

**Abstract:** The sale of business or trade property can be subject to many rules, depending on the details. Factors that affect the taxability of the sale include the type of property, the primary use and how long the property was held. This article gives a rundown of the rules.

## **Selling trade or business property? Know the tax effects**

Many rules can potentially apply to the sale of business property, but what are the tax consequences? For simplicity, let's assume that the property you want to sell is depreciable property used in your business and you've held it for more than a year. (Different rules apply based on property type, such as property held for sale to customers, intellectual property, low-income housing, and farming or livestock property.)

### **General rules**

Under the Internal Revenue Code, your gains and losses from sales of business property are netted against each other. The net gain or loss qualifies for tax treatment as follows:

1. If the netting process results in a net gain, then long-term capital gain treatment results, subject to "recapture" rules discussed below. This treatment is generally more favorable than ordinary income treatment.
2. If the netting of gains and losses results in a net loss, that loss is fully deductible against ordinary income (so, none of the rules that limit the deductibility of capital losses apply).

### **Recapture rules**

The availability of long-term capital gain treatment for business property net gain is limited by recapture rules. Recapture rules specify that amounts are treated as ordinary income rather than capital gain because of previous ordinary loss or deduction treatment for these amounts (such as depreciation, for example).

There's a special recapture rule that applies only to business property. Under this rule, to the extent you've had a business property net loss within the previous five years, any business property net gain is treated as ordinary income, not as long-term capital gain.

### **More tax code details**

Here are some more details about two types of property:

**Section 1245 property.** This is all depreciable personal property, tangible or intangible, and certain depreciable real property (usually, real property with specific functions). If you sell this

property, you must recapture your gain as ordinary income to the extent of your earlier depreciation deductions on the asset.

**Section 1250 property.** This type of property generally includes buildings and their structural components. If you sell such property that was placed in service after 1986, none of the long-term capital gain attributable to depreciation deductions will be subject to depreciation recapture. (Additional rules apply for Section 1250 property placed in service before 1987.)

However, for most noncorporate taxpayers, the gain attributable to depreciation deductions up to the amount of the business property net gain will be taxed at no higher than 28.8% (as reduced by the business property recapture rule above). That's 25% adjusted for the 3.8% net investment income tax, rather than the maximum 23.8% rate (20% adjusted for the 3.8% net investment income tax) that generally applies to long-term capital gains of noncorporate taxpayers.

### **Proceed with caution**

As you can see, the tax treatment of the sale of business assets can be complex. Contact us for help with specific transactions or additional questions.

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