

Sale of Business Property*

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Introduction

While operating a farm or ranch business, producers will dispose of property (e.g., livestock, equipment, real estate, etc.) used in the business. This can occur in a variety of ways, with two common methods being sales of assets and trading (like-kind exchange) of property. The purpose of this fact sheet is to discuss and illustrate correct income tax reporting when business assets are sold.

This discussion also addresses, for income tax purposes, different types of business assets and their tax treatment upon sale. One example is the sale of cull breeding animals that were raised by the operator of the farm or ranch. Though these animals may be regarded as “farm products” by business operators (and therefore receive ordinary income treatment), for income tax purposes these animals may receive capital gains treatment. Breeding animals’ purpose is to produce market calves. These market calves are “farm products”, where the breeding animals, are in a sense, “the factory”, and thus receive different income tax treatment (discussed below). Similarly, dairy animals’ purpose is to produce milk, and draft animals’ purpose is to provide power.

Sale of Tangible Personal Business Property

Business property that is tangible, such as tractors, machinery, and single purpose agricultural or horticultural structures is classified as Internal Revenue Code (IRC) Section 1245 property. Farm and

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ranch operators often purchase such property and place it into service in their farming or ranching business. The cost of this property is recovered (taken as a business expense) through **depreciation**. When these assets are sold, the owner must report the transaction on the tax return. The sale triggers a **taxable event** (gain or loss) that is reported on IRS Form 4797, Sale of Business Property, Part III. This form calculates recapture of depreciation as ordinary income, subject to income tax; however, it escapes self-employment tax, which is a tax benefit of sorts to the operator. Originally the depreciation deduction was allowed as a deduction against both ordinary income taxes and self-employment taxes. These assets are IRC section 1245 property, tangible business property, and depreciation is taken as a business deduction to recover the cost of this property.

Example 1:

Knight N. Gale operates a ranch which has a primary product of feeder calves. During the year Knight sold his used baler for \$3,500 to a neighbor. Knight bought this baler 10 years ago for \$15,000. His adjusted cost basis is zero (meaning he has had the tax benefit of \$15,000 of depreciation). Since the baler is tangible personal property, it is IRC section 1245 property. He reports this sale (disposition) using IRS Form 4797, Part II and Part III. Finally, reporting the net result as calculated on Form 4797 on Line 4 of IRS Schedule 1 for Form 1040, U.S. Individual Income Tax Return.

(Continued below)

Example 1 continued:

Form 4797 Department of the Treasury Internal Revenue Service	Sales of Business Property (Also Involuntary Conversions and Recapture Amounts Under Sections 179 and 280F(b)(2)) Attach to your tax return. Go to www.irs.gov/Form4797 for instructions and the latest information.	OMB No. 1545-0184 2022 Attachment Sequence No. 27					
Name(s) shown on return KNIGHT N. GALE		Identifying number 555-44-3333					
1a Enter the gross proceeds from sales or exchanges reported to you for 2022 on Form(s) 1099-B or 1099-S (or substitute statement) that you are including on line 2, 10, or 20. See instructions		1a					
b Enter the total amount of gain that you are including on lines 2, 10, and 24 due to the partial dispositions of MACRS assets		1b					
c Enter the total amount of loss that you are including on lines 2 and 10 due to the partial dispositions of MACRS assets		1c					
Part I Sales or Exchanges of Property Used in a Trade or Business and Involuntary Conversions From Other Than Casualty or Theft—Most Property Held More Than 1 Year (see instructions)							
2	(a) Description of property	(b) Date acquired (mo., day, yr.)	(c) Date sold (mo., day, yr.)	(d) Gross sales price	(e) Depreciation allowed or allowable since acquisition	(f) Cost or other basis, plus improvements and expense of sale	(g) Gain or (loss) Subtract (f) from the sum of (d) and (e)
3	Gain, if any, from Form 4684, line 39						3
4	Section 1231 gain from installment sales from Form 6252, line 26 or 37						4
5	Section 1231 gain or (loss) from like-kind exchanges from Form 8824						5
6	Gain, if any, from line 32, from other than casualty or theft						6
7	Combine lines 2 through 6. Enter the gain or (loss) here and on the appropriate line as follows						7
Partnerships and S corporations. Report the gain or (loss) following the instructions for Form 1065, Schedule K, line 10, or Form 1120-S, Schedule K, line 9. Skip lines 8, 9, 11, and 12 below.							
Individuals, partners, S corporation shareholders, and all others. If line 7 is zero or a loss, enter the amount from line 7 on line 11 below and skip lines 8 and 9. If line 7 is a gain and you didn't have any prior year section 1231 losses, or they were recaptured in an earlier year, enter the gain from line 7 as a long-term capital gain on the Schedule D filed with your return and skip lines 8, 9, 11, and 12 below.							
8	Nonrecaptured net section 1231 losses from prior years. See instructions						8
9	Subtract line 8 from line 7. If zero or less, enter -0-. If line 9 is zero, enter the gain from line 7 on line 12 below. If line 9 is more than zero, enter the amount from line 8 on line 12 below and enter the gain from line 9 as a long-term capital gain on the Schedule D filed with your return. See instructions.						9
Part II Ordinary Gains and Losses (see instructions)			10 Ordinary gains and losses not included on lines 11 through 16 (include property held 1 year or less):				
11	Loss, if any, from line 7						11 ()
12	Gain, if any, from line 7 or amount from line 8, if applicable						12
13	Gain, if any, from line 31						13 3,500
14	Net gain or (loss) from Form 4684, lines 31 and 38a						14
15	Ordinary gain from installment sales from Form 6252, line 25 or 36						15
16	Ordinary gain or (loss) from like-kind exchanges from Form 8824						16
17	Combine lines 10 through 16.						17 3,500
18	For all except individual returns, enter the amount from line 17 on the appropriate line of your return and skip lines a and b below. For individual returns, complete lines a and b below.						
a If the loss on line 11 includes a loss from Form 4684, line 35, column (b)(ii), enter that part of the loss here. Enter the loss from income-producing property on Schedule A (Form 1040), line 16. (Do not include any loss on property used as an employee.) Identify as from "Form 4797, line 18a." See instructions							
						18a	

