

# 2023 National Income Tax Workbook

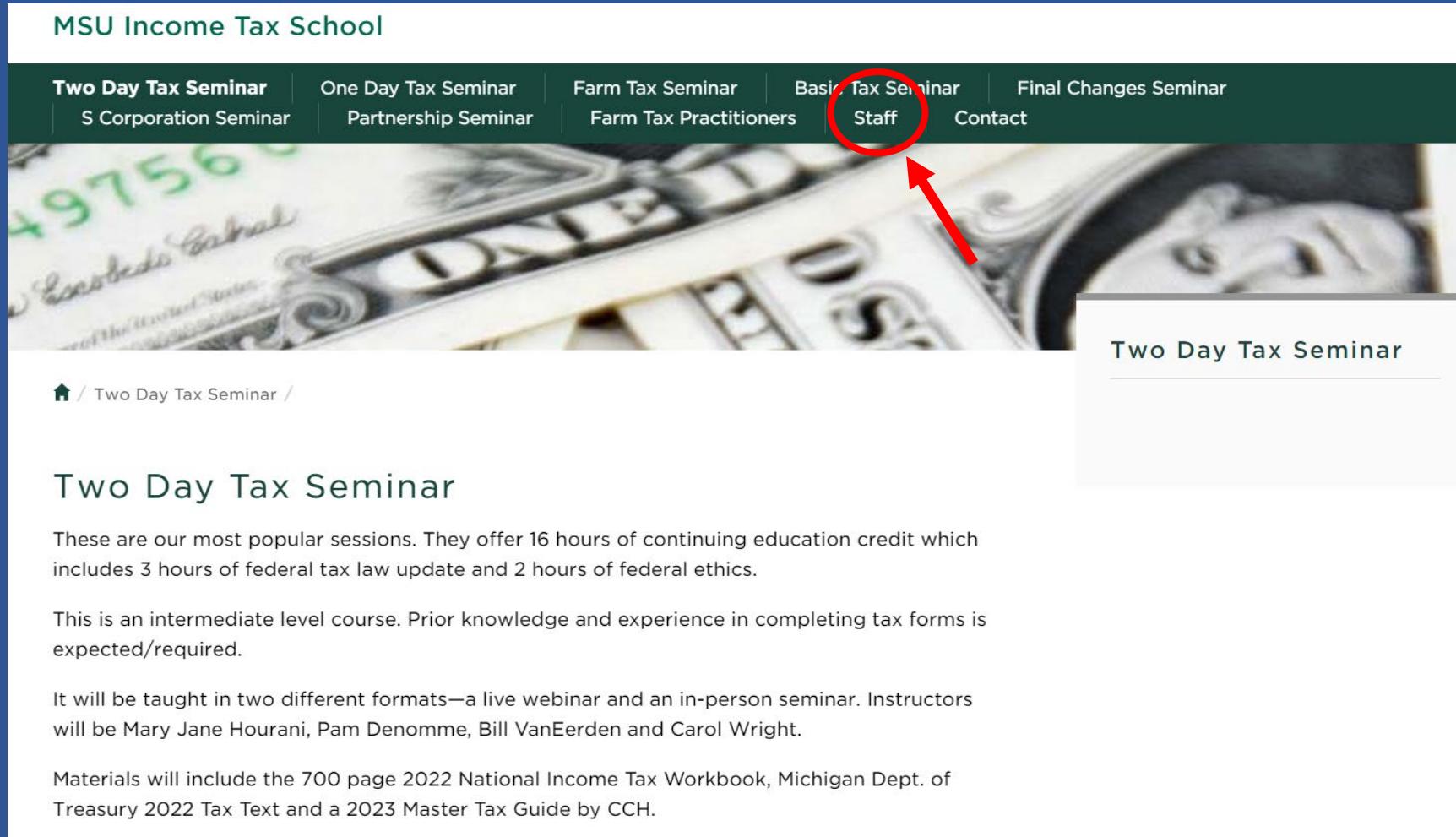
Chapter 4: Form 4797  
Sale of Business Property  
PP 125-162



# Power point slides – 2 ways!

[www.canr.msu.edu/taxschool/2023-two-day-tax-seminar-powerpoint-slides](http://www.canr.msu.edu/taxschool/2023-two-day-tax-seminar-powerpoint-slides)

OR



**MSU Income Tax School**

Two Day Tax Seminar | One Day Tax Seminar | Farm Tax Seminar | Basic Tax Seminar | Final Changes Seminar  
S Corporation Seminar | Partnership Seminar | Farm Tax Practitioners | **Staff** | Contact

Two Day Tax Seminar

Home / Two Day Tax Seminar /

## Two Day Tax Seminar

These are our most popular sessions. They offer 16 hours of continuing education credit which includes 3 hours of federal tax law update and 2 hours of federal ethics.

