Publication 225

Farmer's Tax Guide

For use in preparing **2023** Returns

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Volume 5 of 10

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What Property Qualifies?

To qualify for the section 179 expense deduction, your property must meet all the following requirements.

- It must be eligible property.
- It must be acquired primarily for business use.
- It must have been acquired by purchase.

Eligible Property

To qualify for the section 179 expense deduction, your property must be one of the following types of depreciable property.

1. Tangible personal property.
2. Other tangible property (except buildings and their structural components) used as:
   a. An integral part of manufacturing, production, or extraction or of furnishing transportation,

communications, electricity, gas, water, or sewage disposal services;

b. A research facility used in connection with any of the activities in (a) above; or

c. A facility used in connection with any of the activities in (a) for the bulk storage of fungible commodities.

3. Single-purpose agricultural (livestock) or horticultural structures.

4. Storage facilities (except buildings and their structural components) used in connection with distributing petroleum or any primary product of petroleum.

5. Qualified real property. (Special rules apply to qualified real property that you elect to treat as qualified section 179 real property. For more information, see chapter 2 of Pub.

946, and section 179(f) of the Internal Revenue Code.)

6. Off-the-shelf computer software that is readily available for purchase by the general public, is subject to a nonexclusive lease, and has not been substantially modified.

Tangible personal property. Tangible personal property is any tangible property that is not real property. It includes the following property.

- Machinery and equipment.
- Property contained in or attached to a building (other than structural components), such as milk tanks, automatic feeders, barn cleaners, and office equipment.
- Gasoline storage tanks and pumps at retail service stations.

- Livestock, including horses, cattle, hogs, sheep, goats, and mink and other fur-bearing animals.

Facility used for the bulk storage of fungible commodities. A facility used for the bulk storage of fungible commodities is qualifying property for purposes of the section 179 expense deduction if it is used in connection with any of the activities listed earlier in item 2c under *Eligible Property*. Bulk storage means the storage of a commodity in a large mass before it is used.

Grain bins. A grain bin is an example of a storage facility that is qualifying section 179 property. It is a facility used in connection with the production of grain or livestock for the bulk storage of fungible commodities.

Single-purpose agricultural or horticultural structures. A single-purpose agricultural (livestock) or horticultural structure is qualifying property for purposes of the section 179 expense deduction.

Agricultural structure. A single-purpose agricultural (livestock) structure is any building or enclosure specifically designed, constructed, and used for both the following reasons.

- To house, raise, and feed a particular type of livestock and its produce.
- To house the equipment, including any replacements, needed to house, raise, or feed the livestock.

For this purpose, livestock includes poultry.

Single-purpose structures are qualifying property if used, for example, to breed chickens or hogs, produce milk from dairy cattle, or produce feeder cattle or pigs, broiler chickens, or eggs. The facility must include, as an integral part of the structure or enclosure, equipment necessary to house, raise, and feed the livestock.

Horticultural structure. A single-purpose horticultural structure is either of the following.

- A greenhouse specifically designed, constructed, and used for the commercial production of plants.
- A structure specifically designed, constructed, and used for the commercial production of mushrooms.

Use of structure. A structure must be used only for the purpose that qualified it. For example, a hog barn will not be qualifying property if you use it to house poultry. Similarly, using part of your greenhouse to sell plants will make the greenhouse nonqualifying property.

If a structure includes work space, the work space can be used only for the following activities.

- Stocking, caring for, or collecting livestock or plants or their produce.

- Maintaining the enclosure or structure.
- Maintaining or replacing the equipment or stock enclosed or housed in the structure.

Note. Recent legislation has changed the treatment of qualified improvement property placed in service after December 31, 2017, to 15-year property under MACRS. See chapter 3 of Pub. 946 for more information.

Qualified real property. Qualified real property is any qualified improvement property described in section 168(e)(6), and any of the following improvements to nonresidential real property placed in service after the date such qualified real property was first placed in service.

- Roofs.
- Heating, ventilation, and air conditioning.
- Fire protection and alarms.
- Security systems.

Property Acquired by Purchase

To qualify for the section 179 expense deduction, your property must have been acquired by purchase. For example, property acquired by gift or inheritance does not qualify. Property acquired from a related person (that is, your spouse, ancestors, or lineal descendants) is not considered acquired by purchase. New or used equipment you acquired by purchase during the current tax year qualifies for the section 179 deduction.

Example. You are a farmer. You purchased two tractors, one from your sibling and one from your parent. You placed both tractors in service in the same year you bought them. The tractor purchased from your parent does not qualify for the section 179 expense deduction because you are a related person (as defined above). The tractor purchased from your sibling does qualify for the deduction because you are not a related person (as defined above).

What Property Does Not Qualify?

Land and improvements. Land and land improvements do not qualify as section 179 property. Land improvements include swimming pools, paved parking areas, wharves, docks, bridges, and nonagricultural fences. However, agricultural fences do qualify as section 179 property. Similarly, field drainage tile also qualifies as section 179 property.

Excepted property. Even if the requirements explained in the preceding discussions are met, farmers cannot elect the section 179 expense deduction for the following property.

- Certain property you lease to others (if you are a noncorporate lessor).
- Certain property used predominantly to furnish lodging or in connection with the furnishing of lodging.

- Property used by a tax-exempt organization (other than a tax-exempt farmers' cooperative) unless the property is used mainly in a taxable unrelated trade or business.
- Property used by governmental units or foreign persons or entities (except property used under a lease with a term of less than 6 months).

How Much Can You Deduct?

Your section 179 expense deduction is generally the cost of the qualifying property. However, the total amount you can elect to deduct under section 179 is subject to a dollar limit and a business income limit. These limits apply to each taxpayer, not to each business. However, see *Married individuals* under *Dollar Limits*, later. Also, see the special rules for applying the limits for partnerships and S corporations under *Partnerships and S Corporations*, later.

If you deduct only part of the cost of qualifying property as a section 179 expense deduction, you can generally depreciate the cost you do not deduct.

Use Part I of Form 4562 to figure your section 179 expense deduction.

Partial business use. When you use property for business and nonbusiness purposes, you can elect the section 179 expense deduction only if you use it more than 50% for business in the year you place it in service. If you used the property more than 50% for business, multiply the cost of the property by the percentage of business use. Use the resulting business cost to figure your section 179 expense deduction.

Trade-in of other property. If you buy qualifying property with cash and a trade-in, its cost for purposes of the section 179 expense deduction includes only the cash you paid.

Example. Adyo Farms traded real property X having a total adjusted basis of $6,800 for new real property Z costing $13,200. They received an $8,000 trade-in allowance for the old real property X, and paid $5,200 in cash for the new real property Z.

For purposes of the section 179 expense deduction, only the cash paid by Adyo qualifies for the section 179 expense deduction. Adyo's business costs that qualify for a section 179 expense deduction are $5,200. For information on the maximum amount you can elect to deduct, see *Dollar Limits* next.

