Publication 225

Farmer’s Tax Guide

For use in preparing **2023** Returns

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Volume 4 of 10

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Table 5-1. **Limits on Deducting an Assessment by a Conservation District for Depreciable Property**

Total Limit on Deduction for Assessment for Depreciable Property	Yearly Limit on Deduction for Assessment for Depreciable Property	Yearly Limit for All Conservation Expenses
10% of:	**$500 + 10% of:**	**25% of:**
Total assessment against all members of the district for the property.	Your deductible share of the cost to the district for the property.	Your gross income from farming.
• No one taxpayer can deduct more than 10% of the total assessment. • Any amount over 10% is a capital expense and is added to the basis of your land. • If an assessment is paid in installments, each payment must be prorated between the conservation expense and the capital expense.	• If the amount you pay or incur for any year is more than the limit, you can deduct for that year only 10% of your deductible share of the cost. • You can deduct the remainder in equal amounts over the next 9 tax years.	• Limit for all conservation expenses, including assessments for depreciable property. • Amounts greater than 25% can be carried to the following year and added to that year's expenses. The total is then subject to the 25% of gross income from farming limit in that year.

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To ensure your deduction is within the deduction limits, keep records to show the following.

- *The total assessment against all members of the district for the depreciable property.*
- *Your deductible share of the cost to the district for the depreciable property.*
- *Your gross income from farming.*

Total assessment limit. You can't deduct more than 10% of the total amount assessed to all members of the conservation or drainage district for the depreciable property. This applies whether you pay the assessment in one payment or in installments. If your assessment is more than 10% of the total amount assessed, both the following rules apply.

- The amount over 10% is a capital expense and is added to the basis of your land.

- If the assessment is paid in installments, each payment must be prorated between the conservation expense and the capital expense.

Yearly assessment limit. The maximum amount you can deduct in any 1 year is the total of 10% of your deductible share of the cost as explained earlier, plus $500. If the amount you pay or incur is equal to or less than the maximum amount, you can deduct it in the year it is paid or incurred. If the amount you pay or incur is more, you can deduct in that year only 10% of your deductible share of the cost. You can deduct the remainder in equal amounts over the next 9 tax years. Your total conservation expense deduction for each year is also subject to the 25% of gross income from farming limit on the deduction, discussed later.

Example 1. This year, the soil conservation district levies, and you pay, an assessment of $2,400 against your farm. Of the assessment,

$1,500 is for digging drainage ditches. You can deduct this part as a soil or conservation expense as if you had paid it directly. The remaining $900 is for depreciable equipment to be used in the district's irrigation activities. The total amount assessed by the district against all its members for the depreciable equipment is $7,000.

The total amount you can deduct for the depreciable equipment is limited to 10% of the total amount assessed by the district against all its members for depreciable equipment, or $700. The $200 excess ($900 − $700) is a capital expense you must add to the basis of your farm.

To figure the maximum amount you can deduct for the depreciable equipment this year, multiply your deductible share of the total assessment ($700) by 10% (0.10). Add $500 to the result for a total of $570. Your deductible share, $700, is greater than the maximum amount deductible in 1 year, so you can deduct only $70 of the amount you paid or incurred for depreciable property this year (10% of $700). You can deduct the balance at the rate of $70 a year over the next 9 years.

You add $70 to the $1,500 portion of the assessment for drainage ditches. You can deduct $1,570 of the $2,400 assessment as a soil and water conservation expense this year, subject to the 25% of gross income from farming limit on the deduction, discussed later.

Example 2. Assume the same facts as in *Example 1* except that $1,850 of the $2,400 assessment is for digging drainage ditches and $550 is for depreciable equipment. The total amount assessed by the district against all its members for depreciable equipment is $5,500. The total amount you can deduct for the depreciable equipment is limited to 10% of this amount, or $550.

The maximum amount you can deduct this year for the depreciable equipment is $555 (10% of your deductible share of the total assessment, $55, plus $500). Since your deductible share is less than the maximum amount deductible in 1 year, you can deduct the entire $550 this year. You can deduct the entire assessment, $2,400, as a soil and water conservation expense this year, subject to the 25% of gross income from farming limit on the deduction, discussed below.

Sale or other disposal of land during 9-year period. If you dispose of the land during the 9-year period for deducting conservation expenses subject to the yearly limit, any amounts you have not yet deducted because of this limit are added to the basis of the property.

Death of farmer during 9year period. If a farmer dies during the 9year period, any remaining amounts not yet deducted are deducted in the year of death.

25% Limit on Deduction

The total deduction for conservation expenses in any tax year is limited to 25% of your gross income from farming for that year.

Gross income from farming. Gross income from farming is the income you derive in the business of farming from the production of crops, fish, fruits, other agricultural products, or livestock. Gains from sales of draft, breeding, or dairy livestock are included. Gains from sales of assets such as farm machinery, or from the disposition of land, are not included.

Example. In 2023, you report gross income from farming for your single-member LLC (SMLLC) on Schedule F (Form 1040) of $85,000. Additionally, your gain from sales of cull raised breeding animals reported on Form 4797, line 2(g), is $15,000. Therefore, your gross income from farming is $100,000 ($85,000 + $15,000). Thus, the applicable

25% limitation ($100,000 x 25% (0.25)) is $25,000 for soil and water expenses in 2023.

TIP *The calculation of farm income for soil and water conservation expenses differs from the calculations for income averaging and estimated tax payments. For more information, see* Income Averaging for Farmers *in chapter 3 and* Gross Income *in chapter 15.*

Carryover of deduction. If your deductible conservation expenses in any year are more than 25% of your gross income from farming for that year, you can carry the unused deduction over to later years. However, the deduction in any later year is limited to 25% of the gross income from farming for that year as well.

Example. In 2023, you have gross income of $32,000. During the year, you incurred $10,000 of deductible soil and water conservation expenses. However, your deduction is limited to 25% of $32,000, or

$8,000. The $2,000 excess ($10,000 − $8,000) is carried over to 2024 and added to deductible soil and water conservation expenses made in that year. The total of the 2023 carryover plus 2024 expenses is deductible in 2024, subject to the limit of 25% of your gross income from farming in 2024. Any expenses over the limit in that year are carried to 2025 and later years.

Net operating loss (NOL). The deduction for soil and water conservation expenses, after applying the 25% limit, is included when figuring an NOL for the year. If the NOL is carried to another year, the soil and water conservation deduction included in the NOL is not subject to the 25% limit in the year to which it is carried.

When To Deduct or Capitalize

If you choose to deduct soil and water conservation expenses, you must deduct the total allowable amount on your tax return for the first year you pay or incur these expenses. If you choose not to deduct the expenses, you must capitalize them.

Change of method. If you want to change your method for the treatment of soil and water conservation expenses, or you want to treat the expenses for a particular project or a single farm in a different manner, you must get the approval of the IRS. To get this approval, submit a written request by the due date of your return for the first tax year you want the new method to apply. You or your authorized representative must sign the request. **Do not** use Form 3115 for this request. Use the procedure outlined below.

Your request must include the following information.