This information is intended for educational purposes only. Seek the advice of your tax professional regarding the application of these general principles to your individual circumstances.

Example 1 continued:

Form 4797 (2022)

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Part III Gain From Disposition of Property Under Sections 1245, 1250, 1252, 1254, and 1255
(see instructions)

19	(a) Description of section 1245, 1250, 1252, 1254, or 1255 property:	(b) Date acquired (mo., day, yr.)	(c) Date sold (mo., day, yr.)
A	BALER	05/10/2010	05/01/2022
B			
C			
D			

These columns relate to the properties on lines 19A through 19D.		Property A	Property B	Property C	Property D
20	Gross sales price (Note: See line 1a before completing.)	3,500			
21	Cost or other basis plus expense of sale	15,000			
22	Depreciation (or depletion) allowed or allowable	15,000			
23	Adjusted basis. Subtract line 22 from line 21	0			
24	Total gain. Subtract line 23 from line 20	3,500			
25	If section 1245 property:				
a	Depreciation allowed or allowable from line 22	15,000			
b	Enter the smaller of line 24 or 25a	3,500			
26	If section 1250 property: If straight line depreciation was used, enter -0- on line 26g, except for a corporation subject to section 291.				
a	Additional depreciation after 1975. See instructions				
b	Applicable percentage multiplied by the smaller of line 24 or line 26a. See instructions				
c	Subtract line 26a from line 24. If residential rental property or line 24 isn't more than line 26a, skip lines 26d and 26e				
d	Additional depreciation after 1969 and before 1976				
e	Enter the smaller of line 26c or 26d				
f	Section 291 amount (corporations only)				
g	Add lines 26b, 26e, and 26f				
27	If section 1252 property: Skip this section if you didn't dispose of farmland or if this form is being completed for a partnership.				
a	Soil, water, and land clearing expenses				
b	Line 27a multiplied by applicable percentage. See instructions				
c	Enter the smaller of line 24 or 27b				
28	If section 1254 property:				
a	Intangible drilling and development costs, expenditures for development of mines and other natural deposits, mining exploration costs, and depletion. See instructions				
b	Enter the smaller of line 24 or 28a				
29	If section 1255 property:				
a	Applicable percentage of payments excluded from income under section 126. See instructions				
b	Enter the smaller of line 24 or 29a. See instructions				
Summary of Part III Gains. Complete property columns A through D through line 29b before going to line 30.					
30	Total gains for all properties. Add property columns A through D, line 24				3,500
31	Add property columns A through D, lines 25b, 26g, 27c, 28b, and 29b. Enter here and on line 13				3,500

Knight begins the reporting of this sale on Line 19A of Part III by providing acquisition and sale dates.