Dollar Limits

The total amount you can elect to deduct under section 179 for most property placed in service in 2023 is $1,160,000. If you acquire and place in service more than one item of qualifying property during the year, you can allocate the section 179 expense deduction among the items in any way, as long as the total deduction is not more than $1,160,000. You cannot carry costs in excess of the $1,160,000 limit over to future years.

Reduced dollar limit for cost exceeding $2,890,000. If the cost of your qualifying section 179 property placed in service in 2023 is over $2,890,000, you must reduce the dollar limit (but not below zero) by the amount of cost over $2,890,000. If the cost of your section 179 property placed in service during 2023 is $4,050,000 or more, you cannot take a section 179 expense deduction and you cannot carry over any of the cost that is more than $4,050,000.

Example. This year, George Thomas placed in service machinery costing $2,990,000. Because this cost is $100,000 more than $2,890,000, George must reduce the dollar limit to $1,060,000 ($1,160,000 − $100,000). George cannot carry over any of the costs that exceed the $1,060,000 reduced limit. The remaining cost of the machinery not allowed as a section 179 expense deduction is eligible for a depreciation expense under MACRS. See *Figuring Depreciation Under MACRS*, later.

Limits for sport utility vehicles. The total amount you can elect to deduct for certain sport utility vehicles and certain other vehicles placed in service in 2023 is $28,900. This rule applies to any 4-wheeled vehicle primarily designed or used to carry passengers over public streets, roads, and highways that is rated at more than 6,000 pounds gross vehicle weight and not more than 14,000 pounds gross vehicle weight.

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

Limits for passenger automobiles. For a passenger automobile that is placed in service in 2023, the total section 179 and depreciation deduction is limited. See *Do the Passenger Automobile Limits Apply*, later.

Married individuals. If you are married, how you figure your section 179 expense deduction depends on whether you file jointly or separately. If you file a joint return, you and your spouse are treated as one taxpayer in determining any reduction to the dollar limit, regardless of which of you purchased the property or placed it in service. If you and your spouse file separate returns, you are treated as one taxpayer for the dollar limit, including the reduction for costs over $2,890,000. You must allocate the dollar limit (after any reduction) equally between you, unless you both elect a different allocation. If the percentages elected by each of you do not total 100%, 50% will be allocated to each of you.

Joint return after separate returns. If you and your spouse elect to amend your separate returns by filing a joint return after the due date for filing your return, the dollar limit on the joint return is the lesser of the following amounts.

- The dollar limit (after reduction for any cost of section 179 property over $2,890,000).
- The total cost of section 179 property you and your spouse elected to expense on your separate returns.

Business Income Limit

The total cost you can deduct each year after you apply the dollar limit is limited to the taxable income from the active conduct of any trade or business during the year. Generally, you are considered to actively conduct a trade or business if you meaningfully participate in the management or operations of the trade or business.

Any cost not deductible in one year under section 179 because of this limit can be carried to the next year. See *Carryover of disallowed deduction*, later.

Taxable income. In general, figure taxable income for this purpose by totaling the net income and losses from all trades and businesses you actively conducted during the year. In addition to net income or loss from a sole proprietorship, partnership, or S corporation, net income or loss derived from a trade or business also includes the following items.

- Section 1231 gains (or losses) as discussed in chapter 9.
- Interest from working capital of your trade or business.
- Wages, salaries, tips, or other pay earned by you (or your spouse if you file a joint return) as an employee of any employer.

In addition, figure taxable income without regard to any of the following.

- The section 179 expense deduction.
- The self-employment tax deduction.

- Any net operating loss carryback or carryforward.
- Any unreimbursed employee business expenses.

Also, see chapter 2 of Pub. 946.

Two different taxable income limits. In addition to the business income limit for your section 179 expense deduction, you may have a taxable income limit for some other deduction (for example, charitable contributions). You may have to figure the limit for this other deduction taking into account the section 179 expense deduction. If so, complete the following steps.

Step	Action
1	Figure taxable income without the section 179 expense deduction or the other deduction.

2	Figure a hypothetical section 179 expense deduction using the taxable income figured in Step 1.
3	Subtract the hypothetical section 179 expense deduction figured in Step 2 from the taxable income figured in Step 1.
4	Figure a hypothetical amount for the other deduction using the amount figured in Step 3 as taxable income.
5	Subtract the hypothetical other deduction figured in Step 4 from the taxable income figured in Step 1.
6	Figure your actual section 179 expense deduction using the taxable income figured in Step 5.

7	Subtract your actual section 179 expense deduction figured in Step 6 from the taxable income figured in Step 1.
8	Figure your actual other deduction using the taxable income figured in Step 7.

Example. On February 1, 2023, the XYZ farm corporation purchased and placed in service qualifying section 179 property that cost $500,000. It elects to expense the entire $500,000 cost under section 179. In June, the corporation gave a charitable contribution of $100,000. A corporation's limit on charitable contributions is figured after subtracting any section 179 expense deduction. The business income limit for the section 179 expense deduction is figured after subtracting any allowable charitable contributions. XYZ's taxable income figured without the section 179 expense deduction or the deduction for charitable contributions is $700,000. XYZ figures its section 179 expense deduction and its deduction for charitable contributions as follows.

Step 1. Taxable income figured without either deduction is $700,000.

Step 2. Using $700,000 as taxable income, XYZ's hypothetical section 179 expense deduction is $500,000.

Step 3. $200,000 ($700,000 − $500,000).

Step 4. Using $200,000 (from Step 3) as taxable income, XYZ's hypothetical charitable contribution (limited to 10% of taxable income) is $20,000.

Step 5. $680,000 ($700,000 − $20,000).

Step 6. Using $680,000 (from Step 5) as taxable income, XYZ figures the actual section 179 expense deduction. Because the taxable income is at least $500,000, XYZ can take a $500,000 section 179 expense deduction.

Step 7. $200,000 ($700,000 – $500,000).

Step 8. Using $200,000 (from Step 7) as taxable income, XYZ's actual charitable contribution (limited to 10% of taxable income) is $20,000.

Carryover of disallowed deduction. You can carry over for an unlimited number of years the cost of any section 179 property you elected to expense but were unable to because of the business income limit.

The amount you carry over is used in determining your section 179 expense deduction in the next year. However, it is subject to the limits in that year. If you place more than one property in service in a year, you can select the properties for which all or a part of the cost will be carried forward. Your selections must be shown in your books and records.

Example. Last year, Diana Reynolds placed in service a machine that cost $100,000 and elected to deduct all $100,000 under section 179. The taxable income from Diana’s business (determined without regard to both a section 179 expense deduction for the cost of the machine and the self-employment tax deduction) was $80,000. Diana’s section 179 expense deduction was limited to $80,000. The $20,000 cost that was not allowed as a section 179 expense deduction (because of the business income limit) is carried to this year.

