Recapture of §179 deductions

Abstract:
The §179 expense deduction is recaptured when the business use of the qualifying property drops to 50% or less. The material discusses how to compute the recapture amount and where to claim it on the tax return.

ISSUE 6: RECAPTURE OF I.R.C. §179 DEDUCTIONS

An I.R.C. §179 recapture is triggered when the **business use** of property placed in service in a previous year is reduced to 50% or less during the recapture period. The recapture period of the expense election is the entire recovery period of the qualifying I.R.C. §179 property I.R.C. §179(d)(10).

The **recapture amount** (reported on Form 4797) equals the I.R.C. §179 expense deduction taken minus the MACRS depreciation amount that **would have been allowed** on the expense amount from the time the property was placed in service up to and **including** the year of recapture [Treas. Reg. §1.179-1(e)(1)].

Listed Property

If an I.R.C. §179 deduction is claimed on listed property, and the business use of the property later falls to 50% or less, the I.R.C. §179 recapture is included with the recapture of the excess depreciation I.R.C. §280F(d). The I.R.C. §280F(b)(2) recapture rule requires the taxpayer to report as income the difference between the depreciation and §179 deduction that has been claimed, and the depreciation that would have been allowed using the alternative MACRS depreciation rules.

Listed property includes any of the following:

1. Any passenger automobile

2. Any other property used for transportation

3. Any property of a type generally used for entertainment, recreation, or amusement (including photographic, phonographic, communication, and video recording equipment)

4. Any computer and related peripheral equipment, unless it is used only at a regular business establishment and is owned or leased by the person operating the establishment. A regular business establishment includes a portion of a dwelling unit if and only if that portion is used both regularly and exclusively for business

5. Any cellular telephone (or similar telecommunication equipment) placed in service or leased in a tax year beginning after 1989

Example 1. Steve Jones paid $10,000 for a horse trailer in 1998. Steve used the trailer 80% in his farming business and 20% for personal use. Therefore, his basis in the portion used for business was $8,000. He claimed a $6,000 I.R.C. §179 deduction for the trailer on his 1998 income tax return. He depreciated the remaining $2,000 business basis using MACRS. He deducted the following depreciation:

Year	Depreciation Rate	Depreciation Basis	Depreciation Amount
1998	15.00%	$2,000	$300
1999	25.50%	$2,000	$510
2000	17.85%	$2,000	$358
			$1,168

The total depreciation deducted through 2000 is $7,168.

In 2001, Steve used the trailer only 40% for business. Therefore, he must recapture the I.R.C. §179 deduction and depreciation claimed to the extent they exceed the depreciation that is allowed under alternative MACRS. The recapture is calculated as follows:

Alternative MACRS Depreciation Allowable (Straight-Line Method)					
Year		**Depreciation Rate**		**Depreciation Basis**	**Depreciation Amount**
1998		10.00%		$8,000	$ 00
1999		20.00%		$8,000	$1,600
2000		20.00%		$8,000	$1,600
					$4,000

Total depreciation taken $ 7,168
Total depreciation allowable $(4,000)
Excess depreciation recapture $ 3,168

Steve reports the recapture on Part IV of Form 4797. He carries the $3,168 recapture amount to his 2001 Schedule C, line 6 (Other Income). The $3,168 originally taken reduced his self-employment income in 1998–2000; likewise, the $3,168 recapture amount in 2001 is subject to self-employment tax.

Practitioner Note. Steve's depreciation for 2001 is zero. The $10,000 cost 40% business use gives a $4,000
business basis. When the $4,000 of depreciation claimed in prior years is subtracted, there is no remaining
business basis to be depreciated.

Other than Listed Property

If business use of property that is not listed property falls to 50% or below, the taxpayer must report as ordinary income the difference between the I.R.C. §179 expense claimed and the depreciation that **would have been allowed** on that amount had it not been expensed.

Example 2. In 1999 Needfor Speed bought a super-fast copier that cost $20,000. In 1999 and 2000 he used the machine 100% in his accounting business. He claimed $4,000 of his $20,000 business basis as an I.R.C. §179 deduction in 1999 and depreciated the remaining $16,000 business basis using 200% declining balance.

Year		**Depreciation Rate**		**Business Use**		**Depreciation Basis**		**Allowable Depreciation Amount**
1999		20.00%		100%		$4,000		$800
2000		32.00%		100%		$4,000		$1,280
2001		19.20%		40%		$4,000		$307.20
								$2,387.20

In 2001, Needfor's wife used the copier for her volunteering activities, which reduced his business use of the copier to 40%. That reduction in business use requires Needfor to report his excess I.R.C. §179 deduction as other income on line 10 of his 2001 Schedule C. The amount of the excess I.R.C. §179 deduction is calculated as follows:

The excess recapture amount is $1,612.80 ($4,000 $2,387.20). Needfor reports the recapture amount on Form 4797. He also reports $1,612.80 as other income on his 2001 Schedule C, line 6 (other income)
and adds that amount to the basis of the printer at the beginning of 2001.