This is an intermediate level course. Prior knowledge and experience in completing tax forms is expected/required.

It will be taught in two different formats—a live webinar and an in-person seminar. Instructors will be Mary Jane Hourani, Pam Denomme, Bill VanEerden and Carol Wright.

Materials will include the 700 page 2022 National Income Tax Workbook, Michigan Dept. of Treasury 2022 Tax Text and a 2023 Master Tax Guide by CCH.

On cell phone, hit menu first

# Bill VanEerden

---



## Contact Me

**Instructor**

MSU Income Tax School

## Related Work

[Chapter 4 - Business Tax Issues](#)

[Chapter 7 - Partnership Issues](#)

[Chapter 3 - Agriculture & Natural Resources Issues \(Bill\)](#)

p. 125

Follow along in book



End of topic  
Questions?

X

# Learning Objectives

p. 125

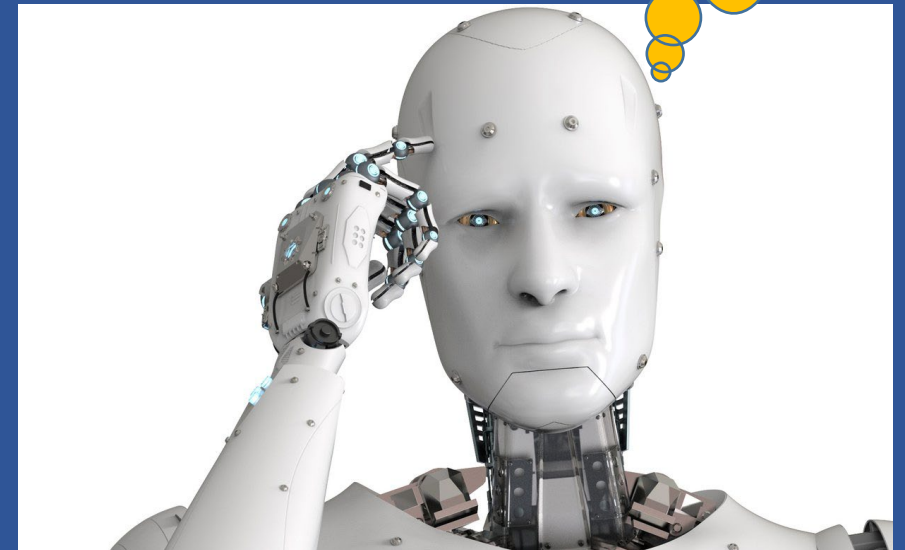
- ★ Understand 1231 transactions
- ★ Know how to *calculate* and *report* (on 4797)
  - \* Sale of 1231 property
  - \* Depreciation recapture
  - \* Gain on an installment sale
  - \* 179 and 280F Recapture

- ✦ Taxpayers must use Form 4797 (not report directly on 1040)
- ✦ Besides 1231 transactions, collection point for:
  - Installment sales – Form 6252
  - Like Kind exchanges – Form 8824
  - Casualty and theft gains and losses - Form 4684
  - Recapture – 179 and 280F

# Key Terms

p. 126

- ★ Boot (in like kind exchange)
- ★ Realized Gain  
Less Deferred Gain  
= Recognized gain
- ★ Different types of property
  - 1231 Property
  - 1245 Property
  - 1250 Property
  - Listed Property - recapture



# 1231 Property

p. 127

- Includes both depreciable and nondepreciable assets used in a trade or business
- Meet holding period
- ★ **BIG BENEFIT:**
  - Net gain is generally treated as Capital Gains
  - Net loss deductible as an Ordinary Loss
- **BUT, LIMIT ON THIS BIG BENEFIT:**
  - Net 1231 gains for the current tax year is reduced by the nonrecaptured net section 1231 losses in previous 5 years.



# 1231 Transactions

p. 127

1. Sale of *real* or *depreciable personal property*
2. Sale of leaseholds used in a trade or business
3. – 6. Certain Farm assets
7. Condemnation of business property
8. Casualty or theft of business property

# HOLDING PERIOD

Most property must be held for than 12 months.  
(Special rules for livestock)



# EXCLUDED PROPERTY

p. 128

Inventory / Primarily for sale to customers

Patent

US Government Publication

Property expenses under de minimis rule



# EXCLUDED GAIN

p. 128

## IRC 1239 – ORDINARY INCOME

Sale of depreciable property between certain related taxpayers

Strange – “related taxpayers” does not include family members!