This year, Diana placed another machine in service that cost $110,000. Diana’s taxable income from business (determined without regard to both a section 179 expense deduction for the cost of the machine and the self-employment tax deduction) is $120,000.

Diana can deduct the full cost of the machine ($110,000) but only

$10,000 of the carryover from last year because of the business income limit. Diana can carry over the balance of $10,000 to next year.

Partnerships and S Corporations

The section 179 expense deduction limits apply both to the partnership or S corporation and to each partner or shareholder. The partnership or S corporation determines its section 179 expense deduction subject to the limits. It then allocates the deduction among its partners or shareholders.

If you are a partner in a partnership or shareholder of an S corporation, you add the amount allocated from the partnership or S corporation to any section 179 costs not related to the partnership or S corporation and then apply the dollar limit to this total. To determine any reduction in the dollar limit for costs over $2,890,000, you do not include any of the cost of section 179 property placed in service by the partnership or S corporation. After you apply the dollar limit, you apply the business income limit to any remaining section 179 costs. For more information, see chapter 2 of Pub. 946.

Example. In 2023, Partnership P placed in service section 179 property with a total cost of $2,990,000. P must reduce its dollar limit by $100,000 ($2,990,000 − $2,890,000). Its maximum section 179 expense deduction is $1,060,000 ($1,160,000 − $100,000), and it elects to expense that amount. Because P's taxable income from the active conduct of all its trades or businesses for the year was $2,000,000, it can deduct the full $1,060,000. P allocates $200,000 of its section 179 expense deduction and $500,000 of its taxable income to John, one of its partners.

John also conducts a business as a sole proprietor and, in 2023, placed in service in that business, section 179 property costing $800,000. John's taxable income from that business was $200,000. In addition to the $200,000 allocated from P, John elects to expense the $550,000 of the sole proprietorship's section 179 costs. However, John's deduction is limited to the business taxable income of $700,000 ($500,000 from P plus $200,000 from the sole proprietorship). John carries over $50,000 ($750,000 − $700,000) of the elected section 179 costs to 2024.

How Do You Elect the Deduction?

You elect to take the section 179 expense deduction by completing Part I of Form 4562.

CAUTION *If you elect the deduction for listed property, complete Part V of Form 4562 before completing Part I.*

File Form 4562 with either of the following.

- Your original tax return (whether or not you filed it timely).

- An amended return filed within the time prescribed by law. An election made on an amended return must specify the item of section 179 property to which the election applies and the part of the cost of each such item to be taken into account. The amended return must also include any resulting adjustments to taxable income.

Revoking an election. An election (or any specification made in the election) to take a section 179 expense deduction for 2023 can be revoked without IRS approval by filing an amended return. The amended return must be filed within the time prescribed by law. The amended return must also include any resulting adjustments to taxable income (for example, allowable depreciation in that tax year for the item of section 179 property for which the election pertains). Once made, the revocation is irrevocable.

When Must You Recapture the Deduction?

You may have to recapture the section 179 expense deduction if, in any year during the property's recovery period, the percentage of business use drops to 50% or less. In the year the business use drops to 50% or less, you include the recapture amount as ordinary income. You also increase the basis of the property by the recapture amount. Recovery periods for property are discussed later.

CAUTION *If you sell, exchange, or otherwise dispose of the property, do not figure the recapture amount under the rules explained in this discussion. Instead, use the rules for recapturing depreciation explained under Section 1245 Property in chapter 9.*

CAUTION *If the property is listed property, do not figure the recapture amount under the rules explained in this discussion when the percentage of business use drops to*

50% or less. Instead, use the rules for recapturing depreciation explained under Recapture of Excess Depreciation in chapter 5 of Pub. 946.

Figuring the recapture amount. To figure the amount to recapture, take the following steps.

1. Figure the allowable depreciation for the section 179 expense deduction you claimed. Begin with the year you placed the property in service and include the year of recapture.
2. Subtract the depreciation figured in (1) from the section 179 expense deduction you actually claimed. The result is the amount you must recapture.

Example. In January 2021, you are a calendar year taxpayer. You bought and placed in service section 179 property costing $10,000. The property is 3-year property and is depreciated under MACRS and a half-year convention. The property is not listed property. You elected a $5,000 section 179 expense deduction for the property and also elected not to claim a special depreciation allowance. You used the property only for business in 2021 and 2022. During 2023, you used the property 40% for business and 60% for personal use. You figure the recapture amount as follows.

Section 179 expense deduction claimed (2021)		$5,000
Minus: Allowable depreciation (instead of section 179 expense deduction):		
2021	$1,250	
2022	1,875	
2023 ($1,250 × 40% (business))	500	3,625
2023 — Recapture amount		**$1,375**

You must include $1,375 in income for 2023.

Where to report recapture. Report any recapture of the section 179 expense deduction as ordinary income in Part IV of Form 4797 and include it in income on Schedule F (Form 1040).

Recapture for qualified section 179 GO Zone property. If any qualified section 179 GO Zone property ceases to be used in the GO Zone in a later year, you must recapture the benefit of the increased section 179 expense deduction as “other income.”

Claiming the Special Depreciation Allowance

For qualified property (defined below) placed in service in 2023, you can take a special depreciation allowance depending on the date you acquired the qualified property. The allowance is an additional deduction you can take before you figure regular depreciation under MACRS. Figure the special depreciation allowance by multiplying the depreciable basis of the qualified property by the applicable percentage.

What Is Qualified Property?

For farmers, qualified property is certain property acquired after September 27, 2017, and certain specified plants.

Certain qualified property acquired after September 27, 2017. You can elect to take an 80% special depreciation allowance 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). 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), you can elect to take a 60% special depreciation allowance.

You can elect to take a 100% special depreciation allowance for certain property with a long production period and certain aircraft acquired and placed in service after September 27, 2017, and before January 1, 2024. For certain property with a long production period and certain aircraft acquired after September 27, 2017, and placed in service after December 31, 2023, and before January 1, 2025, you can elect to take an 80% special depreciation allowance.

Your property is qualified property if it meets the following requirements.

1. It is one of the following types of property.

   a. Tangible property depreciated under MACRS with a recovery period of 20 years or less.

   b. Water utility property depreciated under MACRS.

   c. Computer software defined in and depreciated under section

167(f)(1) of the Internal Revenue Code.

2. Qualified property can be either new property or certain used property.

3. It is not excepted property.

For more information, see chapter 3 of Pub. 946.

Certain specified plants. You can elect to claim an 80% special depreciation allowance for the adjusted basis of certain specified plants (defined later) bearing fruits and nuts planted or grafted after December 31, 2022, and before January 1, 2024.. For certain specified plants bearing fruits and nuts planted or grafted after December 31, 2023, and before January 1, 2025, you can elect to claim a 60% special allowance.

