of reporting depreciation recapture depends on whether the depreciation was recaptured because business use dropped to 50% or less, or recaptured because the vehicle was sold.

**Reporting depreciation recapture when vehicle is sold.** Depreciation recapture due to the sale of a vehicle is reported on Part III, Form 4797. The gain flows through from Form 4797 and depreciation recapture is reported on Schedule D (Form 1040), Capital Gains and Losses. See Sales of Business Property, Tab 6.

**Reporting depreciation recapture when business use drops to 50% or less.** Depreciation recapture due to business use falling to 50% or below is computed on Part IV, Form 4797, and is then carried to the form or schedule on which the depreciation was originally deducted. For a sole proprietor, depreciation recapture is carried to Schedule C (Form 1040) and reported as other income. Depreciation recaptured because business use dropped to 50% or less will also increase self-employment tax for the year of recapture.

**Sale of Business Auto**

If a vehicle used for business is sold, the portion of any gain that represents depreciation allowed or allowable, including the Section 179 expense and the special depreciation allowance, is recaptured as ordinary income. The amount recaptured is the lesser of the gain from the sale or the depreciation allowed or allowable.

**Depreciation in year of sale.** Under general MACRS rules, under the half-year convention, depreciation in the year of sale is generally 50% of the total MACRS deduction that would have been allowed if there was no sale. An exception to this is if the auto was originally placed in service under the mid-quarter convention rules. See Conventions, Tab 9.

**Section 280F limit in year of sale.** The depreciation limitation under section 280F in the year of sale is the same as if the auto was not sold during the year. Even if the half-year or mid-quarter convention applies, the full section 280F limit is available.

**Example:** Edy purchased a car for $30,000 on June 1, 2016, and used it 90% for business in 2016, 2017, and 2018 before selling it on July 1, 2018.

Assume no Section 179 expense or special depreciation allowance was taken. Depreciation allowed or allowable is calculated as follows.

<table>
<thead>
<tr>
<th>Year</th>
<th>Depreciation Allowed or Allowable</th>
<th>Total Depreciation Claimed</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>$30,000 × 90% × 20% = $5,400</td>
<td>$17,379</td>
</tr>
<tr>
<td>2017</td>
<td>$30,000 × 90% × 32% = $8,640</td>
<td></td>
</tr>
<tr>
<td>2018</td>
<td>$30,000 × 90% × 19.2% × 50% = $2,592</td>
<td></td>
</tr>
</tbody>
</table>

**Business Auto Trade-In Rules**

**TCA** Prior to 2018, when a business auto was traded in for a new vehicle, like-kind exchange rules applied and any gain on the transaction could be deferred. See Trade-Ins Before 2018, next column. Beginning in 2018, personal property, including vehicles, is not covered under like-kind exchange provisions. Under the new rules, trade-in of a vehicle is reported as two transactions, the sale of the old vehicle and the purchase of a new one. See Like Kind Exchanges (Form 8824), Tab 6.

**Trade-Ins Before 2017**

For trade-ins of business autos after 2017, the transaction is treated as the sale of the old auto and purchase of the new one. Unlike prior year rules, gain on the old auto cannot be deferred, and must be reported on Form 4797, Sales of Business Property.

**Example:** Mark traded in his old car for a new one on July 1, 2018. He originally purchased the old car for $30,000 on June 1, 2016, and did not elect out of special depreciation in order to claim the higher first year limit under section 280F. Mark used the old car 90% for business in 2016, 2017, and 2018. Mark’s new car cost $45,000. The dealer gave Mark an allowance of $18,000 on his old car.

<table>
<thead>
<tr>
<th>Year</th>
<th>Basis at Trade ($30,000 – $17,379)</th>
<th>Gain on Sale Reported on Form 4797</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>$19,800 × 32% = $6,336</td>
<td>$12,621</td>
</tr>
<tr>
<td>2017</td>
<td>$18,000 × 90% = $16,200</td>
<td>$3,579</td>
</tr>
</tbody>
</table>

**Trade-Ins Before 2018**

For trade-ins before 2018, if a car was traded in for another car, the taxpayer had two options for treatment of the disposition.

1) The taxpayer could elect to treat the transaction as a tax-free disposition of the old car and the purchase of the new car. The old car was treated as disposed of at the time of the trade-in. The depreciable basis of the new car was the adjusted basis of the old car, figured as if 100% of the car’s use had been for business purposes, plus any additional amount paid for the new car. The depreciation deduction was then figured for the new car, beginning with the date it was placed in service.

2) If the election described in option #1, above, was not made, depreciation was figured separately for the remaining basis of the old car and for any additional amount paid for the new car. Two separate depreciation limits applied. The 280F limit that applied to the remaining basis of the old car generally was the amount that would have been allowed had the taxpayer not traded in the old car. The limit that applied to the additional amount paid for the new car generally was the limit that applied for that tax year, reduced by the depreciation allowance for the remaining basis of the old car.

For rules on how to use option #2, above, see IRS Pub. 946, How to Depreciate Property. The following applies to rules under option #1, as described above.

**Making the election.** To use the method under option #1, above, the taxpayer was required to make an election on a timely-filed tax return, including extensions. Self-employed taxpayers complete Form 4562 and attach a statement indicating Election is made under Regulation section 1.168(i)-6(i) for each property involved in the exchange.
Form 8824, Like-Kind Exchanges. Form 8824 is required to be filed if utilizing method #1.

