Publication 550

Investment Income and Expenses

(Including Capital Gains and Losses)

For use in preparing

2022 Returns

Volume 6 of 9

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Table 4-2. **Example of How To Figure Basis of Shares Sold**

This is an example showing two different ways to figure basis. It compares the cost basis using the FIFO method with the average basis method.

Date	Action	Share Price	No. of Shares	Total Shares Owned
2/10/2020	Invest $4,000	$25	160	160
8/11/2020	Invest $4,800	$20	240	400
12/15/2020	Reinvest $300 dividend	$30	10	410
10/2/2022	Sell 210 shares for $6,720	$32	210	200

COST BASIS (FIFO)

To figure the basis of the 210 shares sold on 10/2/2022, use the share price of the first 210 shares you bought, namely the 160 shares you purchased on 2/10/2020 and 50 of those purchased on 8/11/2020.

$4,000 (cost of 160 shares on 2/10/2020)
\+ $1,000 (cost of 50 shares on 8/11/2020)
Basis = $5,000

AVERAGE BASIS

To figure the basis of the 210 shares sold on 10/2/2022, use the average basis of all 410 shares owned on 10/2/2022.

$9,100 (cost of 410 shares)
÷ 410 (number of shares)
$22.20 (average basis per share)

$22.20
× 210
Basis = $4,662

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Nontaxable Trades

This section discusses trades that generally do not result in a taxable gain or a deductible loss. For more information on nontaxable trades, see chapter 1 of Pub. 544, Sales and Other Dispositions of Assets.

Like-Kind Exchanges

If you trade business or investment real property solely for other business or investment real property of a like kind, you do not pay tax on any gain or deduct any loss from the trade. To be nontaxable, a trade must meet all six of the following conditions.

1. The property must be business or invest-ment property. You must hold both the property you trade and the property you receive for productive use in your trade or business or for investment. Neither prop-erty may be property used for personal purposes, such as your home or family car.

2. The property you trade and the property you receive must be real property.
3. There must be a trade of like-kind property. The trade of real estate for real estate is a trade of like-kind property. The trade of an apartment house for a store building is a trade of like-kind property. Real property located in the United States and real property located outside the United States are not like-kind property.
4. The property must not be held primarily for sale. The property you trade and the property you receive must not be property you sell to customers, such as merchandise.
5. The property to be received must be identified in writing within 45 days after the date you transfer the property given up in the trade. If you received the replacement property before the end of the 45-day period,

you are automatically treated as having met the 45-day written notice requirement.

6. The property to be received must be received by the earlier of:
   a. The 180th day after the date on which you transfer the property given up in the trade; or
   b. The due date, including extensions, for your tax return for the year in which the transfer of the property given up occurs.

If you trade property with a related party in a like-kind exchange, a special rule may apply. See *Related Party Transactions*, later in this chapter. Also, see chapter 1 of Pub. 544 for more information on exchanges of business property and special rules for exchanges using qualified intermediaries or involving multiple properties.

Transition rule for exchanges of personal or intangible property. Under the Tax Cuts and Jobs Act, section 1031 only applies to exchanges of real property, other than real property held primarily for sale. Before enactment of the new tax law, section 1031 also applied to certain exchanges of personal or intangible property. A transition rule in the new law provides that section 1031 will still apply to a qualifying exchange of personal or intangible property if the taxpayer disposed of the exchanged property on or before December 31, 2017, or received replacement property on or before December 31, 2017.

Partly nontaxable exchange. If you receive money or property that is not like-kind property in addition to the like-kind property, and the preceding six conditions are met, you have a partly nontaxable trade. You are taxed on any gain you realize, but only up to the amount of the money and the fair market value of the property that is not like-kind you receive. You cannot deduct a loss.

Like-kind property and unlike property transferred. If you give up unlike property in addition to the like-kind property, you must recognize gain or loss on the unlike property you give up. The gain or loss is the difference between the adjusted basis of the unlike property and its fair market value.

Like-kind property and money transferred. If conditions (1)–(6) above are met, you have a nontaxable trade even if you pay money in addition to the like-kind property.

Basis of property received. You figure your basis in property received in a nontaxable or partly nontaxable trade as explained under *Basis Other Than Cost*, earlier.