- Your name and address.
- The first tax year the method or change of method is to apply.
- Whether the method or change of method applies to all your soil and water conservation expenses or only to those for a particular project or farm. If the method or change of method doesn't apply to all your expenses, identify the project or farm to which the expenses apply.
- The total expenses you paid or incurred in the first tax year the method or change of method is to apply.
- A statement that you will account separately in your books for the expenses to which this method or change of method relates.

Send your request to the following address.

Department of the Treasury

Internal Revenue Service Center

Cincinnati, OH 45999

For more information, see *Change in Accounting Method* in chapter 2.

Sale of a Farm

If you sell your farm, you can't adjust the basis of the land at the time of the sale for any unused carryover of soil and water conservation expenses (except for deductions of assessments for depreciable property, discussed earlier). However, if you acquire another farm and return to the business of farming, you can start taking deductions again for the unused carryovers.

Gain on sale of farmland. If you held the land 5 years or less before you sold it, gain on the sale of the land is treated as ordinary income up to the amount you previously deducted for soil and water conservation expenses. If you held the land less than 10 but more than 5 years, the gain is treated as ordinary income up to a specified percentage of the previous deductions. See *Section 1252 property* under *Other Gains* in chapter 9.

6.

Basis of Assets

Introduction

Your basis is the amount of your investment in property for tax purposes. Use basis to figure the gain or loss on the sale, exchange, or other disposition of property. Also use basis to figure depreciation, amortization, depletion, and casualty losses. You may have property that you use for both business or the production of income purposes and for personal purposes. You must allocate the basis of this property based on its use. Only the basis allocated to the business or the production of income use of the property can be depreciated.

Your original basis in property is adjusted (increased or decreased) by certain events. For example, if you make improvements to the property, increase your basis. If you take deductions for depreciation, or casualty losses, or claim certain credits, reduce your basis.

Keep accurate records of all items that affect the basis of your assets. For information on keeping records, see chapter 1.

Topics

This chapter discusses:

- Cost basis
- Adjusted basis
- Basis other than cost

Useful Items

You may want to see:

Publication

☐ **544** Sales and Other Dispositions of Assets

☐ **551** Basis of Assets

☐ **946** How To Depreciate Property

See chapter 16 for information about getting publications and forms.

Cost Basis

The basis of property you buy is usually its cost. Cost is the amount you pay in cash, debt obligations, other property, or services. Your cost includes amounts you pay for sales tax, freight, installation, and testing. The basis of real estate and business assets will include other items, discussed later. Basis generally does not include interest payments.

You may also have to capitalize (add to basis) certain other costs related to buying or producing property. Under the uniform capitalization rules, discussed later, you may have to capitalize direct costs and certain indirect costs of producing property.

Loans with low or no interest. If you buy property on a time-payment plan that charges little or no interest, the basis of your property is your stated purchase price minus the amount considered to be unstated interest. You generally have unstated interest if your interest rate is less than the applicable federal rate. See the discussion of unstated interest in Pub. 537, Installment Sales.

Real Property

Real property, also called real estate, is land and generally anything built on, growing on, or attached to land.

If you buy real property, certain fees and other expenses related to the purchase of the property are part of your cost basis in the property. Some of these expenses are discussed next.

Lump-sum purchase. If you buy improvements, such as buildings, and the land on which they stand for a lump sum, allocate your cost basis between the land and improvements. See *Allocating the Basis*, later.

Real estate taxes. If you pay the real estate taxes the seller owed on real property you bought, and the seller did not reimburse you, treat those taxes as part of your basis. If the seller reimburses you for the portion of real estate taxes from the time they owned the property, reduce your deductible real estate tax expense by the amount of the reimbursement.

If you reimburse the seller for taxes the seller paid for you, you can generally deduct that amount as a tax expense in the year of purchase. If you do not reimburse the seller for real estate taxes, you cannot deduct the amount paid on your behalf as a tax expense. In either case, do not include that amount in the basis of your property.

Settlement costs. Your basis includes the settlement fees and closing costs for buying the property. See Pub. 551 for a detailed list of items you can and cannot include in basis.

Do not include fees and costs for getting a loan on the property. Also, do not include amounts placed in escrow for the future payment of items such as taxes and insurance.

Points. If you pay points to get a loan (including a mortgage, second mortgage, home equity loan, or line of credit), do not add the points to the basis of the related property. You may be able to deduct the points currently or over the term of the loan.

Assumption of a mortgage. If you buy property and assume (or buy the property subject to) an existing mortgage, your basis includes the amount you pay for the property plus the amount of the mortgage that you assumed.

Example. If you buy a farm for $100,000 cash and assume a mortgage of $400,000, your basis is $500,000.

Constructing assets. If you build property or have assets built for you, your expenses for this construction are part of your basis. Some of these expenses include the following costs.

- Land.
- Labor and materials.
- Architect's fees.
- Building permit charges.
- Payments to contractors.
- Payments for rental equipment.
- Inspection fees.

In addition, if you use your own employees, farm materials, and equipment to build an asset, do not deduct the following expenses.

- Employee wages paid for the construction work, reduced by any employment credits allowed.
- Depreciation on equipment you own while it is used in the construction.
- Operating and maintenance costs for equipment used in the construction.
- The cost of business supplies and materials used in construction.

You must capitalize these expenses by including them in the asset's basis.

CAUTION *Do not include the value of your own labor, or any other labor you did not pay for, in the basis of any property you construct.*

Allocating the Basis

In some instances, the rules for determining basis apply to a group of assets acquired in the same transaction or to property that consists of separate items. To determine the basis of these assets or separate items, there must be an allocation of basis.

Land and buildings. Allocate the cost basis according to the respective fair market values (FMVs) of the land and improvements at the time of purchase. Figure the basis of each asset by multiplying the lump sum by a fraction. The numerator is the FMV of that asset, and the denominator is the FMV of the whole property at the time of purchase.

Fair market value (FMV). FMV is the price at which property would change hands between a willing buyer and a willing seller, neither having to buy or sell, and both having reasonable knowledge of all necessary facts. Sales of similar property on or about the same date may help in figuring the FMV of the property.

Group of assets acquired. If you buy multiple assets for a lump sum, allocate the amount you pay among the assets. Use this allocation to figure your basis for depreciation and gain or loss on a later disposition of any of these assets. You and the seller may agree in the sales contract to a specific allocation of the purchase price among the assets. If this allocation is based on the value of each asset and you and the seller have adverse tax interests, the allocation will generally be accepted.

Farming business acquired. If you buy a group of assets that make up a farming business, there are special rules you must use to allocate the purchase price among the assets. Generally, reduce the purchase price by any cash received. Allocate the remaining purchase price to the other business assets received in proportion to (but not more than) their FMVs and in a certain order. See *Trade or Business Acquired* under *Allocating the Basis* in Pub. 551 for more information. Also, see the examples under *Sale of a Farm* in chapter 8.

Transplanted embryo. If you buy a cow that is pregnant with a transplanted embryo, allocate to the basis of the cow the part of the purchase price equal to the FMV of the cow without the implant. Allocate the rest of the purchase price to the basis of the calf. Neither the cost allocated to the cow nor the cost allocated to the calf is deductible as a current business expense, however, you may be able to take a deduction for depreciation for the cow.

Uniform Capitalization Rules

Under the uniform capitalization rules, you must include certain direct and indirect costs in the basis of property you produce or in your inventory costs, rather than claim them as a current year deduction. You recover these costs through depreciation, amortization, or cost of goods sold when you use, sell, or otherwise dispose of the property.