100% business use. If the old car was used 100% for business, and is traded for a new car that will be used 100% for business, the original basis of the new car is the adjusted basis of the old car, plus any additional amount paid for the new car.

Example: Paul traded in a car that had an adjusted basis (after depreciation) of $3,000 for a new car. In addition, he paid cash of $17,000 for the new car. Basis in the new car for depreciation purposes equals $20,000.

Less than 100% business use. If the old auto was not used 100% for business, a trade-in adjustment must be made for personal use. The adjustment has the effect of reducing the basis in the old auto, but not below zero, for purposes of figuring depreciation for the new auto. The adjustment does not, however, affect basis for purposes of determining gain or loss on any subsequent sale of the new auto.

To figure the unadjusted basis of the new auto for depreciation purposes, first add the adjusted basis of the old auto plus any additional amount paid for the new auto. From this amount, subtract the excess, if any, of:
1) The total of the amounts that would have been allowable as depreciation during the tax years before the trade if 100% of the use of the auto had been business and investment use, over
2) The total of the amounts actually allowable as depreciation during those years. In the year of disposition, use 50% of the depreciation determined for a full year for property using the half-year-convention method.

Use the Business Auto Trade-In Worksheet, below, to make the calculation.

Business Auto Trade-In Worksheet

Election made under Regulation section 1.168(i)-6(i) to treat the trade-in as a tax-free disposition of the old car for depreciation purposes.

1) Enter original cost basis of old car plus any improvements minus any tax credits ........................................ 1)
2) Enter total depreciation allowed on old car, including Section 179 and special depreciation allowance.
   Year 1      Year 3      Year 5
   Year 2      Year 4      Year 6
   Total                    ................................................... 2)
3) Adjusted basis of old car. Subtract line 2 from line 1 ................................................................. 3)
4) Additional cash or boot paid for new car .......................................................... 4)
5) Basis of new car. Add line 3 plus line 4. This is the new car’s original basis for sales and exchange purposes .......................................................... 5)
6) Enter total depreciation of old car that would have been allowable if it had been used 100% for business each year.
   Year 1      Year 3      Year 5
   Year 2      Year 4      Year 6
   Total                    ................................................... 6)
7) Subtract line 2 from line 6 ................................................................. 7)
8) Basis for depreciation. Subtract line 7 from line 5. This is the new car’s basis for depreciation purposes only ................................................................. 8)

Leased Autos

The standard mileage rate is allowed for leased vehicles. If chosen, the standard mileage rate must be used for the first year placed in service and continued for the entire lease term.

If the taxpayer uses the actual expense method, the business percentage of each lease payment is allowed as a current deduction.

Lease down payment. The deduction for the down payment on business use of a leased vehicle is amortized over the lease term.

Example: Rico is a sole proprietor. He leased a car to use 100% for business. The lease term is 36 months, and Rico put a down payment of $2,500 toward the lease. His monthly lease payments are $450. Rico will use the actual expense method for deducting his auto expenses. Rico deducts $519 per month as a lease expense.

$2,500 down payment ÷ 36 months.......................... $69
Monthly lease payment ...........................................$450
Monthly lease expense ........................................... $519

Lease inclusion amount. To apply the section 280F limits to leased vehicles, the taxpayer’s expense for lease payments must be reduced. Although this reduction is called a “lease inclusion amount,” the amount must be subtracted from total lease payments made. This provision applies to vehicles leased for a term of 30 days or more, with a cost greater than $50,000 (2018).

For each tax year during the lease, determine the lease inclusion amount using the following steps.

1) Find the yearly inclusion amounts from the Lease Inclusion Tables, page 10-10, based on the FMV of the vehicle on the first day of the lease term.
2) Prorate the dollar amount shown by the number of days of the lease term included during the tax year.
3) Multiply the amount from (2) by the business percentage for the year. Subtract this amount from the lease payments made during the year to determine the allowable deduction for lease payments.

See Lease Inclusion Tables, page 10-10.

Example: Amber is a sole proprietor. She leased a car on January 17, 2018, and her first monthly lease payment is on February 1. The lease term is 36 months, and the FMV of the car is $59,500. Amber uses the car 75% for business each year. Her lease payment is $585 per month.

Using the Lease Inclusion Tables, page 10-10, Amber computes her lease inclusion amounts for each year as follows.

<table>
<thead>
<tr>
<th>Year</th>
<th>Tax Table</th>
<th>Proration</th>
<th>Business Percentage</th>
<th>Inclusion Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>$26</td>
<td>349/365</td>
<td>75%</td>
<td>$19</td>
</tr>
<tr>
<td>2019</td>
<td>$57</td>
<td>365/365</td>
<td>75%</td>
<td>$43</td>
</tr>
<tr>
<td>2020</td>
<td>$85</td>
<td>366/366</td>
<td>75%</td>
<td>$64</td>
</tr>
<tr>
<td>2021</td>
<td>$101</td>
<td>16/365</td>
<td>75%</td>
<td>$3</td>
</tr>
</tbody>
</table>

For 2018, the lease inclusion amount of $19 is subtracted from Amber’s total lease payments reported as expenses on Schedule C (Form 1040).

Lease payments (11 × $585 × 75%) ......................... $4,826
Lease inclusion amount ........................................ (19)
Lease expense deduction on Schedule C (Form 1040) ...... $4,807