

# What is depreciation expense?

Depreciation expense is the allocated portion of the cost of a company's fixed assets that is appropriate for the accounting period indicated on the company's income statement. For instance, if a company had paid \$2,400,000 for its office building (excluding land) and the building has an estimated useful life of 40 years, each monthly income statement will report straight-line depreciation expense of \$5,000 for 480 months. [However, the allocated cost of the fixed assets used in *manufacturing* will be part of the manufacturing overhead which will become part of the cost of the products manufactured.]

## WHAT IS USEFUL LIFE?

Useful life is "an estimate of the average number of years an asset is considered useable before its value is fully depreciated."<sup>1</sup>

<https://www.bench.co/blog/tax-tips/depreciation>

**What it is:** The Modified Accelerated Cost Recovery System (MACRS) is the depreciation method generally required on a U.S. tax return. Under MACRS, assets are assigned to a specific asset class, and that class determines the asset's useful life. Double Declining balance and Sum of the Years' Digits methods are examples of MACRS depreciation. You can find a detailed table of asset classes in [IRS Publication 946, Appendix B](#).

**A summary of the MACRS tables**

Asset Class	Useful Life (Years)	Types of Assets
3-year property	3	Tractors, qualified rent-to-own property
5-year property	5	Vehicles, computers, office equipment, research equipment, appliances for a rental property
7-year property	7	Office furniture and fixtures, farm equipment, any assets that don't fit into other classes

10-year property	10	Boats, single-purpose farm structures
15-year property	15	Land improvement (landscaping, roads, and bridges)
20-year property	20	Multiple-purpose farm structures
Residential rental property	27.5	Any rental property where 80% of its rental income is from residential dwellings
Non-residential rental property	39	Office buildings, stores or warehouses that aren't residential property, or which fit into other classes

## What is a 'Salvage Value'

Salvage value is the estimated value that the owner is paid when the item is sold at the end of its useful life. The value is used to determine annual depreciation in the accounting records, and salvage value is used to calculate depreciation expense on the tax return. The value is based on an estimate of the asset's value, or the value can be determined by a regulatory body, such as the U.S. Internal Revenue Service (IRS).

“Per annum” is a Latin term that means annually or each year.

When it comes to contracts, per annum refers to recurring obligations or those that occur each year throughout an agreement. For example, if a bank charges an interest of 3% on a loan per annum, it means that you will need to pay an additional 3% of the principal amount every year until the end of the contract.

# What does per annum mean?

Per annum means yearly or annually. For example, if a business charges its customers 1.5% per month on any unpaid balance, the per annum rate is 18%. The per annum rate was the result of  $1.5\% \times 12$  months in a year.

When a supplier offers a credit customer an early-payment discount of 2% for paying an invoice in 10 days instead of paying the full amount in 30 days, the supplier is giving up 2% of the invoice amount in order to be paid 20 days early. To compute the rate per annum we multiply both the "2%" and the "20 days" by 18 (in order to get close to the 365 days in a year). Hence, the per annum rate is approximately 36%. To test this, let's assume that the invoice amount was \$1,000 and the supplier states that the customer may deduct 36% per annum if the invoice is paid 20 days before the due date. The calculation will be  $\$1,000 \times 36\% \text{ per annum} \times 20 \text{ days} / 360 \text{ days per year} = \$20$ . This amount agrees with the early-payment discount expressed as 2% of the \$1,000 invoice amount.

## What is 'Book Value'

The book value of an asset is equal to its carrying value on the balance sheet and is calculated by netting the asset against its accumulated depreciation.

Book value is also the net asset value of a company, calculated as total assets minus intangible assets (patents, goodwill) and liabilities. For the initial outlay of an investment, book value may be net or gross of expenses such as trading costs, sales taxes, service charges and so on.

<https://cpcongroup.com/fixed-asset-useful-life-table/>

**Start Optimizing Your Fixed Asset Management Process Now**

Specific depreciable assets used in all business activities, except as noted

		Recovery Periods (in years)		
Asset Class	Depreciation of Assets Included	Class Life (in years)	General Depreciation System (GDS)	Alternative Depreciation System (ADS)
00.11	Office Furniture, Fixtures & Equip.	10	7	10
00.12	Information Systems	6	5	5
00.13	Data Handling Equipment, Except Computers	6	5	6
00.21	Airplanes (airframes & engines), except those used in commercial or contract carrying of passengers or freight, & all other aircraft	6	5	6

**Prepared by Eng.Maged Kamel.**