# FORM 4797: BIG PICTURE

p. 129

PART I – calculates what is eligible for Capital Gains treatment

PART II – calculates what is taxed as ordinary income

PART III – calculates depreciation recapture (1245 / 1250)

PART IV – recapture under 179 and 280F

## Transactions without recapture (Part III)

Line 2 – Description – continuation sheet, if needed

Line 3 – Form 4684 – Casualty

Line 4 – Form 6252 – Installment sales

Line 5 – Form 8824 – Like Kind Exchanges

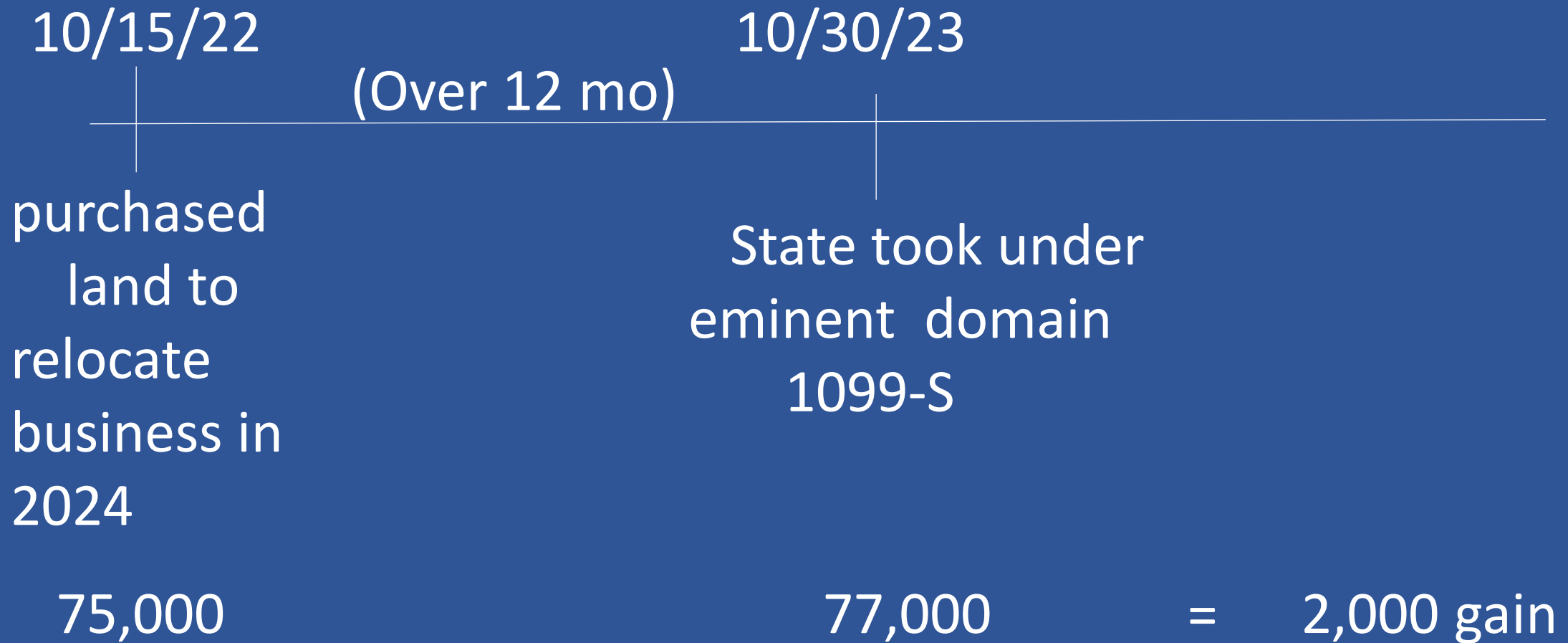
Line 6 – From Part III – portion that qualifies for Capital Gains

Line 7 – NET

- If no nonrecaptured 1231 losses, goes to Schedule D
- If nonrecaptured 1231 losses, that portion goes to Part II

# Example 4.1

p. 129 - 130



SEE PAGE 130 FOR 4797

# Example 4.2 – netting gains and losses





## Example 4.2 – netting gains and losses

Since there is a loss on the equipment, there is no 1245 depreciation recapture. No need to complete Part III.

See Form 4797 on page 131

- 120,000 listed on line 1a
- Land – detail listed
- Equipment – various is OK
- Net the loss against the gain and report as capital gains.

## **Part II captures the ordinary income.**

**Line 10** - Report gains or losses on sale of property that does not qualify under 1231. I.e: not held the required holding period.