Example 1 continued:

Further Knight reports the original cost to him on Line 21 and the depreciation allowed on line 22. These two numbers are the same, \$15,000 which represents the amount he paid for the baler 10 years ago and the depreciation taken over the baler’s depreciable life (7 years as an agricultural asset). Subtracting Line 22 from Line 21 yields \$0 as seen on Line 23. Subtracting Line 23 from Line 20 calculates the net gain, which is depreciation recapture. Depreciation recapture is recognized as the lesser of the depreciation taken (\$15,000) or the gain upon sale (\$3,500). The \$3,500 is now reported on Lines 30 and 31. The value reported on Line 31 is now reported on Page 1 of Form 4797 line 13 per the form instructions. Further, \$3,500 is reported on Line 17 as the total from this example and on Line 18b because Knight is an individual. This example’s net number, \$3,500, is now reported on Knight’s Schedule 1, Additional Income and Adjustments to Income, Line 4 as part of the calculation of other income, subject to income tax but not self-employment tax as shown below on Line 14.

SCHEDULE 1 (Form 1040)		Additional Income and Adjustments to Income		OMB No. 1545-0074
Department of the Treasury Internal Revenue Service		Attach to Form 1040, 1040-SR, or 1040-NR. Go to www.irs.gov/Form1040 for instructions and the latest information.		2022 Attachment Sequence No. 01
Name(s) shown on Form 1040, 1040-SR, or 1040-NR			Your social security number	
KNIGHT N. GALE			555-44-3333	
Part I Additional Income				
1	Taxable refunds, credits, or offsets of state and local income taxes	1		
2a	Alimony received	2a		
b	Date of original divorce or separation agreement (see instructions):			
3	Business income or (loss). Attach Schedule C	3		
4	Other gains or (losses). Attach Form 4797	4		3,500

Sale of Business Property Triggering a Capital Gain

Sometimes a transaction involving personal tangible business property (or other business property) may trigger a *capital gain* when a sale or *deemed sale* occurs. A capital gain occurs when an individual receives, in a transaction, an amount greater than was paid originally for an item when sold. Long-term capital gain income receives preferential income tax treatment due to lower tax rates applied to capital gain income. Therefore, it is important for individuals to properly report the transaction on their tax return to benefit from the preferential tax rates that capital gains enjoy.

Long-term holding period is generally greater than one year. However, for breeding livestock, dairy, and draft animals the holding period is greater than 24 months.

Example 2:

Frazier Firr, a Christmas tree grower, suffered a theft when his 4-wheeler was stolen from his shop building. Frazier's insurance company made a replacement payment of \$4,750. Frazier had already purchased a new 4-wheeler when the insurance check arrived. Frazier's **adjusted cost basis** in the stolen 4-wheeler was \$3,612 (\$4,250 originally paid less \$638 allowable depreciation taken = \$3,612). He bought the first machine fourteen months ago. Frazier must treat the insurance payment as a sale to the insurance company and report on IRS Form 4797 in a similar fashion as the previous example, however, an IRC 1231 gain of \$500 is also calculated; this gain is treated as a capital gain and reported on line 11 of Schedule D. ($\$4,750 - \$4,250 = \$500$ gain)

Example 2 continued:

Form 4797 Department of the Treasury Internal Revenue Service	Sales of Business Property (Also Involuntary Conversions and Recapture Amounts Under Sections 179 and 280F(b)(2)) Attach to your tax return. Go to www.irs.gov/Form4797 for instructions and the latest information.	OMB No. 1545-0184 2022 Attachment Sequence No. 27
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Name(s) shown on return FRAZIER FIRR	Identifying number 999-88-7777
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1a Enter the gross proceeds from sales or exchanges reported to you for 2022 on Form(s) 1099-B or 1099-S (or substitute statement) that you are including on line 2, 10, or 20. See instructions	1a	
b Enter the total amount of gain that you are including on lines 2, 10, and 24 due to the partial dispositions of MACRS assets	1b	
c Enter the total amount of loss that you are including on lines 2 and 10 due to the partial dispositions of MACRS assets	1c	

Part I Sales or Exchanges of Property Used in a Trade or Business and Involuntary Conversions From Other Than Casualty or Theft—Most Property Held More Than 1 Year (see instructions)