A specified plant is:

- Any tree or vine that bears fruits or nuts, and

- Any other plant that will have more than one yield of fruits or nuts and generally has a preproductive period of more than 2 years from planting and grafting to the time it begins bearing fruits or nuts.

Any property planted or grafted outside the United States does not qualify as a specified plant.

If you elect to claim the special depreciation allowance for any specified plant, the plant will not be treated as qualified property eligible for the special depreciation allowance in the subsequent tax year in which it is placed in service.

To make the election, attach a statement to your timely filed return (including extensions) for the tax year in which you plant or graft the specified plant(s) indicating you are electing to apply section 168(k)(5) and identifying the specified plant(s) for which you are making the election. Once made, the election cannot be revoked without IRS consent.

See section 168(k)(5) of the Internal Revenue Code.

How Can You Elect Not To Claim the Allowance?

You can elect, for any class of property, not to deduct the special depreciation allowance for all property in such class placed in service during the tax year. To make the election, attach a statement to your return indicating the class of property for which you are making the election.

Generally, you must make the election on a timely filed tax return (including extensions) for the year in which you place the property in service. However, 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 original return (not including extensions). Attach the election statement to the amended return. On the amended return, write “Filed pursuant to section 301.91002.”

Once made, the election may not be revoked without IRS consent.

If you elect not to have the special depreciation allowance apply, the property may be subject to an alternative minimum tax adjustment for depreciation.

When Must You Recapture an Allowance?

When you dispose of property for which you claimed a special depreciation allowance, any gain on the disposition is generally recaptured (included in income) as ordinary income up to the amount of the special depreciation allowance previously allowed or allowable. For more information, see chapter 3 of Pub. 946.

Figuring Depreciation Under MACRS

MACRS is used to recover the basis of most business and investment property placed in service after 1986. MACRS consists of two depreciation systems, the General Depreciation System (GDS) and the Alternative Depreciation System (ADS). Generally, these systems provide different methods and recovery periods to use in figuring depreciation deductions.

CAUTION *To be sure you can use MACRS to figure depreciation for your property, see* Can You Use MACRS To Depreciate Your Property*, earlier.*

This part explains how to determine which MACRS depreciation system applies to your property. It also discusses the following information that you need to know before you can figure depreciation under MACRS.

- Property's recovery class.

- Placed-in-service date.
- Basis for depreciation.
- Recovery period.
- Convention.
- Depreciation method.

Finally, this part explains how to use this information to figure your depreciation deduction.

Which Depreciation System (GDS or ADS) Applies?

Your use of either GDS or ADS to depreciate property under MACRS determines what depreciation method and recovery period you use. You must generally use GDS unless you are specifically required by law to use ADS or you elect to use ADS.

Required use of ADS. You must use ADS for the following property.

- All property used predominantly in a farming business and placed in service in any tax year during which an election not to apply the uniform capitalization rules to certain farming costs is in effect.
- Listed property used 50% or less in a qualified business use. See *Additional Rules for Listed Property*, later.
- Any tax-exempt use property.
- Any tax-exempt bond-financed property.
- Any property imported from a foreign country for which an Executive order is in effect because the country maintains trade restrictions or engages in other discriminatory acts.
- Any tangible property used predominantly outside the United States during the year.

Note. You must use ADS if you are required to file Form 8990 and you elect to expense farming interest expense.

If you are required to use ADS to depreciate your property, you cannot claim the special depreciation allowance.

Electing ADS. Although your property may qualify for GDS, you can elect to use ADS. The election must generally cover all property in the same property class you placed in service during the year. However, the election for residential rental property and nonresidential real property can be made on a property-by-property basis. Once you make this election, you can never revoke it.

You make the election by completing line 20 in Part III of Form 4562.

Which Property Class Applies Under GDS?

The following is a list of the nine property classes under GDS.

1. 3-year property.

2. 5-year property.
3. 7-year property.
4. 10-year property.
5. 15-year property.
6. 20-year property.
7. 25-year property.
8. Residential rental property.
9. Nonresidential real property.

See *Which Property Class Applies Under GDS?* in chapter 4 of Pub. 946 for examples of the types of property included in each class.

What Is the Placed-in-Service Date?

You begin to claim depreciation when your property is placed in service for use either in a trade or business or for the production of income. The placed-in-service date for your property is the date the property is ready and available for a specific use. It is therefore not necessarily the date it is first used. If you converted property held for personal use to use in a trade or business or for the production of income, treat the property as being placed in service on the conversion date. See *Placed in Service* under *When Does Depreciation Begin and End*, earlier, for examples illustrating when property is placed in service.

Also, see *Certain specified plants*, earlier, for information on the placed-in-service date for specified plants bearing fruits and nuts for which you elect to claim the special depreciation allowance.

What Is the Basis for Depreciation?

The basis for depreciation of MACRS property is the property's cost or other basis multiplied by the percentage of business/investment use. Reduce that amount by any credits and deductions allocable to the property. The following are examples of some of the credits and deductions that reduce basis.

- Any deduction for section 179 property.
- Any deduction for removal of barriers to the disabled and the elderly.
- Any disabled access credit, enhanced oil recovery credit, and credit for employer-provided childcare facilities and services.
- Any special depreciation allowance.
- Basis adjustment for investment credit property under section 50(c) of the Internal Revenue Code.

For information about how to determine the cost or other basis of property, see *What Is the Basis of Your Depreciable Property*, earlier. Also, see chapter 6.

For additional credits and deductions that affect basis, see section 1016 of the Internal Revenue Code.

Which Recovery Period Applies?

The recovery period of property is the number of years over which you recover its cost or other basis. It is determined based on the depreciation system (GDS or ADS) used. See Table 7-1 for recovery periods under both GDS and ADS for some commonly used assets. For a complete list of recovery periods, see the Table of Class Lives and Recovery Periods in Appendix B of Pub. 946.

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Table 7-1. **Farm Property Recovery Periods**

Assets	Recovery Period in Years	
	GDS	ADS
Agricultural structures (single purpose)	10	15
Automobiles	5	5
Calculators and copiers	5	6
Cattle (dairy or breeding)	5	7
Communication equipment[1]	7	10
Computer and peripheral equipment	5	5
Drainage facilities	15	20
Farm buildings[2]	20	25
New farm machinery and equipment[3]	5	10
Used farm machinery and equipment	7	10
Fences (agricultural)	7	10
Goats and sheep (breeding)	5	5
Grain bin	7	10
Hogs (breeding)	3	3
Horses (age when placed in service)		
Breeding and working (12 years or less)	7	10
Breeding and working (more than 12 years)	3	10
Racing horses (more than 2 years)	3	12
Horticultural structures (single purpose)	10	15
Logging machinery and equipment[4]	5	6
Nonresidential real property	39[5]	40
Office furniture, fixtures, and equipment (not calculators, copiers, or typewriters)	7	10
Paved lots	15	20
Residential rental property	27.5	40
Tractor units (over-the-road)	3	4
Trees or vines bearing fruits or nuts	10	20
Truck (heavy duty, unloaded weight 13,000 lbs. or more)	5	6
Truck (actual weight less than 13,000 lbs.)	5	5
Water wells	15	20

[1] Not including communication equipment listed in other classes.
[2] Not including single-purpose agricultural or horticultural structures.
[3] Not including grain bin, cotton ginning, asset fence, or other land improvement and the original use starts with you and placed in service after December 31, 2017.
[4] Used by logging and sawmill operators for cutting of timber.
[5] For property placed in service after May 12, 1993; for property placed in service before May 13, 1993, the recovery period is 31.5 years.