Any farming business that has average annual gross receipts of $29 million or less for the 3 preceding tax years and is not a tax shelter is not subject to the uniform capitalization rules.

Generally, you are subject to the uniform capitalization rules if you do either of the following.

1. Produce real property or tangible personal property.
2. Acquire property for resale.

You produce property if you construct, build, install, manufacture, develop, improve, or create the property.

You are not subject to the uniform capitalization rules if the property is produced for personal use.

In a farming business, you produce property if you raise or grow any agricultural or horticultural commodity, including plants and animals.

Plants. A plant produced in a farming business includes the following items.

- A fruit, nut, or other crop-bearing tree.
- An ornamental tree.
- A vine.
- A bush.
- Sod.
- The crop or yield of a plant that will have more than one crop or yield.

Animals. An animal produced in a farming business includes any stock, poultry or other bird, and fish or other sea life.

The direct and indirect costs of producing plants or animals include preparatory costs and preproductive period costs. Preparatory costs include the acquisition costs of the seed, seedling, plant, or animal. For plants, preproductive period costs include the costs of items such as irrigation, pruning, frost protection, spraying, and harvesting. For animals, preproductive period costs include the costs of items such as feed, maintaining pasture or pen areas, breeding, veterinary services, and bedding.

Exceptions. In a farming business, the uniform capitalization rules do not apply to:

1. Any animal,
2. Any plant with a preproductive period of 2 years or less, or
3. Any costs of replanting certain plants lost or damaged due to casualty.

Exceptions (1) and (2) do not apply to a corporation, partnership, or tax shelter required to use an accrual method of accounting. See *Accrual Method Required* under *Accounting Methods* in chapter 2.

In addition, you can elect not to use the uniform capitalization rules for plants with a preproductive period of more than 2 years. This election cannot be made by a corporation, partnership, or tax shelter required to use an accrual method of accounting. This election also does not apply to any costs incurred for the planting, cultivation, maintenance, or development of any citrus or almond grove (or any part thereof) within the first 4 years the trees were planted.

CAUTION *If you elect not to use the uniform capitalization rules, you must use the alternative depreciation system for all property used in any of your farming businesses and placed in service in any tax year during which the election is in effect. See* *chapter 7* *for additional information on depreciation.*

Example. You grow trees that have a preproductive period of more than 2 years.

The trees produce an annual crop. You are an individual and the uniform capitalization rules apply to your farming business. You must capitalize the direct costs and an allocable part of indirect costs incurred due to the production of the trees. You are not required to capitalize the costs of producing the annual crop because its preproductive period is 2 years or less.

Preproductive period of more than 2 years. The preproductive period of plants grown in commercial quantities in the United States is based on their nationwide weighted average preproductive period. Plants producing the crops or yields shown in Table 6-1 have a nationwide weighted average preproductive period of more than 2 years. Other plants (not shown in Table 6-1) may also have a nationwide weighted average preproductive period of more than 2 years.

Table 6-1. **Plants With a Preproductive Period of More Than 2 Years**

Plants producing the following crops or yields have a nationwide weighted average preproductive period of more than 2 years.

- Almonds
- Apples
- Apricots
- Avocados
- Blueberries
- Cherries
- Chestnuts
- Coffee beans
- Currants
- Dates
- Macadamia nuts
- Mangoes
- Nectarines
- Olives
- Oranges
- Peaches
- Pears
- Pecans
- Persimmons
- Pistachio nuts

- Figs
- Grapefruit
- Grapes
- Guavas
- Kiwifruit
- Kumquats
- Lemons
- Limes
- Plums
- Pomegranates
- Prunes
- Tangelos
- Tangerines
- Tangors
- Walnuts

More information. For more information on the uniform capitalization rules that apply to property produced in a farming business, see Regulations section 1.263A-4.

Adjusted Basis

Before figuring gain or loss on a sale, exchange, or other disposition of property or figuring allowable depreciation, depletion, or amortization, you must usually make certain adjustments to the cost basis or basis other than cost (discussed later) of the property. The adjustments to the original basis are increases or decreases to the cost basis or other basis which result in the adjusted basis of the property.

Increases to Basis

Increase the basis of any property by all items properly added to a capital account. These include the cost of any improvements having a useful life of more than 1 year.

The following costs increase the basis of property.

- The cost of extending utility service lines to property.
- Legal fees, such as the cost of defending and perfecting title.
- Legal fees for seeking a decrease in an assessment levied against property to pay for local improvements.

- Assessments for items such as paving roads and building ditches that increase the value of the property assessed. Do not deduct these expenses as taxes. However, you can deduct as taxes amounts assessed for maintenance or repairs, or for meeting interest charges related to the improvements.

If you make additions or improvements to business property, depreciate the basis of each addition or improvement as separate depreciable property using the rules that would apply to the original property if you had placed it in service at the same time you placed the addition or improvement in service. See chapter 7 for more information.

Deducting vs. capitalizing costs. Do not add to your basis costs that you can deduct as current expenses. For example, amounts paid for incidental repairs or maintenance are deductible as business expenses and are not added to basis. However, you can elect either to deduct or to capitalize certain other costs. See Deducting vs. Capitalizing Costs under Increase to Basis in Pub. 551.

Note. Generally, you can deduct amounts paid for repairs and maintenance to your tangible property if the amounts paid are not otherwise required to be capitalized. However, you may elect to capitalize amounts paid for repair and maintenance consistent with the treatment on your books and records. If you make this election, it applies to all amounts paid for repair and maintenance to tangible property that you treat as capital expenditures on your books and records for the tax year. To make the election to treat repairs and maintenance as capital expenditures, attach a statement titled "Section 1.263(a)3(n) Election" to your timely filed return (excluding extensions). For more information on what to include in the statement, see Regulations section 1.263(a)3(n). If you timely filed your return for the year without making the election, you can still make the election by filing an amended return within 6 months of the due date of the return (excluding extensions). Attach the statement to the amended return and enter “Filed pursuant to section 301.91002” on the statement. File the amended return at the same address you filed the original return.

Decreases to Basis

The following are some items that reduce the basis of property.

- Section 179 deduction.
- Deductions previously allowed or allowable for amortization, depreciation, and depletion.
- Residential energy efficient property credits. See Form 5695.
- Investment credit (part or all) taken.

- Casualty and theft losses and insurance reimbursements.
- Payments you receive for granting an easement.
- Exclusion from income of subsidies for energy conservation measures.
- Certain canceled debt excluded from income.
- Rebates from a manufacturer or seller.
- Patronage dividends received from a cooperative association as a result of a purchase of property. See *Patronage Dividends* in chapter 3.
- Gas-guzzler tax. See Form 6197.

Some of these items are discussed next. For a more detailed list of items that decrease basis, see section 1016 of the Internal Revenue Code and Pub. 551.

Depreciation and section 179 deduction. The adjustments you must make to the basis of the property if you take the section 179 deduction or depreciate the property are explained next. For more information on these deductions, see chapter 7.

Section 179 deduction. If you take the section 179 expense deduction for all or part of the cost of qualifying business property, decrease the basis of the property by the deduction.

