



Form 4797: Mysteries, Myths and Methods

Tom O'Saben, EA, CFP®

When Form 4797 is Used

- Sale Or Exchange Of:
 - Property used in trade or business
 - Depreciable or amortizable property
 - Oil, gas, geothermal or other mineral property
 - Cost-sharing payment property



When Form 4797 is Used

Involuntary Conversions:

- Used in trade or business
- Capital assets in trade or business



Form 4797 is Used

- Gain/loss from disposition of §179 property by partnership or S-corps
 - Reported by the partner or shareholder
- Computation of recapture amounts from §§179 and 280F(b)(2)
 - When business use drops to less than 50%

When Form 4797 is Used

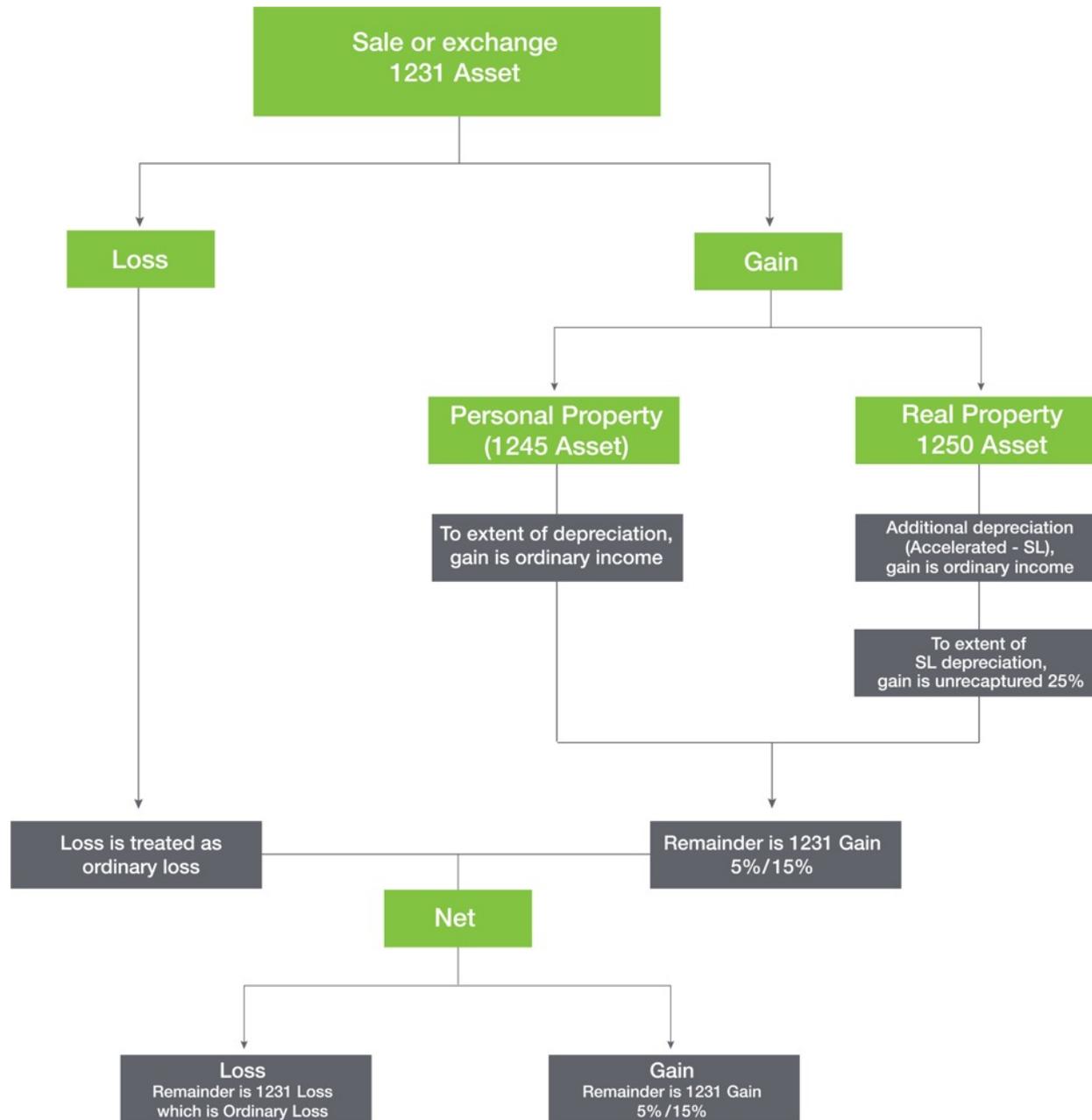
- Disposition of Non-Capital Assets
 - **Not** reported on Schedule D
 - **Not** inventory or other property held for sale to customers



Most Common Code Sections Used on 4797

- §1231: Land, Buildings and Equipment Used in Business
 - Gains may be subject to ordinary income tax or long-term capital gains





Recapture Provisions

- §1245 Property
 - Lesser of gain realized or depreciation allowed (or allowable) to be recaptured as ordinary income
 - Amount of sales price that exceeds original cost is §1231 gain

What's Treated as Depreciation?