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House trailers for farm laborers. To depreciate a house trailer you supply as housing for those who work on your farm, use one of the following recovery periods if the house trailer is mobile (it has wheels and a history of movement).

- A 7-year recovery period under GDS.
- A 10-year recovery period under ADS.

However, if the house trailer is not mobile (its wheels have been removed and permanent utilities and pipes attached to it), use one of the following recovery periods.

- A 20-year recovery period under GDS.
- A 25-year recovery period under ADS.

Water wells. Water wells used to provide water for raising poultry and livestock are land improvements. If they are depreciable, use one of the following recovery periods.

- A 15-year recovery period under GDS.

- A 20-year recovery period under ADS.

The types of water wells that can be depreciated were discussed earlier in *Irrigation systems and water wells* under *Property Having a Determinable Useful Life*.

Which Convention Applies?

Under MACRS, averaging conventions establish when the recovery period begins and ends. The convention you use determines the number of months for which you can claim depreciation in the year you place property in service and in the year you dispose of the property. Use one of the following conventions.

- The half-year convention.
- The mid-month convention.
- The mid-quarter convention.

For a detailed explanation of each convention, see *Which Convention Applies?* in chapter 4 of

Pub. 946. Also, see the Instructions for Form 4562.

Which Depreciation Method Applies?

MACRS provides three depreciation methods under GDS and one depreciation method under ADS.

- The 200% declining balance method over a GDS recovery period.
- The 150% declining balance method over a GDS recovery period.
- The straight line method over a GDS recovery period.
- The straight line method over an ADS recovery period.

Depreciation Table. The following table lists the types of property you can depreciate under each method. The declining balance method is abbreviated as DB and the straight line method is abbreviated as SL.

Depreciation Table

System/Method	Type of Property
GDS using 150% DB	• All 15- and 20-year property • Farm or Nonfarm 3-, 5-, 7-, and 10-year property1
GDS using SL	• Nonresidential real property • Residential rental property • Trees or vines bearing fruits or nuts • All 3-, 5-, 7-, 10-, 15-, and 20-year property1

ADS using SL	• Property used predominantly outside the United States • Farm property used when an election not to apply the uniform capitalization rules is in effect • Tax-exempt property • Tax-exempt bond-financed property • Imported property 2 • Any property for which you elect to use this method1
GDS using 200% DB	• Nonfarm 3-, 5-, 7-, and 10-year property

- Farm 3-, 5-, 7-, and 10-year property placed in service after 2017

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1 Elective method.

2 See section 168(g)(6) of the Internal Revenue Code.

Property used in farming business. For 3-, 5-, 7-, or 10-year property used in a farming business and placed in service after 2017, the 150% declining balance method is no longer required. However, for 15or 20-year property placed in service in a farming business, you must use the 150% declining balance method over a GDS recovery period or you can elect one of the following methods.

- The straight line method over a GDS recovery period.
- The straight line method over an ADS recovery period.

Real property. You can depreciate real property using the straight line method under either GDS or ADS.

Switching to straight line. If you use a declining balance method, you switch to the straight line method in the year it provides an equal or greater deduction. If you use the MACRS percentage tables, discussed later under *How Is the Depreciation Deduction Figured*, you do not need to determine in which year your deduction is greater using the straight line method. The tables have the switch to the straight line method built into their rates.

Fruit or nut trees and vines. Depreciate trees and vines bearing fruits or nuts under GDS using the straight line method over a 10-year recovery period.

ADS required for some farmers. If you elect not to limit interest expense, you must use ADS to depreciate any property with a recovery period of 10 years or more. See chapter 4 for a discussion of interest rules. If you elect not to apply the uniform capitalization rules to any plant shown in Table 6-1 of chapter 6 and produced in your farming business, you must use ADS for all property you place in service in any year the election is in effect. See chapter 6 for a discussion of the application of the uniform capitalization rules to farm property.

Electing a different method. As shown in the Depreciation Table, you can elect a different method for depreciation for certain types of property. You must make the election by the due date of the return (including extensions) for the year you placed the property in service. However, 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 your return (excluding extensions). Attach the election to the amended return and write “Filed pursuant to section 301.9100-2” on the election statement. File the amended return at the same address you filed the original return. Once you make the election, you cannot change it.

CAUTION

If you elect to use a different method for one item in a property class, you must apply the same method to all property in that class placed in service during the year of the election. However, you can make the election on a property-by-property basis for residential rental and nonresidential real property.

Straight line election. Instead of using the declining balance method, you can elect to use the straight line method over the GDS recovery period. Make the election by entering “S/L” under column (f) in Part III of Form 4562.

ADS election. As explained earlier under *Which Depreciation System (GDS or ADS) Applies*, you can elect to use ADS even though your property may come under GDS. ADS uses the straight line method of depreciation over the ADS recovery periods, which are generally longer than the GDS recovery periods. The ADS recovery periods for many assets used in the business of farming are listed in Table 7-1. Additional ADS recovery periods for other classes of property may be found in the Table of Class Lives and Recovery Periods in Appendix B of Pub. 946.

How Is the Depreciation Deduction Figured?

To figure your depreciation deduction under MACRS, you first determine the depreciation system, property class, placed-in-service date, basis amount, recovery period, convention, and depreciation method that applies to your property. Then you are ready to figure your depreciation deduction. You can figure it in one of two ways.

- You can use the percentage tables provided by the IRS.
- You can figure your own deduction without using the tables.

Figuring your own MACRS deduction will generally result in a slightly different amount than using the tables.

See Using the MACRS Percentage Tables and Figuring the Deduction Without Using the Tables under How is the Depreciation Deduction Figured in chapter 4 of Pub. 946, for details on how to figure your depreciation deduction under MACRS.

Figuring the Deduction for Property Acquired in a Nontaxable Exchange

If your property has a carryover basis because you acquired it in an exchange or involuntary conversion of other property or in a nontaxable transfer, you generally figure depreciation for the property as if the exchange, conversion, or transfer had not occurred.