Depreciation. Decrease the basis of property by the depreciation you deducted or could have deducted on your tax returns under the method of depreciation you chose. If you took less depreciation than you could have under the method chosen, decrease the basis by the amount you could have taken under that method. If you did not take a depreciation deduction, reduce the basis by the full amount of the depreciation you could have taken.

If you deducted more depreciation than you should have, decrease your basis by the amount you should have deducted plus the part of the excess depreciation you deducted that actually reduced your tax liability for any year.

See chapter 7 for information on figuring the depreciation you should have claimed.

In decreasing your basis for depreciation, take into account the amount deducted on your tax returns as depreciation and any depreciation you must capitalize under the uniform capitalization rules.

Casualty and theft losses. If you have a casualty or theft loss, decrease the basis in your property by any insurance or other reimbursement and by any deductible loss not covered by insurance. See chapter 11 for information about figuring your casualty or theft loss.

You must increase your basis in the property by the amount you spend on clean-up costs (such as debris removal) and repairs that substantially prolong the life of the property, increase its value, or adapt it to a different use. To make this determination, compare the repaired property to the property before the casualty. For more information on casualty and theft losses, see Pub. 547.

Easements. The amount you receive for granting an easement is usually considered to be proceeds from the sale of an interest in the real property. It reduces the basis of the affected part of the property. If the amount received is more than the basis of the part of the property affected by the easement, reduce your basis in that part to zero and treat the excess as a recognized gain. See *Easements and rights-of-way* in chapter 3.

Exclusion from income of subsidies for energy conservation measures. You can exclude from gross income any subsidy you received from a public utility company for the purchase or installation of an energy conservation measure for a dwelling unit. Reduce the basis of the property by the excluded amount.

Canceled debt excluded from income. If a debt you owe is canceled or forgiven, other than as a gift or bequest, you must generally include the canceled amount in your gross income for tax purposes. A debt includes any indebtedness for which you are liable or which attaches to property you hold.

You can exclude your canceled debt from income if the debt is any of the following.

1. Debt canceled in a bankruptcy case or when you are insolvent.
2. Qualified farm debt.
3. Qualified real property business debt (provided you are not a C corporation).

If you exclude canceled debt from income as described in (1) or (2), you may have to reduce the basis of your depreciable and nondepreciable property. If you exclude canceled debt described in (3), you must only reduce the basis of your depreciable property by the excluded amount.

For more information about canceled debt in a bankruptcy case, see Pub. 908, Bankruptcy Tax Guide. For more information about insolvency and canceled debt that is qualified farm debt, see chapter 3. For more information about qualified real property business debt, see Pub. 334, Tax Guide for Small Business.

Basis Other Than Cost

There are times when you cannot use cost as basis. In these situations, the FMV or the adjusted basis of property may be used. Examples are discussed next.

Property changed from personal to business or rental use. When you hold property for personal use and then change it to business use or use it to produce rent, you must figure its basis for depreciation. An example of changing property from personal to business use would be changing the use of your pickup truck that you originally purchased for your personal use to use in your farming business.

The basis for depreciation is the lesser of:

- The FMV of the property on the date of the change, or
- Your adjusted basis on the date of the change.

If you later sell or dispose of this property, the basis you use will depend on whether you are figuring a gain or loss. The basis for figuring a gain is your adjusted basis in the property when you sell the property. Figure the basis for a loss starting with the smaller of your adjusted basis or the FMV of the property at the time of the change to business or rental use. Then make adjustments (increases and decreases) for the period after the change in the property's use, as discussed earlier under *Adjusted Basis*.

Property received for services. If you receive property for services, include the property's FMV in income. The amount you include in income becomes your basis. If the services were performed for a price agreed on beforehand, it will be accepted as the FMV of the property if there is no evidence to the contrary.

Example. Rocco Stowsa is an accountant and also operates a farming business. Rocco agreed to do some accounting work for his neighbor in exchange for a dairy cow. The accounting work and the cow are each worth $1,500. Rocco must include $1,500 in income for his accounting services. Rocco's basis in the cow is $1,500.

Taxable Exchanges

A taxable exchange is one in which the gain is taxable, or the loss is deductible. A taxable gain or deductible loss is also known as a recognized gain or loss. A taxable exchange occurs when you receive cash or get property that is not similar or related in use to the property exchanged. If you receive property in exchange for other property in a taxable exchange, the basis of the property you receive is usually its FMV at the time of the exchange.

Example. You trade a tract of farmland with an adjusted basis of $20,000 for a tractor that has an FMV of $60,000. You must report a taxable gain of $40,000 for the land. The tractor has a basis of $60,000.

Nontaxable Exchanges

A nontaxable exchange is an exchange in which you are not taxed on any gain and you cannot deduct any loss. A nontaxable gain or loss is also known as an unrecognized gain or loss. If you receive property in a nontaxable exchange, its basis is usually the same as the basis of the property you transferred.

Involuntary Conversions

If you receive property as a result of an involuntary conversion, such as a casualty, theft, or condemnation, figure the basis of the replacement property you receive using the basis of the converted property.

Similar or related property. If the replacement property is similar or related in service or use to the converted property, the replacement property's basis is the same as the old property's basis on the date of the conversion. However, make the following adjustments.

1. Decrease the basis by the following amounts.
    a. Any loss you recognize on the involuntary conversion.
    b. Any money you receive that you do not spend on similar property.
2. Increase the basis by the following amounts.
    a. Any gain you recognize on the involuntary conversion.
    b. Any cost of acquiring the replacement property.

Money or property not similar or related. If you receive money or property not similar or related in service or use to the converted property and you buy replacement property similar or related in service or use to the converted property, the basis of the replacement property is its cost decreased by the gain not recognized on the involuntary conversion.

Allocating the basis. If you buy more than one piece of replacement property, allocate your basis among the properties based on their respective costs.

Basis for depreciation. Special rules apply in determining and depreciating the basis of MACRS property acquired in an involuntary conversion. For more information, see *Figuring the Deduction for Property Acquired in a Non-taxable Exchange* under *Figuring Depreciation Under MACRS* in chapter 7.

For more information about involuntary conversions, see chapter 11.

Like-Kind Exchanges

Generally, if you exchange real property you use in your business or hold for investment solely for other business or investment real property of a like kind, you do not recognize the gain or loss from the exchange. If you also receive non-like-kind property or money as part of the exchange, you do recognize gain, but only to the extent of the value of the other property or money you received in the exchange, and you do not recognize any loss.

For an exchange to qualify as a like-kind exchange, you must hold for business or investment purposes both the property you transfer and the property you receive. There must also be an exchange of like-kind property. For more information, see *Like-Kind Exchanges* in chapter 8.

The basis of the property you receive is generally the same as the adjusted basis of the property you gave up.

Example. You trade farmland for another larger tract of farmland. Your adjusted basis in your farmland is $110,000. The FMV of the new tract of farmland is $150,000. Because this is a nontaxable exchange, you do not recognize any gain and your basis in the farmland you receive is $110,000, the same as the adjusted basis in the farmland you exchanged.

Note. An exchange of personal property, such as machinery or equipment, does not qualify as a like-kind exchange.

Exchange expenses. Exchange expenses are generally the closing costs that you pay. They include such items as brokerage commissions, attorney fees, and deed preparation fees. Add them to the basis of the like-kind property you receive.

