

Sale of Business Property*

*Guido van der Hoeven, Extension Specialist/Senior Lecturer
Department of Agricultural and Resource Economics, NC State University*

Introduction

During the course of 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 selling them. One common 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, for income tax purposes these animals may receive capital gains treatment.

Sale of Tangible Personal Business Property

Business property that is tangible, such as tractors, machinery and single purpose agricultural or horticultural structures are classified as Internal Revenue Code (IRC) Section 1245 property. Farm and 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 business 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 reporting recaptures any 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 deduction against both ordinary income taxes and self-employment taxes.

* In cooperation with the participating land-grant universities, this project is funded in part by USDA-Risk Management Agency under a cooperative agreement. The information reflects the views of the author(s) and not USDA-RMA. For a list of participating land-grant universities, see RuralTax.org.

Example 1: Knight N. Gale operates a ranch which has a main product of feeder calves. During the year Knight sold his used baler to a neighbor. Knight bought this baler 10 years ago for \$15,000. His cost basis is zero (meaning he has had the tax benefit of \$15,000 of depreciation). He sold this baler for \$3,500. He reports this sale (disposition) in the following manner using IRS Form 4797, Part II and Part III. Finally, reporting the net result as calculated on Form 4797 on Line 14 of IRS Form 1040, U.S. Individual Income Tax Return.

Form 4797 <small>Department of the Treasury Internal Revenue Service (99)</small>	Sales of Business Property (Also Involuntary Conversions and Recapture Amounts Under Sections 179 and 280F(b)(2)) ▶ Attach to your tax return. ▶ See separate instructions.	OMB No. 1545-0184 2009 <small>Attachment Sequence No. 27</small>					
Name(s) shown on return KNIGHT N. GALE		Identifying number 555-44-3333					
1 Enter the gross proceeds from sales or exchanges reported to you for 2009 on Form(s) 1099-B or 1099-S (or substitute statement) that you are including on line 2, 10, or 20 (see instructions)		1					
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 43						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 (except electing large partnerships) and S corporations. Report the gain or (loss) following the instructions for Form 1065, Schedule K, line 10, or Form 1120S, 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 did not 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 35 and 42a						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:						18
a	If the loss on line 11 includes a loss from Form 4684, line 39, column (b)(ii), enter that part of the loss here. Enter the part of the loss from income-producing property on Schedule A (Form 1040), line 28, and the part of the loss from property used as an employee on Schedule A (Form 1040), line 23. 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 Form 1040, line 14						18b 3,500
For Paperwork Reduction Act Notice, see separate instructions.							
<small>Cat. No. 130861</small>					<small>Form 4797 (2009)</small>		

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.

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	05/01/2000	05/01/2010				
B						
C						
D						
			Property A	Property B	Property C	Property D
These columns relate to the properties on lines 19A through 19D. ▶						
20 Gross sales price (Note: See line 1 before completing.)	20		3,500			
21 Cost or other basis plus expense of sale	21		15,000			
22 Depreciation (or depletion) allowed or allowable.	22		15,000			
23 Adjusted basis. Subtract line 22 from line 21.	23		0			
24 Total gain. Subtract line 23 from line 20	24		3,500			
25 If section 1245 property:						
a Depreciation allowed or allowable from line 22	25a		15,000			
b Enter the smaller of line 24 or 25a	25b		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)	26a					
b Applicable percentage multiplied by the smaller of line 24 or line 26a (see instructions)	26b					
c Subtract line 26a from line 24. If residential rental property or line 24 is not more than line 26a, skip lines 26d and 26e	26c					
d Additional depreciation after 1969 and before 1976.	26d					
e Enter the smaller of line 26c or 26d	26e					
f Section 291 amount (corporations only)	26f					
g Add lines 26b, 26e, and 26f.	26g					
27 If section 1252 property: Skip this section if you did not dispose of farmland or if this form is being completed for a partnership (other than an electing large partnership).						
a Soil, water, and land clearing expenses	27a					
b Line 27a multiplied by applicable percentage (see instructions)	27b					
c Enter the smaller of line 24 or 27b	27c					
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)	28a					
b Enter the smaller of line 24 or 28a	28b					
29 If section 1255 property:						
a Applicable percentage of payments excluded from income under section 126 (see instructions)	29a					
b Enter the smaller of line 24 or 29a (see instructions)	29b					
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	30		3,500			
31 Add property columns A through D, lines 25b, 26g, 27c, 28b, and 29b. Enter here and on line 13	31		3,500			
32 Subtract line 31 from line 30. Enter the portion from casualty or theft on Form 4684, line 37. Enter the portion from other than casualty or theft on Form 4797, line 6	32					-0-

Knight begins the reporting of this sale on Line 19A of Part III by providing acquisition and sale dates. Then Knight provides the details of the sale and depreciation items in order to calculate the depreciation recapture which is subject to ordinary income tax rates, but not subject to self-employment (social security) tax. Knight reports the gross sales price, \$3,500, on line 20.