How to report. You must report the trade of like-kind property on Form 8824. If you figure a recognized gain or loss on Form 8824, report it on Schedule D (Form 1040) or on Form 4797, whichever applies.

For information on using Form 4797, see chapter 4 of Pub. 544.

Corporate Stocks

The following trades of corporate stocks generally do not result in a taxable gain or a deductible loss.

Corporate reorganizations. In some instances, a company will give you common stock for preferred stock, preferred stock for common stock, or stock in one corporation for stock in another corporation. If this is a result of a merger, recapitalization, transfer to a controlled corporation, bankruptcy, corporate division, corporate acquisition, or other corporate reorganization, you do not recognize gain or loss.

Example 1. On April 11, 2022, KP1 Corporation was acquired by KP2 Corporation. You held 100 shares of KP1 stock with a basis of $3,500. As a result of the acquisition, you received 70 shares of KP2 stock in exchange for your KP1 stock. You do not recognize gain or loss on the transaction. Your basis in the 70 shares of the new stock is still $3,500.

Example 2. On July 18, 2022, RGB Corporation divests itself of SFH Corporation. You hold 75 shares of RGB stock with a basis of $5,400. You receive 25 shares of SFH stock as a result of the spin-off. You do not recognize any gain or loss on the transaction. You receive information from RGB Corporation that your basis in SFH stock is equal to 10.9624% of your basis in RGB stock ($5,400). Thus, your basis in SFH stock is $592. Your basis in RGB stock (after the spin-off) is $4,808 ($5,400 – $592).

Note. In the case of a distribution, the divesting corporation should send you information that includes details on how to allocate basis between the old and new stock. Keep this information until the period of limitations expires for the year in which you dispose of the stock in a taxable disposition. Usually, this is 3 years from the date the return was due or filed, or 2 years from the date the tax was paid, whichever is later.

Stock for stock of the same corporation. You can exchange common stock for common stock or preferred stock for preferred stock in the same corporation without having a recognized gain or loss. This is true for a trade between two stockholders as well as a trade between a stockholder and the corporation.

If you receive cash for fractional shares, see *Fractional shares* in chapter 1.

Money or other property received. If in an otherwise nontaxable trade you receive money or other property in addition to stock, then your gain on the trade, if any, is taxed, but only up to the amount of the money or other property. Any loss is not recognized.

If you received cash for fractional shares, see *Fractional shares* in chapter 1.

Nonqualified preferred stock. Nonqualified preferred stock is generally treated as property other than stock. Generally, this applies to preferred stock with one or more of the following features.

- The holder has the right to require the issuer or a related person to redeem or purchase the stock.
- The issuer or a related person is required to redeem or purchase the stock.
- The issuer or a related person has the right to redeem the stock, and on the

issue date, it is more likely than not that the right will be exercised.

- The dividend rate on the stock varies with reference to interest rates, commodity prices, or similar indices.

For a detailed definition of nonqualified preferred stock, see section 351(g)(2) of the Internal Revenue Code.

Convertible stocks and bonds. You will generally not have a recognized gain or loss if you convert bonds into stock or preferred stock into common stock of the same corporation according to a conversion privilege in the terms of the bond or the preferred stock certificate.

Example. In November, you bought for $1 a right issued by XYZ Corporation entitling you, on payment of $99, to subscribe to a bond issued by that corporation.

On December 5, you subscribed to the bond, which was issued on December 12. The bond contained a clause stating that you would receive one share of XYZ Corporation common stock on surrender of one bond and the payment of $50.

Later, you presented the bond and $50 and received one share of XYZ Corporation common stock. You did not have a recognized gain or loss. This is true whether the fair market value of the stock was more or less than $150 on the date of the conversion.

The basis of your share of stock is $150 ($1 + $99 + $50). Your holding period is split. Your holding period for the part based on your ownership of the bond ($100 basis) begins on December 5. Your holding period for the part based on your cash investment ($50 basis) begins on the day after you acquired the share of stock.

