | \$100,000 | \$44,450 | \$77,780 |
| 3 | .1481 | \$100,000 | \$14,810 | \$92,950 |
| 4 | .741 | \$100,000 | \$7,410 | \$100,000 |

Note again that the depreciation expense using MACRS is higher in the early years and lower in later years than with the SL method and that the book value after 4 years is again zero. Businesses often use MACRS for tax purposes and SL for profit reporting. Can you think of any reasons why?

Some businesses that invest small amounts in capital assets are allowed to deduct up to \$1,000,000 of the cost of acquired depreciable property as a current expenditure instead of a capital expenditure. This is known as *direct expensing*, and is available only to businesses that don't make large capital purchases each year. The allowable expensing amount is reduced by one dollar for each dollar of capital investment expenditure over \$2,500,000 during the year. Other restrictions also apply.