2	(a) Description of property	(b) Date acquired (mo., day, yr.)	(c) Date sold (mo., day, yr.)	(d) Gross sales price	(e) Depreciation allowed or allowable since acquisition	(f) Cost or other basis, plus improvements and expense of sale	(g) Gain or (loss) Subtract (f) from the sum of (d) and (e)
3	Gain, if any, from Form 4684, line 39						3
4	Section 1231 gain from installment sales from Form 6252, line 26 or 37						4
5	Section 1231 gain or (loss) from like-kind exchanges from Form 8824						5
6	Gain, if any, from line 32, from other than casualty or theft						6 500
7	Combine lines 2 through 6. Enter the gain or (loss) here and on the appropriate line as follows						7 500
Partnerships and S corporations. Report the gain or (loss) following the instructions for Form 1065, Schedule K, line 10, or Form 1120-S, Schedule K, line 9. Skip lines 8, 9, 11, and 12 below.							
Individuals, partners, S corporation shareholders, and all others. If line 7 is zero or a loss, enter the amount from line 7 on line 11 below and skip lines 8 and 9. If line 7 is a gain and you didn't have any prior year section 1231 losses, or they were recaptured in an earlier year, enter the gain from line 7 as a long-term capital gain on the Schedule D filed with your return and skip lines 8, 9, 11, and 12 below.							
8	Nonrecaptured net section 1231 losses from prior years. See instructions						8
9	Subtract line 8 from line 7. If zero or less, enter -0-. If line 9 is zero, enter the gain from line 7 on line 12 below. If line 9 is more than zero, enter the amount from line 8 on line 12 below and enter the gain from line 9 as a long-term capital gain on the Schedule D filed with your return. See instructions.						9

Part II Ordinary Gains and Losses (see instructions)

10 Ordinary gains and losses not included on lines 11 through 16 (include property held 1 year or less):							
11	Loss, if any, from line 7						11 ()
12	Gain, if any, from line 7 or amount from line 8, if applicable						12
13	Gain, if any, from line 31						13 638
14	Net gain or (loss) from Form 4684, lines 31 and 38a						14
15	Ordinary gain from installment sales from Form 6252, line 25 or 36						15
16	Ordinary gain or (loss) from like-kind exchanges from Form 8824						16
17	Combine lines 10 through 16.						17 638
18	For all except individual returns, enter the amount from line 17 on the appropriate line of your return and skip lines a and b below. For individual returns, complete lines a and b below.						
	a If the loss on line 11 includes a loss from Form 4684, line 35, column (b)(ii), enter that part of the loss here. Enter the loss from income-producing property on Schedule A (Form 1040), line 16. (Do not include any loss on property used as an employee.) Identify as from "Form 4797, line 18a." See instructions						18a
	b Redetermine the gain or (loss) on line 17 excluding the loss, if any, on line 18a. Enter here and on Schedule 1 (Form 1040), Part I, line 4						18b 638

This information is intended for educational purposes only. Seek the advice of your tax professional regarding the application of these general principles to your individual circumstances.

Example 2 continued:

Form 4797 (2022)

Page **2**

Part III Gain From Disposition of Property Under Sections 1245, 1250, 1252, 1254, and 1255
(see instructions)