Property plus cash. If you trade property in a like-kind exchange and also pay money, the basis of the property you receive is increased by the money you paid.

Example. Assume the same facts from the previous example except you pay an additional

$20,000 in cash. Your adjusted basis in the newly acquired farming real estate is $130,000 ($110,000 adjusted basis of your old farmland plus the $20,000 cash you paid).

Special rules for related persons. If a like-kind exchange takes place directly or indirectly between related persons and either party disposes of the property within 2 years after the exchange, the exchange no longer qualifies for like-kind exchange treatment. Each person must report any gain or loss not recognized on the original exchange unless the loss is not deductible under the related-party rules. Each person reports it on the tax return filed for the year in which the later disposition occurred. If this rule applies, the basis of the property received in the original exchange will be its FMV. For more information, see chapter 8.

Basis for depreciation. Special rules apply in determining and depreciating the basis of MACRS property acquired in a like-kind transaction. For more information, see *Figuring the Deduction for Property Acquired in a Nontaxable Exchange* under *Figuring Depreciation Un- der MACRS* in chapter 7.

Partially Nontaxable Exchanges

A partially nontaxable exchange is an exchange in which you receive property that is not a like-kind property or money in addition to a like-kind property. The basis of the property you receive is the same as the adjusted basis of the property you gave up with the following adjustments.

1. Decrease the basis by the following amounts.
    a. Any money you receive.
    b. Any loss you recognize on the exchange.
2. Increase the basis by the following amounts.
    a. Any additional costs you incur.

b. Any gain you recognize on the exchange.

If the other party to the exchange assumes your liabilities, treat the debt assumption as money you received in the exchange.

Example. You trade farmland (basis of $100,000) for another tract of farmland (FMV of $110,000) and $30,000 cash. You realize a gain of $40,000. This is the FMV of the land received plus the cash minus the basis of the land you traded ($110,000 + $30,000 − $100,000). Include your gain in income (recognize gain) only to the extent of the cash received. Your basis in the land you received is figured as follows.

Basis of land traded	$100,000
Minus: Cash received (adjustment 1a)	– 30,000
	$70,000
Plus: Gain recognized (adjustment 2b)	+ 30,000
Basis of land received	**$100,000**

Allocation of basis. If you receive like-kind and unlike properties in the exchange, allocate the basis first to the unlike property, other than money, up to its FMV on the date of the exchange. The rest is the basis of the like-kind property.

Example. You trade a tract of farmland with an adjusted basis of $100,000 for another tract of farmland that has an FMV of $92,500. You also receive $4,000 in cash and a pickup truck with an FMV of $11,000. Since only real property qualifies for like-kind exchange treatment, your receipt of the truck and cash means you must recognize gain on the exchange. You realize a gain of $7,500. This is the sum of the FMV of the tract of farmland you receive, the FMV of the truck you receive, and the cash you receive, minus the adjusted basis of the farmland you traded ($92,500 + $11,000 + $4,000 – $100,000). You include in income (recognize) all $7,500 of the gain because it is the lesser of the realized gain

($7,500) and the sum of the FMV of the unlike property and the cash received ($15,000). Your basis in the properties you received is figured as follows.

Adjusted basis old farmland	$100,000
Minus: Cash received (adjustment 1a)	– 4,000
	$96,000
Plus: Gain recognized (adjustment 2b)	+ 7,500
Total basis of properties received	**$103,500**

Allocate the basis of $103,500 first to the unlike property, the truck ($11,000). This is the truck's FMV. The rest ($92,500) is the basis in the farmland.

Sale and Purchase

If you sell property and buy similar property in two mutually dependent transactions, you may have to treat the sale and purchase as a single nontaxable exchange.

Example. You own farmland with a barn. The properties have a combined adjusted basis of $70,000, and an FMV of $150,000. You are interested in another tract of farmland with a larger barn owned by your neighbor who is interested in exchanging the property with you. The total FMV of your neighbor's farmland and barn is $200,000. You want the new barn to have a larger basis for depreciation, so you arrange to sell your old farmland and barn to your neighbor for $150,000. Your neighbor then sells his farmland and barn to you for $200,000. However, you are treated as having exchanged the old property for the new property because the sale and purchase are reciprocal and mutually dependent. Your basis in the new property is $120,000 ($50,000 cash paid plus $70,000 adjusted basis in your old property), which must be allocated between the farmland and the barn.

Property Received as a Gift

To figure the basis of property you receive as a gift, you must know the donor's adjusted basis (defined earlier) just before it was given to you. You must also know its FMV at the time it was given to you and any gift tax paid on it.

FMV equal to or greater than donor's adjusted basis. If the FMV of the property is equal to or greater than the donor's adjusted basis, your basis is the donor's adjusted basis when you received the gift. Increase your basis by all or part of any gift tax paid, depending on the date of the gift.

Also, for figuring gain or loss from a sale or other disposition of the property, or for figuring depreciation, depletion, or amortization deductions on business property, you must increase or decrease your basis (the donor's adjusted basis) by any required adjustments to basis while you held the property. See *Adjusted Basis*, earlier.

If you received a gift during the tax year, increase your basis in the gift (the donor's adjusted basis) by the part of the gift tax paid on it due to the net increase in value of the gift. Figure the increase by multiplying the gift tax paid by the following fraction.

$$\frac{\text{Net increase in value of the gift}}{\text{Amount of the gift}}$$

The net increase in value of the gift is the FMV of the gift minus the donor's adjusted basis. The amount of the gift is its value for gift tax purposes after reduction by any annual exclusion and marital or charitable deduction that applies to the gift.

Example. In 2022, you received a gift of property from your mother that had an FMV of $50,000. Her adjusted basis was $20,000. The amount of the gift for gift tax purposes was $34,000 ($50,000 minus the $16,000 annual exclusion). She paid a gift tax of $6,880. Your basis, $26,054, is figured as follows.

Fair market value	$50,000
Minus: Adjusted basis	– 20,000
Net increase in value	$30,000
Gift tax paid	$6,880
Multiplied by ($30,000 ÷ $34,000)	× 0.88
Gift tax due to net increase in value	$6,054
Adjusted basis of property to your mother	+ 20,000
Your basis in the property	**$26,054**

Note. If you received a gift before 1977, your basis in the gift (the donor's adjusted basis) includes any gift tax paid on it. However, your basis cannot exceed the FMV of the gift when it was given to you.

FMV less than donor's adjusted basis. If the FMV of the property at the time of the gift is less than the donor's adjusted basis, your basis depends on whether you have a gain or a loss when you dispose of the property. Your basis for figuring gain is the donor's adjusted basis plus or minus any required adjustments to basis while you held the property. Your basis for figuring loss is its FMV when you received the gift plus or minus any required adjustments to basis while you held the property. (See *Adjusted Basis*, earlier.)

If you use the donor's adjusted basis for figuring a gain and get a loss, and then use the FMV for figuring a loss and get a gain, you have neither gain nor loss on the sale or other disposition of the property.

Example. You received farmland as a gift from your parents when they retired from farming. At the time of the gift, the land had an FMV of $80,000. Your parents' adjusted basis was $100,000. After you received the land, no events occurred that would increase or decrease your basis.