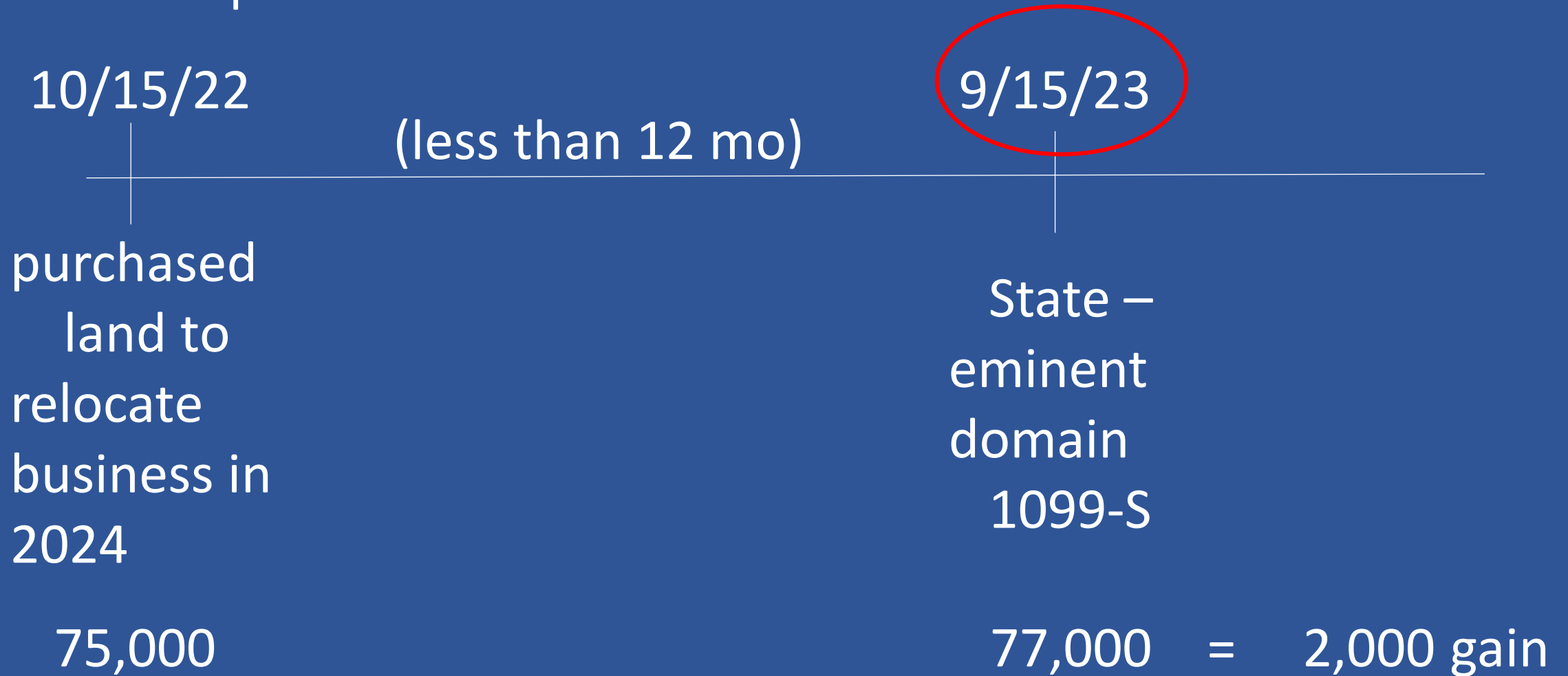
**Line 11** – loss from Part I

**Lines 12 – 16** reports ordinary gains from:

- Recapture
- Casualties
- Installment sales
- Like kind exchanges

# Example 4.4

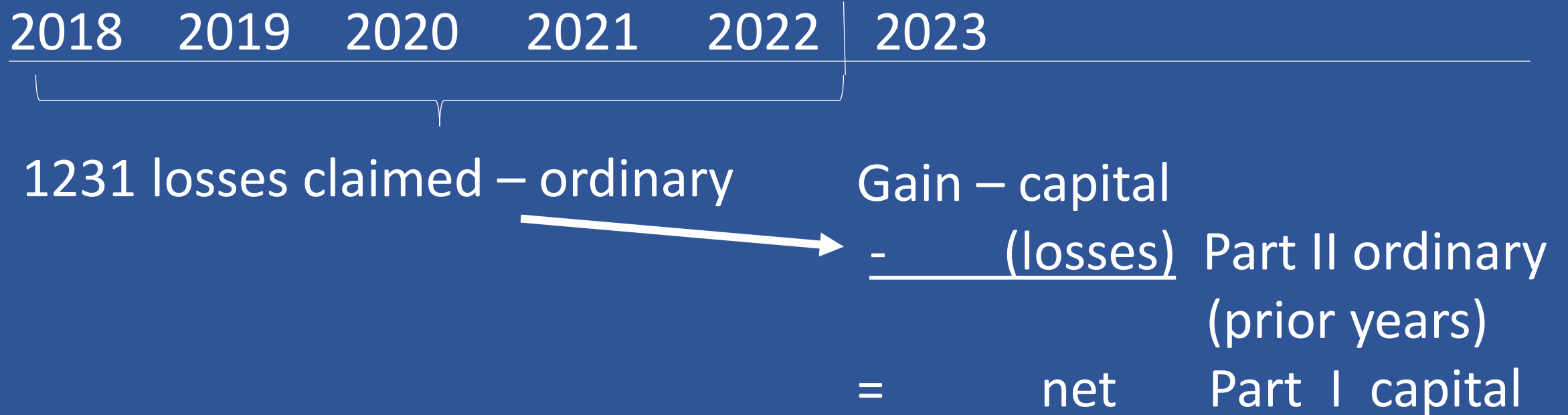
p. 133 - 134



SEE PAGE 134 FOR 4797 – Part II

# Nonrecaptured Section 1231 losses

p. 134



Losses recaptured in  
order occurred

# Example 4.5 recapture 1231 losses

p. 134 - 136

	2019	2020	2021	2022	2023
1231 gains(loss)	(15,000)	5,000	4,000	2,000	6,000
	5,000	ordinary			
	4,000		ordinary		
	2,000			ordinary	
	<u>4,000</u>				ordinary
	-0-				2,000

rest capital

See Page 136 for Form 4797

# DEPRECIATION RECAPTURE

	1245	1250
GAIN	xxx,xxx	xxx,xxx
Depr allowed/ allowable	(xx,xxx) ordinary	
Depr over straight line	<u>          </u>	<u>(xx,xxx)</u> ordinary
Capital Gain	xxx,xxx	xxx,xxx

# FORM 4797 – PART III

p. 138

- ★ Each property calculated separately
- ★ Lines 20 – 23 calculated for each property:
  - Sales price
  - Cost plus expenses of sale
  - Depreciation allowed / allowable
  - Adjusted basis
  - Gain
- ★ Lines 25 – 29
  - Determines recapture amount
- ★ Lines 30-32 bifurcate ordinary and capital

Turn to  
pg 141

# Recomputed Basis

p. 139

***Original Cost***

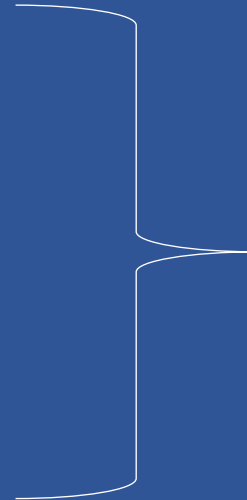
**200,000**

or

***Adjusted basis***

**150,000**

- Credits that reduce basis
- Depreciation 168
- 179 election
- 179A, 179B, 179C, 179D, 179E
- 190, 193, 194, 197, 198, 198A