19	(a) Description of section 1245, 1250, 1252, 1254, or 1255 property:	(b) Date acquired (mo., day, yr.)	(c) Date sold (mo., day, yr.)		
A	4-WHEELER (Stolen: Insurance Settlement)	03/05/2021	05/01/2022		
B					
C					
D					
These columns relate to the properties on lines 19A through 19D.		Property A	Property B	Property C	Property D
20	Gross sales price (Note: See line 1a before completing.)	4,750			
21	Cost or other basis plus expense of sale	4,250			
22	Depreciation (or depletion) allowed or allowable	638			
23	Adjusted basis. Subtract line 22 from line 21	3,612			
24	Total gain. Subtract line 23 from line 20	1,138			
25	If section 1245 property:				
a	Depreciation allowed or allowable from line 22	638			
b	Enter the smaller of line 24 or 25a.	638			
26	If section 1250 property: If straight line depreciation was used, enter -0- on line 26g, except for a corporation subject to section 291.				
a	Additional depreciation after 1975. See instructions				
b	Applicable percentage multiplied by the smaller of line 24 or line 26a. See instructions.				
c	Subtract line 26a from line 24. If residential rental property or line 24 isn't more than line 26a, skip lines 26d and 26e				
d	Additional depreciation after 1969 and before 1976.				
e	Enter the smaller of line 26c or 26d				
f	Section 291 amount (corporations only)				
g	Add lines 26b, 26e, and 26f				
27	If section 1252 property: Skip this section if you didn't dispose of farmland or if this form is being completed for a partnership.				
a	Soil, water, and land clearing expenses				
b	Line 27a multiplied by applicable percentage. See instructions				
c	Enter the smaller of line 24 or 27b				
28	If section 1254 property:				
a	Intangible drilling and development costs, expenditures for development of mines and other natural deposits, mining exploration costs, and depletion. See instructions				
b	Enter the smaller of line 24 or 28a.				
29	If section 1255 property:				
a	Applicable percentage of payments excluded from income under section 126. See instructions				
b	Enter the smaller of line 24 or 29a. See instructions				
Summary of Part III Gains. Complete property columns A through D through line 29b before going to line 30.					
30	Total gains for all properties. Add property columns A through D, line 24				1,138
31	Add property columns A through D, lines 25b, 26g, 27c, 28b, and 29b. Enter here and on line 13				638
32	Subtract line 31 from line 30. Enter the portion from casualty or theft on Form 4684, line 33. Enter the portion from other than casualty or theft on Form 4797, line 6				500

Example 2 continued:

Form 1040 Department of the Treasury—Internal Revenue Service		2022		OMB No. 1545-0074	IRS Use Only—Do not write or staple in this space.
Filing Status <input type="checkbox"/> Single <input type="checkbox"/> Married filing jointly <input type="checkbox"/> Married filing separately (MFS) <input type="checkbox"/> Head of household (HOH) <input type="checkbox"/> Qualifying surviving spouse (QSS)					
Check only one box. If you checked the MFS box, enter the name of your spouse. If you checked the HOH or QSS box, enter the child's name if the qualifying person is a child but not your dependent:					
Your first name and middle initial FRAZIER		Last name FIRR		Your social security number 9 9 9 8 8 7 7 7 7	
If joint return, spouse's first name and middle initial		Last name		Spouse's social security number	
Home address (number and street). If you have a P.O. box, see instructions. 10 HOLLY ROAD				Apt. no.	
City, town, or post office. If you have a foreign address, also complete spaces below. CHRISTMAS HILL			State YOUR STATE	ZIP code YOUR ZIP	
Foreign country name		Foreign province/state/county		Foreign postal code	
Presidential Election Campaign Check here if you, or your spouse if filing jointly, want \$3 to go to this fund. Checking a box below will not change your tax or refund. <input type="checkbox"/> You <input type="checkbox"/> Spouse					

Standard Deduction for— • Single or Married filing	5a	Pensions and annuities	5a		b	Taxable amount	5b	
	6a	Social security benefits	6a		b	Taxable amount	6b	
	7	Capital gain or (loss). Attach Schedule D if required. If not required, check here					7	500
	8	Other income from Schedule 1, line 10					8	

Frazier reports the insurance settlement payment as a sale on Form 4797, Part III in a similar manner as in Example 1; however, a \$500 gain is recognized because the insurance settlement paid was greater than the original cost of the 4-wheeler. The \$500, as calculated on Line 32 of Form 4797, is reported on Lines 6 and 7 of Form 4797 and further goes to Schedule D (illustrated below) to be treated as a capital gain. The net result of which is reported on Line 7 of Form 1040 as illustrated above.

SCHEDULE 1 (Form 1040)	Additional Income and Adjustments to Income	OMB No. 1545-0074	
Department of the Treasury Internal Revenue Service	Attach to Form 1040, 1040-SR, or 1040-NR. Go to www.irs.gov/Form1040 for instructions and the latest information.	2022 Attachment Sequence No. 01	
Name(s) shown on Form 1040, 1040-SR, or 1040-NR FRAZIER FIRR		Your social security number 999-88-7777	
Part I Additional Income			
1	Taxable refunds, credits, or offsets of state and local income taxes	1	
2a	Alimony received	2a	
b	Date of original divorce or separation agreement (see instructions):		
3	Business income or (loss). Attach Schedule C	3	
4	Other gains or (losses). Attach Form 4797	4	638

Example 2 continued:

<p>SCHEDULE D (Form 1040)</p> <p>Department of the Treasury Internal Revenue Service</p>	<p>Capital Gains and Losses</p> <p>Attach to Form 1040, 1040-SR, or 1040-NR. Go to www.irs.gov/ScheduleD for instructions and the latest information. Use Form 8949 to list your transactions for lines 1b, 2, 3, 8b, 9, and 10.</p>	<p>OMB No. 1545-0074</p> <p style="font-size: 24pt; font-weight: bold;">2022</p> <p>Attachment Sequence No. 12</p>															
Name(s) shown on return FRAZIER		Your social security number 999-88-7777															
<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 80%;">11 Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and long-term gain or (loss) from Forms 4684, 6781, and 8824</td> <td style="width: 5%; text-align: center;">11</td> <td style="width: 15%; text-align: right;">500</td> </tr> <tr> <td>12 Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1</td> <td style="text-align: center;">12</td> <td></td> </tr> <tr> <td>13 Capital gain distributions. See the instructions</td> <td style="text-align: center;">13</td> <td></td> </tr> <tr> <td>14 Long-term capital loss carryover. Enter the amount, if any, from line 13 of your Capital Loss Carryover Worksheet in the instructions</td> <td style="text-align: center;">14</td> <td style="text-align: right;">()</td> </tr> <tr> <td>15 Net long-term capital gain or (loss). Combine lines 8a through 14 in column (h). Then, go to Part III on the back</td> <td style="text-align: center;">15</td> <td style="text-align: right;">500</td> </tr> </table>			11 Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and long-term gain or (loss) from Forms 4684, 6781, and 8824	11	500	12 Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1	12		13 Capital gain distributions. See the instructions	13		14 Long-term capital loss carryover. Enter the amount, if any, from line 13 of your Capital Loss Carryover Worksheet in the instructions	14	()	15 Net long-term capital gain or (loss). Combine lines 8a through 14 in column (h). Then, go to Part III on the back	15	500
11 Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and long-term gain or (loss) from Forms 4684, 6781, and 8824	11	500															
12 Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1	12																
13 Capital gain distributions. See the instructions	13																
14 Long-term capital loss carryover. Enter the amount, if any, from line 13 of your Capital Loss Carryover Worksheet in the instructions	14	()															
15 Net long-term capital gain or (loss). Combine lines 8a through 14 in column (h). Then, go to Part III on the back	15	500															
For Paperwork Reduction Act Notice, see your tax return instructions.		Cat. No. 11338H Schedule D (Form 1040) 2022															

Sale of Raised Breeding, Dairy or Draft Animals

Farmers and ranchers often keep replacement heifers or draft animals from their own breeding herd to replace culled animals or to naturally increase the size of their operations. The farmer and rancher must report the sales of these animals for income tax purposes. Frequently, however, an easy and common error can be made on the individual’s tax return. That error is failing to recognize that these mature animals are treated as the “sale of business property” and qualify as IRC Section 1231 property. Being classified as Section 1231 property allows for favorable tax treatment. Property qualifying as Section 1231 is treated as being a “capital” good if the transaction triggers a gain. Further, if the taxable event triggers a loss, then the loss is treated as an ordinary loss not subject to any capital loss limitations. Simply said, Section 1231 property enjoys the best of both worlds from an income tax perspective. The required holding period is 24 months from the date of acquisition (birth for raised animals) for beef or dairy cattle and horses for Section 1231 treatment. Sales of these animals are not reported on Schedule F, Profit or Loss from Farming, which is where the mistake is made, resulting in a tax liability that is too high. Because these animals are **not** reported on Schedule F the gains escape self-employment tax and if a net gain is determined on all IRC Section 1231 transactions capital gains treatment results by reporting on Form 4797.

Cattle held for breeding or dairy purposes that do not meet the required holding period (24 months) still escape self-employment taxation, however, these sales are subject to ordinary income tax rates.

Other animals held for breeding, such as goats or swine, are treated in the same manner as the illustrated dairy cattle example; however, the holding period for IRC Section 1231 treatment is 12

months from the date of acquisition (birth in the case of raised animals).

Example 3:

Laque Toose, a dairy farmer, has a milking herd of 150 cows. Laque generally replaces 20 percent of his herd each year with his own raised heifers; he sells the replaced cull cows, which he raised, at the local livestock sales barn. During the course of the year, some of his replacement heifers develop conditions that require removal from the milking herd before they become productive. In 2022, Laque has sales of \$20,000 of culled milk cows and \$4,500 of culled replacement heifers. Laque reports his sales of these culled animals as illustrated below.