Property acquired in a like-kind exchange or involuntary conversion. You must generally depreciate the carryover basis of MACRS property acquired in a like-kind exchange or involuntary conversion over the remaining recovery period of the property exchanged or involuntarily converted. You also generally continue to use the same depreciation method and convention used for the exchanged or involuntarily converted property. This applies only to acquired property with the same or a shorter recovery period and the same or more accelerated depreciation method than the property exchanged or involuntarily converted. The excess basis, if any, of the acquired MACRS property is treated as newly placed-in-service MACRS property.

Election out. You can elect not to use the above rules. The election, if made, applies to both the acquired property and the exchanged or involuntarily converted property. If you make the election, figure depreciation by treating the carryover basis and excess basis, if any, for the acquired property as if placed in service the later of the date you acquired it, or the time of the disposition of the exchanged or involuntarily converted property. For depreciation purposes, the basis and figuring the depreciation deduction for MACRS property in a GAA acquired in a like-kind exchange or involuntary conversion. For more details, see Regulations section 1.168(i)-1 (as in effect for tax years beginning after December 31, 2013). Also, see chapter 4 of Pub. 946.

When Do You Recapture MACRS Depreciation?

When you dispose of property you depreciated using MACRS, any gain on the disposition is generally recaptured (included in income) as ordinary income up to the amount of the depreciation previously allowed or allowable for the property. For more information on depreciation recapture, see chapter 9. Also, see chapter 4 of Pub. 946.

Additional Rules for Listed Property

Listed property includes cars and other property used for transportation, property used for entertainment, and certain computers.

Deductions for listed property (other than certain leased property) are subject to the following special rules and limits.

- Deduction for employees.

- Business-use requirement.
- Passenger automobile limits and rules.

What Is Listed Property?

Listed property is any of the following.

- Passenger automobiles weighing 6,000 pounds or less.
- Any other property used for transportation, unless it is an excepted vehicle.
- Property generally used for entertainment, recreation, or amusement.
- Certain aircraft.

Passenger automobiles. A passenger automobile is any 4wheeled vehicle made primarily for use on public streets, roads, and highways and rated at 6,000 pounds or less of unloaded gross vehicle weight (6,000 pounds or less of gross vehicle weight for trucks and vans). It includes any part, component, or other item physically attached to the automobile or usually included in the purchase price of an automobile. Electric passenger automobiles are vehicles produced by an original equipment manufacturer and designed to run primarily on electricity.

Note. A truck or van that is a qualified nonpersonal use vehicle is not considered a passenger automobile. See *Qualified nonpersonal use vehicles* under *Passenger Automobiles* in chapter 5 of Pub. 946 for the definition of qualified nonpersonal use vehicles.

TIP *For most vehicles, the gross vehicle weight rating can generally be found on the driver door post of the vehicle.*

Other property used for transportation. This includes trucks, buses, boats, airplanes, motorcycles, and other vehicles used for transporting persons or goods.

Excepted vehicles. Other property used for transportation does not include the following vehicles.

- Tractors and other special-purpose farm vehicles.
- Bucket trucks (cherry pickers), dump trucks, flatbed trucks, and refrigerated trucks.
- Combines, cranes and derricks, and forklifts.
- Any vehicle designed to carry cargo with a loaded gross vehicle weight of over 14,000 pounds.

For more information, see chapter 5 of Pub. 946.

What Is the Business-Use Requirement?

You can claim the section 179 expense deduction for listed property and depreciate listed property using GDS and a declining balance method, if the property meets the business-use requirement. To meet this requirement, listed property must be used predominantly (more than 50% of its total use) for qualified business use. To determine whether the business-use requirement is met, you must allocate the use of any item of listed property used for more than one purpose during the year among its various uses.

Do the Passenger Automobile Limits Apply?

The depreciation deduction (including the section 179 expense deduction) you can claim for a passenger automobile each year is limited. The passenger automobile limits are the maximum depreciation amounts you can deduct for a passenger automobile. They are based on the date you placed the vehicle in service. See chapter 5 of Pub. 946 for tables that show the maximum depreciation deduction for passenger automobiles. Also, see the Instructions for Form 4562.

For information about deducting expenses for the business use of your passenger automobile, see chapter 4 of Pub. 463.

Deductions for passenger automobiles acquired in a trade-in. Special rules apply in figuring the depreciation for a passenger automobile received in a like-kind exchange or involuntary conversion. See chapter 5 of Pub. 946 and Regulations section 1.168(i)6(d)(3).

Depletion

Depletion is the using up of natural resources by mining, quarrying, drilling, or cutting. The depletion deduction allows an owner or operator to account for the reduction of a product's reserves.

Who Can Claim Depletion?

If you have an economic interest in mineral property or standing timber (defined below), you can take a deduction for depletion. More than one person can have an economic interest in the same mineral deposit or timber.

You have an economic interest if both the following apply.

- You have acquired by investment any interest in mineral deposits or standing timber.
- You have a legal right to income from the extraction of the mineral or the cutting of the timber, to which you must look for a return of your capital investment.

A contractual relationship that allows you an economic or monetary advantage from products of the mineral deposit or standing timber is not, in itself, an economic interest. A production payment carved out of, or retained on the sale of, mineral property is not an economic interest.

Mineral property is each separate interest you own in each mineral deposit in each separate tract or parcel of land. You can treat two or more separate interests as one property or as separate properties. See section 614 of the Internal Revenue Code and the related regulations for rules on how to treat separate mineral interests.

Timber property is your economic interest in standing timber in each tract or block representing a separate timber account.

Figuring Depletion

There are two ways of figuring depletion.

- Cost depletion.
- Percentage depletion.

For mineral property, you must generally use the method that gives you the larger deduction. For standing timber, you must use cost depletion.

Cost Depletion

To figure cost depletion, you must first determine the following.

- The property's basis for depletion.
- The total recoverable units of mineral in the property's natural deposit.
- The number of units of mineral sold during the tax year.

You must estimate or determine recoverable units (tons, barrels, board feet, thousands of cubic feet, or other measure) using the current industry method and the most accurate and reliable information you can obtain.

Basis for depletion. To figure the property's basis for depletion, subtract all of the following from the property's adjusted basis.

1. Amounts recoverable through:
    a. Depreciation deductions,
    b. Deferred expenses (including deferred exploration and development costs), and
    c. Deductions other than depletion.
2. The residual value of land and improvements at the end of operations.
3. The cost or value of land acquired for purposes other than mineral production.

Adjusted basis. The adjusted basis of your property is your original cost or other basis, plus certain additions and improvements, and minus certain deductions such as depletion allowed or allowable and casualty losses. Your adjusted basis can never be less than zero. See Pub. 551 for more information on adjusted basis.

Total recoverable units. The total recoverable units is the sum of the following.

- The number of units of mineral remaining at the end of the year (including units recovered but not sold).
- The number of units of mineral sold during the tax year (determined under your method of accounting, as explained next).