**50,000**

***Recomputed Basis***

**200,000**




# Example 4.6

p. 139

Recomputed basis?

Cost	reconcile	Adjusted Basis	42,240
120,000		Section 179	10,000
		accum depr	<u>67,760</u>
		recomputed basis	120,000



 Need to know what reduced cost. Require recapture?

# Example 4.6

p. 141

## Page 141

**19 (a)** Description of section 1245, 1250, 1252, 1254, or 1255 property:

**A** Loader

**B**

**C**

**D**

These columns relate to the properties on lines 19A through 19D.		Property A	Property B
<b>20</b>	Gross sales price ( <b>Note:</b> See line 1a before completing.) . . . . .	20	75,000
<b>21</b>	Cost or other basis plus expense of sale . . . . .	21	120,000
<b>22</b>	Depreciation (or depletion) allowed or allowable. . . . .	22	77,760
<b>23</b>	Adjusted basis. Subtract line 22 from line 21. . . . .	23	42,240
<b>24</b>	Total gain. Subtract line 23 from line 20 . . . . .	24	32,760
<b>25</b>	<b>If section 1245 property:</b>		
<b>a</b>	Depreciation allowed or allowable from line 22 . . . . .	25a	77,760
<b>b</b>	Enter the smaller of line 24 or 25a. . . . .	25b	32,760
<b>26</b>	<b>If section 1250 property:</b> If straight line depreciation was used, enter -0- on line 26c, except for a corporation subject to section 391		

179      10,000  
 Depr      67,760  
 Total      77,760

# Section 1250 recapture

p. 142

## **BASIC 1250 CONCEPTS**

Depreciable real property that has never been section 1245 property

Gain on 1250 property held longer than 1 year is capital, but depreciation over straight line is ordinary.