Form 4797 Department of the Treasury Internal Revenue Service	Sales of Business Property (Also Involuntary Conversions and Recapture Amounts Under Sections 179 and 280F(b)(2)) ▶ Attach to your tax return. ▶ Go to www.irs.gov/Form4797 for instructions and the latest information.	OMB No. 1545-0184 2021 Attachment Sequence No. 27					
Name(s) shown on return LAQUE TOOSE		Identifying number 111-22-3333					
1a Enter the gross proceeds from sales or exchanges reported to you for 2021 on Form(s) 1099-B or 1099-S (or substitute statement) that you are including on line 2, 10, or 20. See instructions		1a					
1b Enter the total amount of gain that you are including on lines 2, 10, and 24 due to the partial dispositions of MACRS assets.		1b					
1c Enter the total amount of loss that you are including on lines 2 and 10 due to the partial dispositions of MACRS assets		1c					
Part I Sales or Exchanges of Property Used in a Trade or Business and Involuntary Conversions From Other Than Casualty or Theft—Most Property Held More Than 1 Year (see instructions)							
2	(a) Description of property	(b) Date acquired (mo., day, yr.)	(c) Date sold (mo., day, yr.)	(d) Gross sales price	(e) Depreciation allowed or allowable since acquisition	(f) Cost or other basis, plus improvements and expense of sale	(g) Gain or (loss) Subtract (f) from the sum of (d) and (e)
	CULL DAIRY COWS	VARIOUS	VARIOUS	20,000	-0-	-0-	20,000
	RAISED, HELD > 24 MONTHS						
3 Gain, if any, from Form 4684, line 39							3
4 Section 1231 gain from installment sales from Form 6252, line 26 or 37							4
5 Section 1231 gain or (loss) from like-kind exchanges from Form 8824.							5
6 Gain, if any, from line 32, from other than casualty or theft							6
7 Combine lines 2 through 6. Enter the gain or (loss) here and on the appropriate line as follows							20,000
Partnerships and S corporations. Report the gain or (loss) following the instructions for Form 1065, Schedule K, line 10, or Form 1120-S, Schedule K, line 9. Skip lines 8, 9, 11, and 12 below.							
Individuals, partners, S corporation shareholders, and all others. If line 7 is zero or a loss, enter the amount from line 7 on line 11 below and skip lines 8 and 9. If line 7 is a gain and you didn't have any prior year section 1231 losses, or they were recaptured in an earlier year, enter the gain from line 7 as a long-term capital gain on the Schedule D filed with your return and skip lines 8, 9, 11, and 12 below.							
8 Nonrecaptured net section 1231 losses from prior years. See instructions							8
9 Subtract line 8 from line 7. If zero or less, enter -0-. If line 9 is zero, enter the gain from line 7 on line 12 below. If line 9 is more than zero, enter the amount from line 8 on line 12 below and enter the gain from line 9 as a long-term capital gain on the Schedule D filed with your return. See instructions.							9

This information is intended for educational purposes only. Seek the advice of your tax professional regarding the application of these general principles to your individual circumstances.

Example 3 continued:

Laque begins reporting the culled milk cow sales on Line 2 by describing the property in Column a. Columns b and c are used to provide acquisition and sales dates, in this case “various” was used as a simplifying technique to report all raised cattle as one number. Column d is where Laque reports the gross sales price followed by Columns e and f with zeros since these cattle were raised on the farm. Column g is therefore the gain of \$20,000, which is equal to the sales price. Line 7 is the total of Lines 2-6, in this example there is only one value on Line 2 that is summed. As can be seen in the line instructions for Line 9, Form 4797, the net gain, in this case \$20,000 is reported on Schedule D, like Example 2 above, so that these cull cows will receive capital gains income tax treatment as well as escape self-employment tax.

The reporting of the cull heifers- held less than 24 months is also reported on Form 4797, Sales of Business Property, however, on Part II instead of Part I as illustrated below.

