How to Calculate Depreciation Using the Straight Line Method

Depreciation of assets is an integral part of a company's tax strategy. It lowers the amount of earnings that taxes are based on, which in turn reduces the amount of taxes owed. Generally Accepted Accounting Principles, or GAAP, give business owners the choice of five different methods of depreciation to use. Let's talk about the straight line method.

Straight line depreciation is the most straightforward way to calculate an assets depreciation. It's ideal for smaller businesses looking for simplicity. Here's how it works: you calculate a fixed depreciation amount annually for the asset's life. This consistency is what makes it so simple and popular.

Let's look at an example: let's say one company buys a machine for $10,000 and it's expected to last for 5 years with a salvage value of $2,000 at the end. So to calculate yearly depreciation, you subtract the salvage value from the original cost, and then divide the rest by the useful life. In this case, that's $10,000 minus $2,000, divided 5, so the annual depreciation expense is $1,600. The company will record this amount each year for 5 years and by the end of its useful life, the machine's book value equals its salvage value of $2,000.

As you can see this method is a simple yet effective way to handle depreciation.

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