- Allowed/allowable depreciation (including bonus)
- Amortization, depletion or pre-productive expenses
- Debt forgiveness excluded from income and election was made to reduce basis in depreciable assets
- §179 claimed as a deduction

Depreciation Recapture

- Remember we're talking about recapture as ordinary income under §1245



§1250 Property

- 3 Types
 - Intangible real property
 - Buildings and their structural components
 - All other tangible real property

§Property: 3 Potential Tax Treatments

- Gain attributable to accumulated depreciation allowed/allowable = unrecaptured gain
 - Taxed at a maximum 25% rate
- Gain from depreciation in excess of straight line = recaptured gain
 - Tax as ordinary income
- Gain in excess of original cost = capital gain

Reporting Transactions on Form 4797

- **Part I**

- Report sales/exchanges of property held > 1 year when depreciation was not allowed/allowable or property was sold at a loss
 - §1231 gains/losses

- **Part II**

- Report ordinary gains/losses from property held ≤ 1 year

Reporting Transactions on Form 4797

- **Part III**

- Report gains subject to depreciation recapture (§§1245 and 1250 gains) and other items that may result in ordinary income

- **Part IV**

- Report recapture under §§179 and 280F(b)(2) when business use drops to <50%

Recapture of Previous-Year §1231 Losses

- Losses are allowed in full
 - When gains receive preferential tax treatment, look back 5 years for allowed ordinary losses
 - To extent of ordinary losses, capital gain is taxed as ordinary income

Form 4797 Part II

- Reports sale of business property held \leq 1 year



Form 4797 Part III: Example

Item	Gross Sales Price	Cost Basis	Depreciation	Adjusted Basis	Gain on Sale	§1245 Recap	§1231 Gain
Dump Truck	\$4,000	\$15,000	\$15,000	\$0	\$4,000	\$4,000	\$0
Road Grader	\$1,500	\$1,000	\$475	\$525	\$975	\$475	\$500
Totals					\$4,975	\$4,475	\$500

Form 4797 Part III: Example

- Observation
 - When depreciation deductions were taken, they reduced the Schedule C net profit
 - This impacted self-employment tax in addition to income tax
 - Upon sale, worst case scenario: income tax on gain; no self employment tax impact

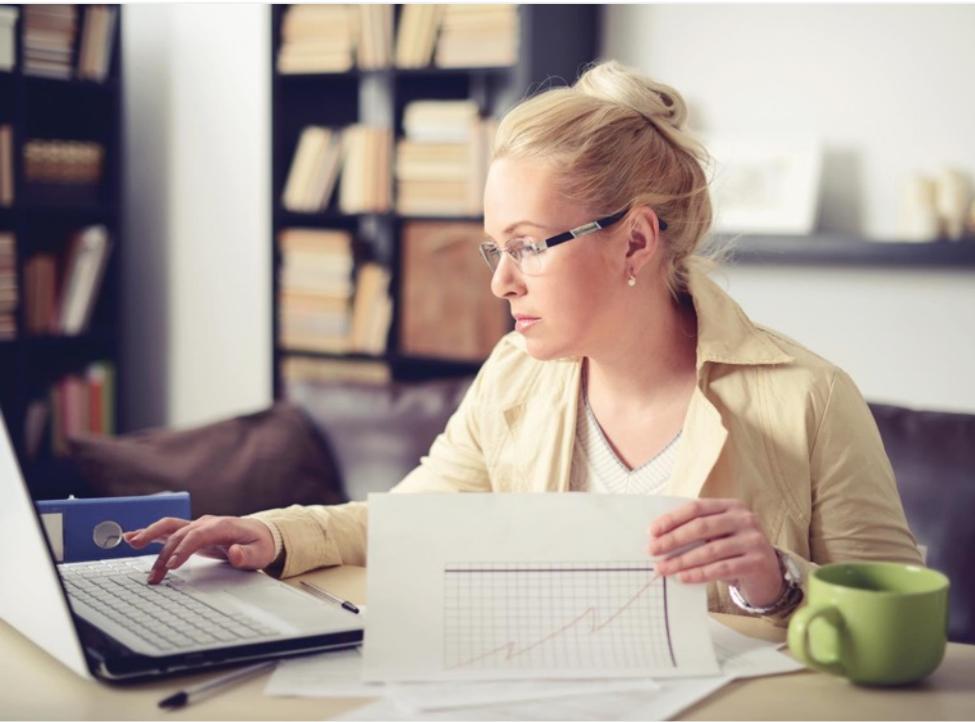
Form 4797 Part IV

- Recapture
- This part used when asset was NOT sold or otherwise disposed of
- Business use dropped BELOW 50%
 - This is key



Form 4797 Part IV

- Is my 2-year-old computer, stored in a file cabinet, and only brought out to retrieve old records, still be used more than 50% for business?



Form 4797 Part IV: Example

• 5-year asset purchased in 2016:	\$10,000
• §179 claimed:	\$10,000
• Adjusted basis:	\$0
• In June 2017 asset given to kids	
• Business use drops below 50%	
• 'Normal' depreciation would have been:	\$3,600
• Recapture amount =	\$6,400

Form 4797 Part IV Observations

- Difference between §179 claimed and regular depreciation is reported when original §179 deduction was claimed
 - Likely Schedule C or F, has potential S/E tax impact
- Income recapture amount restores that amount of basis to the asset
- Restored basis is depreciable

Depreciation Recapture on Installment Sales

- §1245 Property
 - All gain from depreciation recaptured in Year 1
- §1250 Property
 - Gain from depreciation spread out over the life of the contract

4797 in the age of De Minimis Safe Harbors

- Asset purchases of \$2,500 or less treated as de minimis materials and supplies
- What happens upon disposition:
 - Ordinary income?
 - Back to whence the deduction came?
 - Do nothing?
- Guidance seems to conclude that we do use Form 4797 but Part II meaning ordinary income treatment for the full sales price, no capital gain treatment for any part of the sale proceeds.