How to Calculate Depreciation Using the Declining Balance Method

Depreciation of assets effectively reduces the earnings on which taxes are calculated, thereby lowering the overall tax liability. Under Generally Accepted Accounting Principles (GAAP), businesses have the flexibility to choose from five depreciation methods, allowing them to align their strategy with their financial and tax objectives.

The declining balance depreciation method offers a unique perspective on asset appreciation, especially for assets that lose value quickly. In this method, assets depreciate more quickly in the early years of their life, making it a great fit for assets that become outdated fast, like computers, cell phones, and other technology items. Using this method offers larger deductions sooner, making it a smart choice for managing tax liabilities as well.

Let's break this down with an example: imagine a company buys a machine for $10,000 and it's is planning to use the declining balance method over 5 years, with a salvage value of $1,000. The formula is straightforward: current book value times depreciation rate. Our depreciation rate here is double the straight line rate, meaning 40% instead of 20%. In the first year, we calculate 40% of $10,000, which is $4,000, so now the new book value is $6,000. Each year we apply the 40% rate to the new book value, leading to a continuously decreasing depreciation expense. Say that five times fast. By the end of 5 years, the machine's book value closely matches its salvage value.

The declining balance method is a great way to handle appreciation for technology and similar assets.

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