Portion of gain equivalent to straight line depreciation is taxed at maximum rate of 25%

# EXAMPLE 4.7

p. 142 - 146

7/1/2013	
Building	100,000
Land	<u>20,000</u>
Total	120,000



*Just the facts ma'am*

7/2/2023 basis	
Building	100,000
Depreciation	<u>(55,385)</u>
Adjusted basis	44,615
Land basis	<u>20,000</u>
Basis	64,615

7/2/2023	
Sold for 250,000:	
Building	207,500
Land	<u>42,500</u>
	250,000

Gain
185,385

# EXAMPLE 4.7

## Steps

- Calculate straight line depreciation on the building – 50,000

- Calculate excess depreciation over straight line:

$$55,365 - 50,000 = \mathbf{5,365} \text{ ordinary income}$$

- Determine the amount of “unrecaptured section 1250 gain:

**50,000** taxed at a maximum rate of 25%

- Calculate section 1231 gain – taxed at maximum 20%

building	207,500	-	100,000	=	<b>107,500</b>
----------	---------	---	---------	---	----------------

land	42,500	-	20,000	=	<b>22,500</b>
------	--------	---	--------	---	---------------

$$\mathbf{5,365 + 50,000 + 107,500 + 22,500 = 185,365}$$

# EXAMPLE 4.7

p. 142 - 146

**Go to Pages 145 - 146**

How to prepare 4797

Land – easy – goes in Part 1

22,500 gain

Building – because recapture required, must complete Part III.

Lines 20 – 24 calculates overall gain - 162,885

Line 26a and 26b – calculates recapture – 5,385

Lines 30 – 32 calculates the capital gains portion – 157,500

Back to front of 4797: 180,000 Capital Gains

5,385 Ordinary Income



# Installment Sales

- ★ Nondealer sales
- ★ At least one payment received in a tax year after the year of sale
- ★ Defers recognition of income
- ★ Will look at:
  - ★ Eligibility
  - ★ Gain calculation
  - ★ When debt paid or assumed
  - ★ Depreciation recapture

# Installment Sales - eligibility

p. 147

- ★ Real or personal property that is not inventory
- ★ 4 criteria
  - ★ Cannot be a “dealer”
  - ★ Must be a gain (losses deductible in year of sale)
  - ★ At least one payment deferred to later year
  - ★ Gain cannot be recapture gain
- ★ Default method. Can elect out

That's the  
tie in to  
the 4797

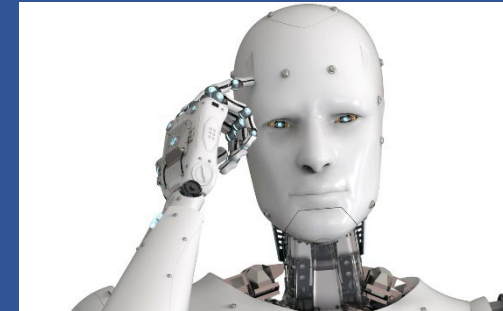




# Installment Sales - Terms

p. 147 - 148

- ★ Selling Price
- ★ Contract price
- ★ Qualified indebtedness
- ★ Gross Profit
- ★ Gross profit %
- ★ Contingent payment sale



## SELLING PRICE

- ★ Gross selling price – No reduction for mortgages or selling expenses
- ★ Includes:
  - ★ Cash
  - ★ FMV other property
  - ★ Debt seller assumes

# Installment Sales - Terms

p. 147 - 148

## **CONTRACT PRICE**

Selling price

Less : part of qualifying indebtedness assumed or  
taken by the buyer

= Contract price

## QUALIFIED INDEBTEDNESS

- ★ Encumbering the property
- ★ Debt not secured by the property, but assumed by the buyer incident to the acquisition

# Installment Sales - Terms

p. 147 - 148

## **GROSS PROFIT**

Selling price

Less: adjusted basis

(commissions and other selling  
expenses added to basis)

= gross profit

# Installment Sales - Terms

p. 147 - 148

## GROSS PROFIT %

$$\frac{\text{gross profit}}{\text{contract price}} = \text{gross profit \%}$$

# Depreciation Recapture

Only the gain in excess of any depreciation recapture may be reported using the installment method

1.