If you sell the land for $120,000, you will have a $20,000 gain because you must use the donor's adjusted basis at the time of the gift ($100,000) as your basis to figure a gain. If you sell the land for $70,000, you will have a $10,000 loss because you must use the FMV at the time of the gift ($80,000) as your basis to figure a loss.

If the sales price is between $80,000 and $100,000, you have neither gain nor loss. For instance, if the sales price was $90,000 and you tried to figure a gain using the donor's adjusted basis ($100,000), you would get a $10,000 loss. If you then tried to figure a loss using the FMV ($80,000), you would get a $10,000 gain.

Business property. If you hold the gift as business property, your basis for figuring any depreciation, depletion, or amortization deductions is the same as the donor's adjusted basis plus or minus any required adjustments to basis while you hold the property. For more information on depreciation, depletion or amortization, see chapter 7.

Property Transferred From a Spouse

The basis of property transferred to you or transferred in trust for your benefit by your spouse is the same as your spouse's adjusted basis. The same rule applies to a transfer by your former spouse if the transfer is incident to divorce. However, for property transferred in trust, adjust your basis for any gain recognized by your spouse or former spouse if the liabilities assumed plus the liabilities to which the property is subject are more than the adjusted basis of the property transferred.

The transferor must give you the records needed to determine the adjusted basis and holding period of the property as of the date of the transfer.

For more information, see *Property Settlements* in Pub. 504, Divorced or Separated Individuals.

Inherited Property

Your basis in property you inherited from a decedent is generally one of the following.

- The FMV of the property at the date of the decedent's death. If Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, you can use its appraised value.
- The FMV on the alternate valuation date if the personal representative for the estate elects to use alternate valuation. For information on the alternate valuation, see the Instructions for Form 706.
- The decedent's adjusted basis in land to the extent of the value that is excluded from the decedent's taxable estate as a qualified conservation easement.

If a federal estate tax return does not have to be filed, your basis in the inherited property is its appraised value at the date of death for state inheritance or transmission taxes.

Special-use valuation method. Under certain conditions, when a person dies, the executor or personal representative of that person's estate may elect to value qualified real property at other than its FMV. If so, the executor or personal representative values the qualified real property based on its use as a farm or other closely held business. If the executor or personal representative elects this method of valuation for estate tax purposes, this value is the basis of the property for the qualified heirs. The qualified heirs should be able to get the necessary value from the executor or personal representative of the estate.

If you are a qualified heir who received special-use valuation property, increase your basis by any gain recognized by the estate or trust because of post-death appreciation. Post-death appreciation is the property's FMV on the date of distribution minus the property's FMV either on the date of the individual's death or on the alternate valuation date. Figure all FMVs without regard to the special-use valuation.

You may be liable for an additional estate tax if, within 10 years after the death of the decedent, you transfer the property or the property stops being used as a farm. This tax does not apply if you dispose of the property in a like-kind exchange or in an involuntary conversion in which all of the proceeds are reinvested in qualified replacement property. The tax also does not apply if you transfer the property to a member of your family and certain requirements are met.

You can elect to increase your basis in special-use valuation property if it becomes subject to the additional estate tax. To increase your basis, you must make an irrevocable election and pay interest on the additional estate tax figured from the date 9 months after the decedent's death until the date of payment of the additional estate tax.

If you meet these requirements, increase your basis in the property to its FMV on the date of the decedent's death or the alternate valuation date. The increase in your basis is considered to have occurred immediately before the event that resulted in the additional estate tax.

You make the election by filing, with Form 706A, United States Additional Estate Tax Return, a statement that:

- Contains your (and the estate's) name, address, and taxpayer identification number;
- Identifies the election as an election under section 1016(c) of the Internal Revenue Code;
- Specifies the property for which you are making the election; and
- Provides any additional information required by the Form 706A instructions.

For more information, see Form 706; Form 706A; and the related instructions.

Property Distributed From a Partnership or Corporation

The following rules apply to determine a partner's basis and a shareholder's basis in property distributed respectively from a partnership to the partner with respect to the partner's interest in the partnership and from a corporation to the shareholder with respect to the shareholder's ownership of stock in the corporation.

Partner's basis. Unless there is a complete liquidation of a partner's interest, the basis of property (other than money) distributed by a partnership to the partner is its adjusted basis to the partnership immediately before the distribution. However, the basis of the property to the partner cannot be more than the adjusted basis of his or her interest in the partnership reduced by any money received in the same transaction. For more information, see *Partner's Basis for Distributed Property* in Pub. 541, Partnerships.

Shareholder's basis. The basis of property distributed by a corporation to a shareholder is its FMV. For more information about corporate distributions, see *Distributions to Shareholders* in Pub. 542, Corporations.

7.

Depreciation, Depletion, and Amortization

What's New for 2023

Increased section 179 expense deduction dollar limits. The maximum amount you can elect to deduct for most section 179 property you placed in service in 2023 is $1,160,000. This limit is reduced by the amount by which the cost of the property placed in service during the tax year exceeds $2,890,000. Also, the maximum section 179 expense deduction for sport utility vehicles placed in service in tax years beginning in 2023 is $28,900. See *Dollar Limits* under *Section 179 Expense Deduction*, later.

Phase down of special depreciation allowance. The special depreciation allowance is 80% for certain qualified property acquired after September 27, 2017, and placed in service after December 31, 2022, and before January 1, 2024 (other than certain property with a long production period and certain aircraft). The special depreciation allowance is also 80% for certain specified plants bearing fruits and nuts planted or grafted after December 31, 2022, and before January 1, 2024. See *Certain qualified property acquired after September 27, 2017* and *Certain specified plants* under *What Is Qualified Property*, later.

What’s New for 2024

Phase down of special depreciation allowance. The special depreciation allowance is 60% for certain qualified property acquired after September 27, 2017, and placed in service after December 31, 2023, and before January 1, 2025 (other than certain property with a long production period and certain aircraft). For property with a long production period and certain aircraft placed in service after December 31, 2023, and before January 1, 2025, the special depreciation allowance is 80%. The special depreciation allowance is also 60% for certain specified plants bearing fruits and nuts planted or grafted after December 31, 2023, and before January 1, 2025. See *Certain qualified property acquired after September 27, 2017* and *Certain specified plants* under *What Is Qualified Property*, later.

Introduction

If you buy or make improvements to farm property, such as machinery, equipment, livestock, or a structure with a useful life of more than a year, you generally cannot deduct its entire cost in one year. Instead, you must spread the cost over the time you use the property and deduct part of it each year. For most types of property, this is called depreciation.

This chapter gives information on depreciation methods that generally apply to property placed in service after 1986. For information on depreciating pre1987 property, see Pub. 534, Depreciating Property Placed in Service Before 1987.

Topics

This chapter discusses:

- Overview of depreciation
- Section 179 expense deduction
- Special depreciation allowance
- Modified Accelerated Cost Recovery System (MACRS)
- Listed property
- Basic information on cost depletion (including timber depletion) and percentage depletion
- Amortization of the costs of going into business, reforestation costs, the costs of

pollution control facilities, and the costs of section 197 intangibles

Useful Items

You may want to see:

Publication

- ☐ **463** Travel, Gift, and Car Expenses

- ☐ **534** Depreciating Property Placed in Service Before 1987

- ☐ **544** Sales and Other Dispositions of Assets

- ☐ **551** Basis of Assets

- ☐ **946** How To Depreciate Property

Form (and Instructions)

- ☐ **T** (Timber), Forest Activities Schedule

☐ **3115** Application for Change in Accounting Method

☐ **4562** Depreciation and Amortization

☐ **4797** Sales of Business Property

See chapter 16 for information about getting publications and forms.

