

) Phyllis believes that the firm should use straight-line depreciation for a capital project because it results in higher net income during the early years of the project's life. Joanna believes that the firm should use the modified accelerated cost recovery system depreciation because it reduces the tax liability during the early years of the project's life. Assuming you have a choice between depreciation methods, whose advice should you follow? Why?

In my opinion, modified accelerated cost recovery system depreciation method has greater benefits apart from tax liability. Whenever a straight line method is adopted, a fixed amount of depreciation is deducted every year from the asset value. One of the drawbacks, I suppose, is that it is never fair and in line with the book value of the asset. When the asset has the maximum bookvalue in the first year, and the minimum in the last year of its estimated life, the amount of depreciation charges is equal. However, when MACRS is used, it allows you to take larger deductions in the early years of the project which is a time value benefit. Also, the asset will be depreciated faster in the books as compared to SLM and therefore can easily be sold at profit (as compared to its book value) in the later years. Also under this method, larger amount can be set aside for asset replacements if needed. Therefore, MACRS method should be the method used.