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. Since the baler is tangible personal property, it is IRC section 1245 property and the 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 further reported on Lines 30 and 31. The value reported on Line 30 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 page 1, Form 1040 as part of his ordinary income, subject to income tax but not self-employment tax as shown below on Line 14.

Form 1040 Department of the Treasury—Internal Revenue Service		U.S. Individual Income Tax Return 2009		(99) IRS Use Only—Do not write or staple in this space.	
Label (See instructions on page 14.) Use the IRS label. Otherwise, please print or type. Presidential Election Campaign	L A B E L H E R E	For the year Jan. 1–Dec. 31, 2009, or other tax year beginning , 2009, ending , 20		OMB No. 1545-0074	
		Your first name and initial KNIGHT N.	Last name GALE	Your social security number 5 5 5 4 4 3 3 3 3	
		If a joint return, spouse's first name and initial	Last name	Spouse's social security number	
		Home address (number and street). If you have a P.O. box, see page 14. 1 BOX CANYON ROAD		Apt. no.	You must enter your SSN(s) above.
City, town or post office, state, and ZIP code. If you have a foreign address, see page 14. DUSTY TRAILS, YOUR STATE, YOUR ZIP		Checking a box below will not change your tax or refund. <input type="checkbox"/> You <input type="checkbox"/> Spouse			
Presidential Election Campaign ▶ Check here if you, or your spouse if filing jointly, want \$3 to go to this fund (see page 14) ▶					
If you did not		14 Other gains or (losses). Attach Form 4797	14	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 rates of income tax 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.

Example 2: Frazier Furr, 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 as a year-end clearance model 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, a capital gain of \$500 is also calculated. (\$4,750 – \$4,250 = \$500 gain)

Form **4797**

Department of the Treasury
Internal Revenue Service (99)

Sales of Business Property
(Also Involuntary Conversions and Recapture Amounts
Under Sections 179 and 280F(b)(2))

▶ Attach to your tax return. ▶ See separate instructions.

OMB No. 1545-0184

2009
Attachment
Sequence No. **27**

Name(s) shown on return

FRAZIER FIRR

Identifying number

999-88-7777

1 Enter the gross proceeds from sales or exchanges reported to you for 2009 on Form(s) 1099-B or 1099-S (or substitute statement) that you are including on line 2, 10, or 20 (see instructions) **1**

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 43 **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 (except electing large partnerships) and S corporations. Report the gain or (loss) following the instructions for Form 1065, Schedule K, line 10, or Form 1120S, 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 did not 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** **500**

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 35 and 42a **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 39, column (b)(ii), enter that part of the loss here. Enter the part of the loss from income-producing property on Schedule A (Form 1040), line 28, and the part of the loss from property used as an employee on Schedule A (Form 1040), line 23. Identify as "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 Form 1040, line 14 **18b** **638**

For Paperwork Reduction Act Notice, see separate instructions.

Cat. No. 130861

Form **4797** (2009)

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)	03/05/2009	05/01/2010		
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 1 before completing.)	20	4,750		
21 Cost or other basis plus expense of sale	21	4,250		
22 Depreciation (or depletion) allowed or allowable	22	638		
23 Adjusted basis. Subtract line 22 from line 21.	23	3,612		
24 Total gain. Subtract line 23 from line 20	24	1,138		
25 If section 1245 property:				
a Depreciation allowed or allowable from line 22	25a	638		
b Enter the smaller of line 24 or 25a	25b	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)	26a			
b Applicable percentage multiplied by the smaller of line 24 or line 26a (see instructions)	26b			
c Subtract line 26a from line 24. If residential rental property or line 24 is not more than line 26a, skip lines 26d and 26e	26c			
d Additional depreciation after 1969 and before 1976.	26d			
e Enter the smaller of line 26c or 26d	26e			
f Section 291 amount (corporations only)	26f			
g Add lines 26b, 26e, and 26f.	26g			
27 If section 1252 property: Skip this section if you did not dispose of farmland or if this form is being completed for a partnership (other than an electing large partnership).				
a Soil, water, and land clearing expenses	27a			
b Line 27a multiplied by applicable percentage (see instructions)	27b			
c Enter the smaller of line 24 or 27b	27c			
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)	28a			
b Enter the smaller of line 24 or 28a	28b			
29 If section 1255 property:				
a Applicable percentage of payments excluded from income under section 126 (see instructions)	29a			
b Enter the smaller of line 24 or 29a (see instructions)	29b			
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	30	1,138		
31 Add property columns A through D, lines 25b, 26g, 27c, 28b, and 29b. Enter here and on line 13	31	638		
32 Subtract line 31 from line 30. Enter the portion from casualty or theft on Form 4684, line 37. Enter the portion from other than casualty or theft on Form 4797, line 6	32	500		