It is important to keep good records for property you depreciate. Do not file these records with your return. Instead, you should keep them as part of the permanent records of the depreciated property. They will help you verify the accuracy of the depreciation of assets placed in service in the current and previous tax years. For general information on recordkeeping, see Pub. 583, Starting a Business and Keeping Records. For specific information on keeping records for section 179 property and listed property, see Pub. 946.

Overview of Depreciation

This overview discusses basic information on the following.

- What property can be depreciated.
- What property cannot be depreciated.
- When depreciation begins and ends.
- Whether MACRS can be used to figure depreciation.
- What is the basis of your depreciable property.
- How to treat repairs and improvements.
- When you must file Form 4562.
- How you can correct depreciation claimed incorrectly.

What Property Can Be Depreciated?

You can depreciate most types of tangible property (except land), such as buildings, machinery, equipment, vehicles, certain livestock, and furniture. You can also depreciate certain intangible property, such as copyrights, patents, and computer software. To be depreciable, the property must meet all the following requirements.

- It must be property you own.
- It must be used in your business or income-producing activity.
- It must have a determinable useful life.
- It must have a useful life that extends substantially beyond the year you place it in service.

Property You Own

To claim depreciation, you must usually be the owner of the property. You are considered as owning property even if it is subject to a debt.

Leased property. You can depreciate leased property only if you retain the incidents of ownership in the property (explained below).

This means you bear the burden of exhaustion of the capital investment in the property. If you lease property from someone to use in your trade or business or for the production of income, you generally cannot depreciate its cost because you do not have the incidents of ownership. You can, however, depreciate any capital improvements you make to the leased property. See *Additions and Improvements* under *Which Recovery Period Applies?* in chapter 4 of Pub. 946.

You can generally depreciate the cost of property you lease to someone even if the lessee (the person leasing from you) has agreed to preserve, replace, renew, and maintain the property. However, you cannot depreciate the cost of the property if the lease provides that the lessee is to maintain the property and return to you the same property or its equivalent in value at the expiration of the lease in as good condition and value as when leased.

Incidents of ownership. Incidents of ownership in property include the following.

- The legal title to the property.
- The legal obligation to pay for the property.
- The responsibility to pay maintenance and operating expenses.
- The duty to pay any taxes on the property.
- The risk of loss if the property is destroyed, condemned, or diminished in value through obsolescence or exhaustion.

Life tenant. Generally, if you hold business or investment property as a life tenant, you can depreciate it as if you were the absolute owner of the property. See *Certain term interests in property*, later, for an exception.

Property Used in Your Business or Income-Producing Activity

To claim depreciation on property, you must use it in your business or income-producing activity. If you use property to produce income (investment use), the income must be taxable. You cannot depreciate property that you use solely for personal activities. However, if you use property for business or investment purposes and for personal purposes, you can deduct depreciation based only on the percentage of business or investment use.

Example 1. If you use your car for farm business, you can deduct depreciation based on its percentage of use in farming. If you also use it for investment purposes, you can depreciate it based on its percentage of investment use.

Example 2. If you use part of your home for business, you may be able to deduct depreciation on that part based on its business use. For more information, see [Business Use of Your Home](#) in [chapter 4](#).

TIP *You may be able to use the simplified method to determine your business use of the home deduction. If you choose to use the simplified method, you cannot also deduct depreciation on the part of the home used for business. For more information about the simplified method, see Pub. 587, Business Use of Your Home.*

Inventory. You can never depreciate inventory because it is not held for use in your business. Inventory is any property you hold primarily for sale to customers in the ordinary course of your business.

Livestock. Livestock purchased for draft, breeding, or dairy purposes can be depreciated only if they are not kept in an inventory account. Livestock you raise usually has no depreciable basis because the costs of raising them are deducted and not added to their basis. However, see *Immature livestock* under *When Does Depreciation Begin and End*, later, for a special rule.

Property Having a Determinable Useful Life

To be depreciable, your property must have a determinable useful life. This means it must be something that wears out, decays, gets used up, becomes obsolete, or loses its value from natural causes.

Irrigation systems and water wells. Irrigation systems and water wells used in a trade or business can be depreciated if their useful life can be determined. You can depreciate irrigation systems and water wells composed of masonry, concrete, tile (including drainage tile), metal, or wood. In addition, you can depreciate costs for moving dirt to construct irrigation systems and water wells composed of these materials. However, land preparation costs for center pivot irrigation systems are not depreciable.

Dams, ponds, and terraces. In general, you cannot depreciate earthen dams, ponds, and terraces unless the structures have a determinable useful life.

What Property Cannot Be Depreciated?

Certain property cannot be depreciated, even if the requirements explained earlier are met. This includes the following.

- Land. You can never depreciate the cost of land because land does not wear out, become obsolete, or get used up. The cost of land generally includes the cost of clearing, grading, planting, and landscaping. Although you cannot depreciate land, you can depreciate certain costs incurred in preparing land for business use. See chapter 1 of Pub. 946.

- Property placed in service and disposed of in the same year. Determining when property is placed in service is explained later.
- Equipment used to build capital improvements. You must add otherwise allowable depreciation on the equipment during the period of construction to the basis of your improvements.
- Intangible property such as section 197 intangibles. This property does not have a determinable useful life and generally cannot be depreciated. However, see *Amortization*, later. Special rules apply to computer software (discussed below).
- Certain term interests (discussed below).

Computer software. Computer software is generally not a section 197 intangible even if acquired in connection with the acquisition of a business, if it meets all of the following tests.

- It is readily available for purchase by the general public.
- It is subject to a nonexclusive license.
- It has not been substantially modified.

If the software meets the tests above, it can be depreciated and may qualify for the section 179 expense deduction and the special depreciation allowance (if applicable), discussed later.

Certain term interests in property. You cannot depreciate a term interest in property created or acquired after July 27, 1989, for any period during which the remainder interest is held, directly or indirectly, by a person related to you. This rule does not apply to the holder of a term interest in property acquired by gift, bequest, or inheritance. For more information, see chapter 1 of Pub. 946.

Example. You retain a life interest in a dairy facility but transfer the remainder interest to your daughter. Your term interest in the dairy facility is not depreciable even though you may still be using it in your dairy operation.

When Does Depreciation Begin and End?

You begin to depreciate your property when you place it in service for use in your trade or business or for the production of income. You stop depreciating property either when you have fully recovered your cost or other basis or when you retire it from service, whichever happens first.

Placed in Service

Property is placed in service when it is ready and available for a specific use, whether in a business activity, an income-producing activity, a tax-exempt activity, or a personal activity. Even if you are not using the property, it is in service when it is ready and available for its specific use.

Example. You bought a planter for use in your farm business. The planter was delivered in December 2022 after harvest was over. You begin to depreciate the planter in 2022 because it was ready and available for its specific use in 2022, even though it will not be used until the spring of 2023.