Complete part III of Form 4797. Recapture reported as ordinary income for *year of sale.*

2.

To avoid double taxation, the recapture amount is added back to basis for computing gross profit and gross profit %. Part I, line 12 form 6252.

3.

Unrecaptured 1250 gain may be reported on the installment method. (recognized first)

# Example 4.10

p. 149 - 154

Dale



December 2023

Purchased	290,000
Depreciation	<u>(90,000)</u>
Basis	200,000

Selling price	320,000
(100,000 down & 44,000 x 5 years Starting in 2024)	

**Could you complete the 4797 and 6252?**



# Example 4.10

p. 149 - 154

## Overall calculation

Selling price	320,000
Basis	<u>(200,000)</u>
Gain	120,000

Pg 153

## Recapture – Form 4797 – PART 3

Depreciation claimed	90,000
1245 property –	all ordinary income

Write N/A on line 20 because the capital gains portion is being reported on the installment method

# Example 4.10

p. 149 - 154

## Gross Profit calculation

Selling price		320,000
Basis	200,000	
Depreciation recapture	90,000	
Adj basis for gross profit		<u>(290,000)</u>
Gross profit		30,000

Pg 154

## Gross Profit percentage calculation

Gross profit	<u>30,000</u>	= 9.375%
Selling price	320,000	

# Example 4.10

p. 149 - 154

## Gross profit to be recognized

Payments received in 2023	100,000
Gross profit %	<u>9.375%</u>
Gain to be reported	9,375

Where do you report the 9,375?

Form 4797 Part 1, line 4 – Capital Gains  
Schedule D, line 11

# Example 4.10

p. 149 - 154

How does Dale report the payments received in subsequent years?

Payments received each year	44,000
Gross profit %	<u>9.375%</u>
Gain to be reported	4,125

Proof that it all works out:

Gain reported in 2023	9,375
Gain reported in 2024 – 2028	
4,125 x 5 =	<u>20,625</u>
total	30,000

If a taxpayer has both installment sales and sales that are not installment sales, prepare 2 4797s. On the installment sale 4797, put N/A on line 32 because that gain is transferred to the Form 6252.

# Unstated Interest

p. 155



Installment sales must provide for adequate interest.



If it does not, part of the stated principal recharacterized as interest.



Seller reports the unstated interest as ordinary income.



Adequate interest is tested against the *Applicable Federal Rate*.



# Unstated Interest

p. 155

 Applies to any installment sale payments due more than 6 months after date of sale 

 When total sales price  $> 3,000$  

 Contract calls for interest  $<$  test rate. 

# Unstated Interest

p. 155

At least  
equal to:

## Contract

- Stated interest
- Appropriate compounding

## Applicable Federal Rate (published monthly)

1. Short term – up to 3 year
2. Mid-term – 3 – 9 years
3. Long-term - > 9 years





# Related Party Installment Sales

p. 155 - 156

Original  
Sale

All payments

2 years

Earlier of

Related party sells property

Original seller is treated as receiving the amount realized on the 2<sup>nd</sup> disposition, regardless of whether the related person makes a payment to the original seller.

# Related Party Installment Sales

p. 155 - 156

## Why is this rule necessary?



Installment sale



Cash sale



Defers gain

No gain

26 Subtract line 25 from line 24. Enter here and on Schedule D or Form 4797. See instructions . . . . . **26**

**Part III Related Party Installment Sale Income. Don't complete if you received the final payment this tax year.**

27 Name, address, and taxpayer identifying number of related party \_\_\_\_\_

28 Did the related party resell or dispose of the property ("second disposition") during this tax year? . . . . .  Yes  No

29 **If the answer to question 28 is "Yes," complete lines 30 through 37 below unless one of the following conditions is met. Check the box that applies.**

- a  The second disposition was more than 2 years after the first disposition (other than dispositions of marketable securities). If this box is checked, enter the date of disposition (mm/dd/yyyy) . . . . . \_\_\_\_\_
- b  The first disposition was a sale or exchange of stock to the issuing corporation.
- c  The second disposition was an involuntary conversion and the threat of conversion occurred after the first disposition.
- d  The second disposition occurred after the death of the original seller or buyer.
- e  It can be established to the satisfaction of the IRS that tax avoidance wasn't a principal purpose for either of the dispositions. If this box is checked, attach an explanation. See instructions.