Label (See instructions on page 14.) Use the IRS label. Otherwise, please print or type. Presidential Election Campaign	For the year Jan. 1–Dec. 31, 2009, or other tax year beginning _____, 2009, ending _____, 20	OMB No. 1545-0074	
	Your first name and initial FRAZIER	Last name FIRR	Your social security number 9 9 9 8 8 7 7 7 7
	If a joint return, spouse's first name and initial	Last name	Spouse's social security number
	Home address (number and street). If you have a P.O. box, see page 14. 10 HOLLY ROAD		Apt. no.
City, town or post office, state, and ZIP code. If you have a foreign address, see page 14. CHRISTMAS HILL, YOUR STATE, YOUR ZIP		You must enter your SSN(s) above.	
Check here if you, or your spouse if filing jointly, want \$3 to go to this fund (see page 14)		Checking a box below will not change your tax or refund. <input type="checkbox"/> You <input type="checkbox"/> Spouse	

If you did not get a W-2	13	Capital gain or (loss). Attach Schedule D if required. If not required, check here <input type="checkbox"/>	13	500
	14	Other gains or (losses). Attach Form 4797	14	638

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 that greater than the original cost of the 4-wheeler. The \$500, as calculated on Line 32 of Form 4797, is reported on Lines 6, 7 and 9 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 13 of Form 1040 as illustrated above.

SCHEDULE D (Form 1040)	Capital Gains and Losses	OMB No. 1545-0074 2009 Attachment Sequence No. 12
Department of the Treasury Internal Revenue Service (99)	Attach to Form 1040 or Form 1040NR. See Instructions for Schedule D (Form 1040). Use Schedule D-1 to list additional transactions for lines 1 and 8.	
Name(s) shown on return FRAZIER FIRR		Your social security number 999-88-7777

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 page D-2 of the instructions	13		
14 Long-term capital loss carryover. Enter the amount, if any, from line 15 of your Capital Loss Carryover Worksheet on page D-7 of the instructions	14	()
15 Net long-term capital gain or (loss). Combine lines 8 through 14 in column (f). Then go to Part III on the back	15	500	

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.

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 are qualified 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 enjoy 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.

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.

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 2009, 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 (99)

Sales of Business Property
(Also Involuntary Conversions and Recapture Amounts
Under Sections 179 and 280F(b)(2))

▶ Attach to your tax return. ▶ See separate instructions.

OMB No. 1545-0184

2009
Attachment
Sequence No. 27

Name(s) shown on return

LAQUE TOOSE

Identifying number

111-22-3333

1 Enter the gross proceeds from sales or exchanges reported to you for 2009 on Form(s) 1099-B or 1099-S (or substitute statement) that you are including on line 2, 10, or 20 (see instructions)

1

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 RAISED, HELD > 2 YEARS	VARIOUS	VARIOUS	20,000	-0-	-0-	20,000

3 Gain, if any, from Form 4684, line 43

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

20,000

Partnerships (except electing large partnerships) and S corporations. Report the gain or (loss) following the instructions for Form 1065, Schedule K, line 10, or Form 1120S, 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 did not 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

20,000

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, similar to Example 2 above, so that these cull cows will receive capital gains income tax treatment as well as escaping 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.

Conclusion

Obviously, Examples 1, 2 and 3 are simplified to illustrate the correct reported 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, through the course of a year, may have several such transactions that will be combined on the tax return.

Other animals held for breeding, such as goats, 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).

Operators are encouraged to properly record these transactions in their business records so that they themselves 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 disposition of assets.
- **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 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.

The land-grant universities involved in Rural Tax Education are affirmative action/equal opportunity institutions.