Part II Ordinary Gains and Losses (see instructions)						
10 Ordinary gains and losses not included on lines 11 through 16 (include property held 1 year or less):						
CULL REPLACEMENT HEIFERS	VARIOUS	VARIOUS	4.5	-0-	0	4,500
RAISED, HELD < 24 MONTHS						
11 Loss, if any, from line 7						11
12 Gain, if any, from line 7 or amount from line 8, if applicable						12
13 Gain, if any, from line 31						13
14 Net gain or (loss) from Form 4684, lines 31 and 38a						14
15 Ordinary gain from installment sales from Form 6252, line 25 or 36						15
16 Ordinary gain or (loss) from like-kind exchanges from Form 8824						16
17 Combine lines 10 through 16.						17 4,500
18 For all except individual returns, enter the amount from line 17 on the appropriate line of your return and skip lines a and b below. For individual returns, complete lines a and b below.						
a If the loss on line 11 includes a loss from Form 4684, line 35, column (b)(ii), enter that part of the loss here. Enter the loss from income-producing property on Schedule A (Form 1040), line 16. (Do not include any loss on property used as an employee.) Identify as from "Form 4797, line 18a." See instructions						18a
b Redetermine the gain or (loss) on line 17 excluding the loss, if any, on line 18a. Enter here and on Schedule 1 (Form 1040), Part I, line 4						18b 4,500

Similarly, Laque uses Line 10 to describe and identify the culled heifers held less than 24 months; however, he uses Part II of Form 4797. His acquisition and sale dates varied throughout the ownership period; therefore, he uses the term “various” denoting these dates. The sale proceeds, \$4,500, are reported in column d. Because these animals are raised on the farm there is no depreciation taken or basis to report. The entire sale is a gain and reported as such in column g. In this example, these cull heifers are the only reportable transaction, therefore the \$4,500 is brought to Lines 17 and 18b as seen above on the partial Form 4797.

Laque reports the values: deemed capital gain of \$20,000 and ordinary income of \$4,500 on his IRS Form 1040 like Example 2 earlier in this discussion.

Deemed Sale Resulting from a Trade

With the passage of the Tax Cuts and Jobs Act in 2017, like-kind exchanges of personal property results in a “deemed sale”. The sale price is the trade allowance given by the equipment dealer for example. Therefore, there is an increased responsibility to report traded equipment correctly. Revisiting Example 1, Knight, instead of selling the baler to a neighbor he received a trade-in allowance of \$3,500 however, the income tax reported would be **exactly** the same. However, Knight would be able to increase the basis of the newly acquired equipment by the trade allowance because he recognizes the gain on his income tax return for the year of the trade.

Conclusion

Obviously, Examples 1, 2 and 3 are simplified to illustrate the correct reporting of income that is generated by the sale of business property in the normal course of the operator’s farm or ranch management. A business, over the course of a year, may have several such transactions that will be combined on the tax return.

Operators are encouraged to properly record these transactions in their business records so that they or their tax professional can correctly and accurately report income on the individual’s income tax returns. Notations that reference these transactions, during the year, can provide invaluable information as income tax returns are being prepared and filed.

IRS Publications

To access the forms shown in this paper: Form 1040 and Form 4797, and other IRS forms and publications, go to www.irs.gov and click on “Forms and Publications”. Then click on “Publication number” under “Download forms and publications by:” Type the publication number in the find box to search for the publication. Publications may be viewed online or downloaded by double clicking on the publication.

IRS Publication 225, Farmer’s Tax Guide. Chapter 9 discusses dispositions of property used in farming and Chapter 12 discusses self-employment tax issues.

IRS Publication 547. This publication provides more detail relative to gains or losses from the destruction or theft of business property.

Additional Topics

This fact sheet was written as part of Rural Tax Education, a national effort including Cooperative *Rural Tax Education* (RuralTax.org) · RTE/2023-1 14

This information is intended for educational purposes only. Seek the advice of your tax professional regarding the application of these general principles to your individual circumstances.

Extension programs at participating land-grant universities to provide income tax education materials to farmers, ranchers, and other agricultural producers. For a list of universities involved, other fact sheets and additional information related to agricultural income tax please see RuralTax.org.

Fact sheets that might be of interest include:

- Like-Kind Exchange (Trade) of Business Assets
- Involuntary Conversion of Business Assets
- Weather-Related Sales of Livestock

This information is intended for educational purposes only. You are encouraged to seek the advice of your tax or legal advisor, or other authoritative sources, regarding the application of these general tax principles to your individual circumstances. Pursuant to Treasury Department (IRS) Circular 230 Regulations, any federal tax advice contained here is not intended or written to be used, and may not be used, for the purpose of avoiding tax-related penalties or promoting, marketing or recommending to another party any tax-related matters addressed herein.

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