You must estimate or determine recoverable units (tons, pounds, ounces, barrels, thousands of cubic feet, or other measure) of mineral products using the current industry method and the most accurate and reliable information you can obtain. You must include ores and minerals that are developed, in sight, blocked out, or assured. You must also include probable or prospective ores or minerals that are believed to exist based on good evidence.

Number of units sold. You determine the number of units sold during the tax year based on your method of accounting. Use the following table to make this determination.

IF you use...	THEN the units sold during the year are...
the cash method of accounting	the units sold for which you receive payment during the tax year (regardless of the year of sale).
an accrual method of accounting	the units sold based on your inventories.

The number of units sold during the tax year does not include any units for which depletion deductions were allowed or allowable in earlier years.

Figuring the cost depletion deduction. Once you have figured your property's basis for depletion, the total recoverable units, and the number of units sold during the tax year, you can figure your cost depletion deduction by taking the following steps.

Step	Action	Result
1	Divide your property's basis for depletion by total recoverable units.	Rate per unit.
2	Multiply the rate per unit by units sold during the tax year.	Cost depletion deduction.

Cost depletion for ground water in Ogallala Formation. Farmers who extract ground water from the Ogallala Formation for irrigation are allowed cost depletion. Cost depletion is allowed when it can be demonstrated the ground water is being depleted and the rate of recharge is so low that, once extracted, the water would be lost to the taxpayer and immediately succeeding generations. To figure your cost depletion deduction, use the guidance provided in Revenue Procedure 66-11 in Cumulative Bulletin 1966-1.

Timber Depletion

Depletion takes place when you cut standing timber (including Christmas trees). You can figure your depletion deduction when the quantity of cut timber is first accurately measured in the process of exploitation.

Figuring the timber depletion deduction. To figure your cost depletion allowance, multiply the number of units of standing timber cut by your depletion unit.

Timber units. When you acquire timber property, you must make an estimate of the quantity of marketable timber that exists on the property. You measure the timber using board feet, log scale, cords, or other units. If you later determine that you have more or less units of timber, you must adjust the original estimate.

Depletion units. You figure your depletion unit each year by taking the following steps.

1. Determine your cost or the adjusted basis of the timber on hand at the beginning of the year.
2. Add to the amount determined in (1) the cost of any timber units acquired during the year and any additions to capital.
3. Figure the number of timber units to take into account by adding the number of timber units acquired during the year to the number of timber units on hand in the account at the beginning of the year and then adding (or subtracting) any correction to the estimate of the number of timber units remaining in the account.
4. Divide the result of (2) by the result of (3). This is your depletion unit.

When to claim timber depletion. Claim your depletion allowance as a deduction in the year of sale or other disposition of the products cut from the timber, unless you elect to treat the cutting of timber as a sale or exchange, as explained in chapter 8. Include allowable depletion for timber products not sold during the tax year the timber is cut as a cost item in the closing inventory of timber products for the year. The inventory is your basis for determining gain or loss in the tax year you sell the timber products.

Form T (Timber). Complete and attach Form T (Timber) to your income tax return if you are claiming a deduction for timber depletion, electing to treat the cutting of timber as a sale or exchange, or making an outright sale of timber. See the Instructions for Form T (Timber).

Example. You bought a farm that included standing timber. This year you determined that the standing timber could produce

300,000 units when cut. At that time, the adjusted basis of the standing timber was \$24,000. You then cut and sold 27,000 units. (You did not elect to treat the cutting of the timber as a sale or exchange.) your depletion for each unit for the year is \$0.08 (\$24,000 ÷ 300,000). Your deduction for depletion is \$2,160 (27,000 × \$0.08). If you had cut 27,000 units but sold only 20,000 units during the year, your depletion for each unit would have remained at \$0.08. However, your depletion deduction would have been \$1,600 (20,000 × \$0.08) for this year and you would have included the balance of \$560 (7,000 × \$0.08) in the closing inventory for the year.

Percentage Depletion

You can use percentage depletion on certain mines, wells, and other natural deposits. You cannot use the percentage method to figure depletion for standing timber, soil, sod, dirt, or turf.

To figure percentage depletion, you multiply a certain percentage, specified for each mineral, by your gross income from the property during the year. You can find a complete list of the percentages in section 613(b) of the Internal Revenue Code.

Taxable income limit. The percentage depletion deduction cannot be more than 50% (100% for oil and gas property) of your taxable income from the property figured without the depletion deduction and the domestic production activities deduction.

The following rules apply when figuring your taxable income from the property for purposes of the taxable income limit.

- Do not deduct any net operating loss deduction from the gross income from the property.
- Corporations do not deduct charitable contributions from the gross income from the property.

- If, during the year, you disposed of an item of section 1245 property used in connection with the mineral property, reduce any allowable deduction for mining expenses by the part of any gain you must report as ordinary income that is allocable to the mineral property. See Regulations section 1.613-5(b)(1) for information on how to figure the ordinary gain allocable to the property.

Amortization

Amortization is a method of recovering (deducting) certain capital costs over a fixed period of time. It is similar to the straight line method of depreciation. The amortizable costs discussed in this section include the startup costs of going into business, reforestation costs, the costs of pollution control facilities, and the costs of section 197 intangibles. See the Instructions for Form 4562 for more information on these topics.

Business Startup Costs

When you go into business, treat all costs you incur to get your business started as capital expenses. Capital expenses are a part of your basis in the business. Generally, you recover costs for particular assets through depreciation deductions. However, you generally cannot recover other costs until you sell the business or otherwise go out of business.

Startup costs are costs for creating an active trade or business or investigating the creation or acquisition of an active trade or business. Startup costs include any amounts paid or

incurred in connection with any activity engaged in for profit and for the production of income before the trade or business begins, in anticipation of the activity becoming an active trade or business.

You can elect to currently deduct a limited amount of business startup costs paid or incurred after October 22, 2004. See *Capital Expenses* in chapter 4. If this election is made, any costs that are not currently deducted can be amortized.

Amortization period. The amortization period for business startup costs paid or incurred before October 23, 2004, is 60 months or more. For startup costs paid or incurred after October 22, 2004, the amortization period is 180 months. The period starts with the month your active trade or business begins.

Reporting requirements. To amortize your startup costs that are not currently deductible under the election to deduct, complete Part VI of Form 4562 and attach a statement containing any required information. See the Instructions for Form 4562.

Reforestation Costs

You can elect to currently deduct a limited amount of qualifying reforestation costs for each qualified timber property. See *Capital Expenses* in chapter 4. You can elect to amortize over 84 months any amount not deducted. There is no annual limit on the amount you can elect to amortize. Reforestation costs are the direct costs of planting or seeding for forestation or reforestation.

Qualifying costs. Qualifying costs include only those costs you must otherwise capitalize and include in the adjusted basis of the property. They include costs for the following items.

- Site preparation.
- Seeds or seedlings.
- Labor.
- Tools.
- Depreciation on equipment used in planting and seeding.