30	Selling price of property sold by related party (see instructions) . . . . .	<b>30</b>	
31	Enter contract price from line 18 for year of first sale . . . . .	<b>31</b>	
32	Enter the <b>smaller</b> of line 30 or line 31 . . . . .	<b>32</b>	
33	Total payments received by the end of your 2022 tax year (see instructions) . . . . .	<b>33</b>	
34	Subtract line 33 from line 32. If zero or less, enter -0- . . . . .	<b>34</b>	
35	Multiply line 34 by the gross profit percentage on line 19 for year of first sale . . . . .	<b>35</b>	
36	Enter the part of line 35 that is ordinary income under the recapture rules. See instructions . . . . .	<b>36</b>	
37	Subtract line 36 from line 35. Enter here and on Schedule D or Form 4797. See instructions . . . . .	<b>37</b>	



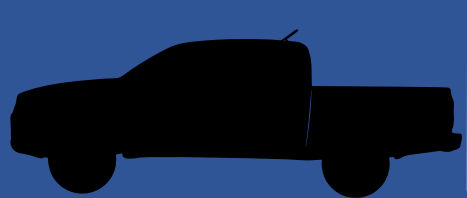
# IRC 179 Recapture

p. 157

- ★ Basically, 179 expensing = depreciation
- ★ When asset sold, 179 treated as depreciation that is subject to ordinary income recapture.
- ★ Property must be used > 50% to qualify for 179.
- ★ If business % drops below 50% before end of recovery period, the excess over MACRS is recaptured as ordinary income.

# Example 4.11

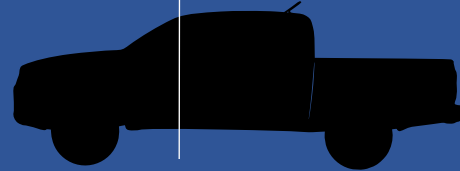
p. 157- 158



100%

2021

2022



40%

2023

Cost 28,000

179 (10,000)

Bal 18,000

MACRS on the 10,000:

2,000 + 3,200 + 768 = 5,968

recapture excess over MACRS

**Recapture 4,032  
Part IV 4797**

# Example 4.11

p. 157- 158

Where does Kelly report the 4,032 after it is reported on Part IV of Form 4797? Line 35 says “see instructions”

Schedule C – Other Income!  
So subject to SE Tax!!

# Observation

p. 158

179 recapture because  
% drops below 50%

Subject to SE Tax

179 recapture because  
asset sold

not Subject to SE Tax

*Listed Property* that is subject to MACRS and satisfies the “more than 50% use test” is eligible for bonus depreciation.

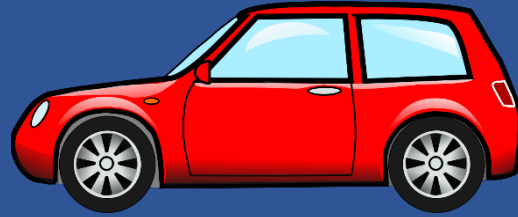
## ***HOWEVER***

If the business use falls below 50%, only straight line depreciation is allowable and the taxpayer must recapture excess depreciation.



# Example 4.12

p. 159



2021

2022

2023

34,000

x 70% business

23,800 eligible – 179

2,975 took 179

20,875 MACRS 5 years

x 20%

4,165 MACRS

Business use  
20%

**NOW WHAT?**

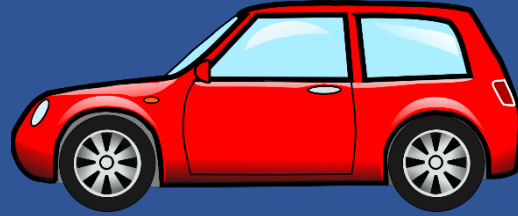
20,825

x 32%

6,664 MACRS

**13,664 claimed**

# Example 4.12



p. 159 - 160

2021

2022

2023

34,000

x 70% business

23,800 eligible

x 10% ADS S/L

2,380

+

23,800

x 20% ADS S/L

4,760

=

Business use

20%

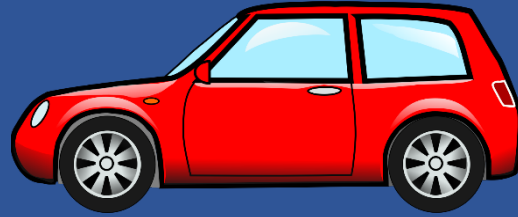
7,140 allowed

13,804 claimed

6,664 recapture

4797 Part IV

# Example 4.12



p. 159 - 161

2021

2022

2023

Straight line



34,000	Cost
<u>(7,140)</u>	Depreciation
26,860	Basis
<u>x 20%</u>	business
5,372	
<u>x 20%</u>	S/L 5 years
1,074	

# Look at page 162

Where to report certain items on the 4797



Any  
Questions