If your planter comes unassembled in December 2022 and is put together in February 2023, it is not placed in service until 2023. You begin to depreciate it in 2023.

If your planter was delivered and assembled in February 2023 but not used until April 2023, it is placed in service in February 2023, because this is when the planter was ready for its specified use. You begin to depreciate it in 2023.

Fruit or nut trees and vines. If you acquire an orchard, grove, or vineyard before the trees or vines have reached the income-producing stage, and they have a preproductive period of more than 2 years, you must capitalize the preproductive-period costs under the uniform capitalization rules (unless you meet the small business taxpayer exception or elect not to use these rules). See chapter 6 for information about the uniform capitalization rules. Your depreciation begins when the trees and vines reach the income-producing stage (that is, when they bear fruits, nuts, or grapes in quantities sufficient to commercially warrant harvesting). For information on claiming the special depreciation allowance for certain specified plants bearing fruits and nuts, see *Certain specified plants*, later.

Note. Any farming business that has average annual gross receipts of $29 million or less for the 3 preceding tax years and is not a tax shelter is not subject to the uniform capitalization rules.

Immature livestock. Depreciation for livestock begins when the livestock reaches the age of maturity. If you bought immature livestock for drafting purposes, depreciation begins when they can be worked. If you bought immature livestock for breeding or dairy purposes, depreciation begins when they can be bred. Your basis for depreciation is your initial cost for the immature livestock.

Idle Property

Continue to claim a deduction for depreciation on property used in your business or for the production of income even if it is temporarily idle. For example, if you stop using a machine because there is a temporary lack of a market for a product made with that machine, continue to deduct depreciation on the machine.

Cost or Other Basis Fully Recovered

You stop depreciating property when you have fully recovered your cost or other basis. This happens when your section 179 and allowed or allowable depreciation deductions equal your cost or investment in the property.

Retired From Service

You stop depreciating property when you retire it from service, even if you have not fully recovered its cost or other basis. You retire property from service when you permanently withdraw it from use in a trade or business or from use in the production of income because of any of the following events.

- You sell or exchange the property.
- You convert the property to personal use.
- You abandon the property.
- You transfer the property to a supplies or scrap account.
- The property is destroyed.

For information on abandonment of property, see chapter 8. For information on destroyed property, see chapter 11, and Pub. 547, Casualties, Disasters, and Thefts.

Can You Use MACRS To Depreciate Your Property?

You must use the Modified Accelerated Cost Recovery System (MACRS) to depreciate most business and investment property placed in service after 1986. MACRS is explained later under *Figuring Depreciation Under MACRS*.

You cannot use MACRS to depreciate the following property.

- Property you placed in service before 1987. Use the methods discussed in Pub. 534.
- Certain property owned or used in 1986. See chapter 1 of Pub. 946.
- Intangible property.
- Films, videotapes, and recordings.

- Certain corporate or partnership property acquired in a nontaxable transfer.
- Property you elected to exclude from MACRS.

For more information, see chapter 1 of Pub. 946.

What Is the Basis of Your Depreciable Property?

To figure your depreciation deduction, you must determine the basis of your property. To determine basis, you need to know the cost or other basis of your property.

Cost or other basis. The basis of property you buy is usually its cost plus amounts you paid for items such as sales tax, freight charges, and installation and testing fees. The cost includes the amount you pay in cash, debt obligations, other property, or services. For more information, see chapter 6.

There are times when you cannot use cost as basis. In these situations, the fair market value (FMV) or the adjusted basis of the property may be used.

Adjusted basis. To find your property's basis for depreciation, you may have to make certain adjustments (increases and decreases) to the basis of the property for events occurring between the time you acquired the property and the time you placed it in service.

Basis adjustment for depreciation allowed or allowable. After you place your property in service, you must reduce the basis of the property by the depreciation allowed or allowable, whichever is greater. Depreciation allowed is depreciation you actually deducted (from which you received a tax benefit). Depreciation allowable is depreciation you are entitled to deduct.

If you do not claim depreciation you are entitled to deduct, you must still reduce the basis of the property by the full amount of depreciation allowable.

If you deduct more depreciation than you should, you must reduce your basis by any amount deducted from which you received a tax benefit (the depreciation allowed).

For more information, see chapter 6.

How Do You Treat Repairs and Improvements?

If you improve depreciable property, you must treat the improvement as separate depreciable property. Improvement means an addition to or partial replacement of property that is a betterment to the property, restores the property, or adapts it to a new or different use. See Regulations section 1.263(a)-3.

You generally deduct the cost of repairing business property in the same way as any other business expense. However, if the cost is for a betterment to the property, restores the property, or adapts it to a new or different use, you must treat it as an improvement and depreciate it. See chapter 1 of Pub. 946 for more information.

Example. You repair a small section on a corner of the roof of a barn that you rent to others. You deduct the cost of the repair as a business expense. However, if you replace the entire roof, the new roof is considered to be an improvement because it increases the value and lengthens the life of the property. You depreciate the cost of the new roof.

Improvements to rented property. You can depreciate permanent improvements you make to business property you rent from someone else.

Example. You rent 100 acres from your landlord on a 5-year term. You install $25,000 of drainage tile. The recovery period for drainage tile is 15 years, not the term of the lease. You may be able to take a section 179 expense deduction, special depreciation allowance, or depreciation expense under MACRS for the drainage tile. See *Section 179 Expense Deduction*, *Claiming the Special Depreciation Allowance*, *Figuring Depreciation Under MACRS*, later.

Do You Have To File Form 4562?

Use Form 4562 to claim your deduction for depreciation and amortization. You must complete and attach Form 4562 to your tax return if you are claiming any of the following.

- A section 179 expense deduction for the current year or a section 179 carryover from a prior year.
- Depreciation for property placed in service during the current year.

- Depreciation on any vehicle or other listed property, regardless of when it was placed in service.
- Amortization of costs that began in the current year.

For more information, see the Instructions for Form 4562.

How Do You Correct Depreciation Deductions?

If you deducted an incorrect amount of depreciation in any year, you may be able to make a correction by filing an amended return for that year. You can file an amended return to correct the amount of depreciation claimed for any property in any of the following situations.

- You claimed the incorrect amount because of a mathematical error made in any year.
- You claimed the incorrect amount because of a posting error made in any year, for

example, omitting an asset from the depreciation schedule.

- You have not adopted a method of accounting for the property placed in service by you in tax years ending after December 29, 2003.
- You claimed the incorrect amount on property placed in service by you in tax years ending before December 30, 2003.

Note. You have adopted a method of accounting if you used the same incorrect method of depreciation for two or more consecutively filed returns.

If you are not allowed to make the correction on an amended return, you may be able to change your accounting method to claim the correct amount of depreciation. See the Instructions for Form 3115.

Section 179 Expense Deduction

You can elect to recover all or part of the cost of certain qualifying property, up to a limit, by deducting it in the year you place the property in service. This is the section 179 expense deduction. You can elect the section 179 expense deduction instead of recovering the cost by taking depreciation deductions.

This part of the chapter explains the rules for the section 179 expense deduction. It explains what property qualifies for the deduction, what property does not qualify for the deduction, the limits that may apply, how to elect the deduction, and when you may have to recapture the deduction.

For more information, see chapter 2 of Pub. 946.