If the government reimburses you for reforestation costs under a cost-sharing program, you can amortize these costs only if you include the reimbursement in your income.

Qualified timber property. Qualified timber property is property that contains trees in significant commercial quantities. It can be a woodlot or other site that you own or lease. The property qualifies only if it meets all the following requirements.

- It is located in the United States.
- It is held for the growing and cutting of timber you will either use in or sell for use in the commercial production of timber products.
- It consists of at least 1 acre planted with tree seedlings in the manner normally used in forestation or reforestation.

Qualified timber property does not include property on which you have planted shelter belts or ornamental trees, such as Christmas trees.

Amortization period. The 84month amortization period starts on the first day of the first month of the second half of the tax year you incur the costs (July 1 for a calendar year taxpayer), regardless of the month you actually incur the costs. You can claim amortization deductions for no more than 6 months of the first and last (eighth) tax years of the period.

How to make the election. To elect to amortize qualifying reforestation costs, enter your deduction in Part VI of Form 4562. Attach a statement containing any required information. See the Instructions for Form 4562.

Generally, you must make the election on a timely filed return (including extensions) for the year in which you incurred the costs. However, 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 your return (excluding extensions). Attach Form 4562 and the statement to the amended return and write “Filed pursuant to section 301.91002” on Form 4562. File the amended return at the same address you filed the original return.

Section 197 Intangibles

You must generally amortize over 15 years the capitalized costs of section 197 intangibles you acquired after August 10, 1993. You must amortize these costs if you hold the section 197 intangible in connection with your farming business or in an activity engaged in for the production of income. Your amortization deduction each year is the applicable part of the intangible's adjusted basis (for purposes of determining gain), figured by amortizing it ratably over 15 years (180 months). You are not allowed any other depreciation or amortization deduction for an amortizable section 197 intangible.

Section 197 intangibles include the following assets.

- Goodwill.
- Patents.
- Copyrights.
- Designs.
- Formulas.
- Licenses.
- Permits.
- Covenants not to compete.
- Franchises.
- Trademarks.

See section 197 of the Internal Revenue Code for more information, including a complete list of assets that are section 197 intangibles and special rules.

8.

Gains and Losses

Introduction

This chapter explains how to figure, and report on your tax return, your gain or loss on the disposition of your property or debt and whether such gain or loss is ordinary or capital. Ordinary gain is taxed at the same rates as wages and interest income, while net capital gain is generally taxed at a lower rate. This chapter discusses dispositions such as sales and exchanges (including like-kind exchanges and sales of capital and noncapital assets); hedging transactions; sale of livestock; cutting timber; sale of a farm; and cancellation of debt from foreclosures, repossessions, and abandonments.

Topics

This chapter discusses:

- Sales and exchanges
- Ordinary or capital gain or loss

Useful Items

You may want to see:

Publication

☐ **334** Tax Guide for Small Business

☐ **523** Selling Your Home

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

☐ **550** Investment Income and Expenses

☐ **908** Bankruptcy Tax Guide

Form (and Instructions)

☐ **982** Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment)

☐ **Sch D (Form 1040)** Capital Gains and Losses

☐ **Sch F (Form 1040)** Profit or Loss From Farming

☐ **1099-A** Acquisition or Abandonment of Secured Property

☐ **1099-C** Cancellation of Debt **4797** Sales of Business Property **8824** Like-Kind Exchanges

☐ **8949** Sales and Other Dispositions of Capital Assets

☐ **8960** Net Investment Income Tax—Individuals, Estates, and Trusts

☐ **8995** Qualified Business Income Deduction Simplified Computation

Sales and Exchanges

If you sell, exchange, or otherwise dispose of your property, you usually have a gain or a loss. This section explains certain rules for determining whether any gain you have is taxable and whether any loss you have is deductible.

A sale is a transfer of property for money or a mortgage, a note, or other promise to pay money. An exchange is a transfer of property for other property or services.

Property sold or exchanged may include the sale of a portion of a MACRS asset. For details, see *Partial Dispositions of MACRS Property* in chapter 1 of Pub. 544.

Determining Gain or Loss

You usually realize a gain or loss when you sell or exchange property. If the amount you realize from a sale or exchange of property is more than its adjusted basis, you have a gain. If the adjusted basis of the property is more than the amount you realize, you have a loss.

Basis and adjusted basis. The basis of property you buy is usually its cost. The adjusted basis of the property is the basis plus certain additions and minus certain deductions. See chapter 6 for more information about basis and adjusted basis.

Amount realized. The amount you realize from a sale or exchange is the total of all money you receive plus the fair market value (FMV) (defined in chapter 6) of all property or services you receive. The amount you realize also includes any of your liabilities assumed by the buyer and any liabilities to which the property you transferred is subject, such as real estate taxes or a mortgage.

If the liabilities relate to an exchange of multiple properties, see *Multiple Property Exchanges* in chapter 1 of Pub. 544.

Amount recognized. Your gain or loss realized from a sale or exchange of certain property is usually a recognized gain or loss for tax purposes. A recognized gain is a gain you must include in gross income and report on your income tax return. A recognized loss is a loss you deduct from gross income. However, your gain or loss realized from the exchange of certain property may not be recognized for tax purposes. See *Like-Kind Exchanges* next. Also, a loss from the disposition of property held for personal use is not deductible.

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. However, if you also receive Non-like-kind property or money as part of the exchange, you recognize gain to the extent of the value of the other property or money you received in the exchange. You do not recognize any losses. In general, your gain or loss will not be recognized until you sell or otherwise dispose of the property you receive in the exchange. See *Qualifying property*, later, for details and exceptions.

The exchange of property for the same kind of property is the most common type of nontaxable exchange. To qualify for treatment as a like-kind exchange, the property traded and the property received must be both of the following (discussed later).

- Qualifying property.
- Like-kind property.

For more information on like-kind exchanges, see Pub. 544.

Multiple-party transactions. The like-kind exchange rules also apply to property exchanges that involve three and four-party transactions. Any part of these multiple-party transactions can qualify as a like-kind exchange if it meets all the requirements described in this section.

Receipt of title from third party. If you receive property in a like-kind exchange and the other party who transfers the property to you does not give you the title, but a third party does, you can still treat this transaction as a like-kind exchange if it meets all the requirements.

Basis of property received. If you receive property in a like-kind exchange, generally the basis of the property will be the same as the basis of the property you gave up. See chapter 6 for more information on basis.

Money paid. If, in addition to giving up like-kind property, you pay money in a like-kind exchange, the basis of the property received is the basis of the property given up, increased by the money paid.

Example. You own farmland with a barn. The combined adjusted basis of the properties is $70,000 and the FMV is $150,000. You are interested in another tract of farmland, with a larger barn, worth $200,000. You exchange your existing property and $50,000 in cash for the new property. Your basis in the new property is $120,000 ($70,000 adjusted basis in your old property plus $50,000 in cash paid).