Bonds for stock of another corporation. Generally, if you convert the bonds of one corporation into common stock of another corporation, according to the terms of the bond issue, you must recognize gain or loss up to the difference between the fair market value of the stock received and the adjusted basis of the bonds exchanged. In some instances, however, such as trades that are part of mergers or other corporate reorganizations, you will have no recognized gain or loss if certain requirements are met. For more information about the tax consequences of converting securities of one corporation into common stock of another corporation, under circumstances such as those just described, consult the respective corporations and the terms of the bond issue. This information is also available on the prospectus of the bond issue.

Property for stock of a controlled corporation. If you transfer property to a corporation solely in exchange for stock in that corporation, and immediately after the trade you are in control of the corporation, you will ordinarily not recognize a gain or loss. This rule applies both to individuals and to groups who transfer property to a corporation. It does not apply if the corporation is an investment company.

If you are in a bankruptcy or a similar proceeding and you transfer property to a controlled corporation under a plan, other than a reorganization, you must recognize gain to the extent the stock you receive in the exchange is used to pay off your debts.

For this purpose, to be in control of a corporation, you or your group of transferors must own, immediately after the exchange, at least 80% of the total combined voting power of all classes of stock entitled to vote and at least 80% of the outstanding shares of each class of nonvoting stock of the corporation.

If this provision applies to you, you may have to attach to your return a complete statement of all facts pertinent to the exchange. For details, see Regulations section 1.351-3.

Money or other property received. If, in an otherwise nontaxable trade of property for corporate stock, you also receive money or property other than stock, you may have a taxable gain. However, you are taxed only up to the amount of money plus the fair market value of the other property you receive. The rules for figuring taxable gain in this situation generally follow those for a partly nontaxable exchange discussed earlier under *Like-Kind Exchanges*. If the property you give up includes depreciable property, the taxable gain may have to be reported as ordinary income because of depreciation. (See chapter 3 of Pub. 544.) No loss is recognized.

Nonqualified preferred stock (described earlier under *Stock for stock of the same corporation*) received is generally treated as property other than stock.

Basis of stock or other property received. The basis of the stock you receive is generally the adjusted basis of the property you transfer. Increase this amount by any amount that was treated as a dividend, plus any gain recognized on the trade. Decrease this amount by any cash you received and the fair market value of any other property you received.

The basis of any other property you receive is its fair market value on the date of the trade.

Exchange of Shares in One Mutual Fund For Shares in Another Mutual Fund

Any exchange of shares in one fund for shares in another fund is a taxable exchange. This is true even if you exchange shares in one fund for shares in another fund within the same family of funds. Report any gain or loss on the shares you gave up as a capital gain or loss in the year in which the exchange occurs. Usually, you can add any service charge or fee paid in connection with an exchange to the cost of the shares acquired. For an exception, see *Commissions and load charges*, earlier.

Insurance Policies and Annuities

You will not have a recognized gain or loss if the insured or annuitant is the same under both contracts and you trade:

- A life insurance contract for another life insurance contract or for an endowment or an annuity contract or for a qualified long-term care insurance contract,
- An endowment contract for another endowment contract that provides for regular payments beginning at a date

no later than the beginning date under the old contract or for an annuity contract or for a qualified long-term insurance contract,

- An annuity contract for an annuity contract or for a qualified long-term care insurance contract, or
- A qualified long-term care insurance contract for a qualified long-term care insurance contract.

You may also not have to recognize gain or loss from an exchange of a portion of an annuity contract for another annuity contract. For transfers completed before October 24, 2011, see Revenue Ruling 2003-76 and Revenue Procedure 2008-24 in Internal Revenue Bulletin 2008-13. Revenue Ruling 2003-76 is available at *IRS.gov/irb/2003-33_IRB#RR-2003-76*. Revenue Procedure 2008-24 is available at *IRS.gov/irb/2008-13_IRB#RP-2008-24.* For transfers completed on or after October 24, 2011, see Revenue

Ruling 2003-76, above, and Revenue Procedure 2011-38 in Internal Revenue Bulletin 2011-30. Revenue Procedure 2011-38 is available at *IRS.gov/irb/ 2011-30_IRB#RP-2011-38.* For tax years beginning after 2010, amounts received as an annuity for a period of 10 years or more, or for the lives of one or more individuals, under any portion of an annuity, endowment, or life insurance contract, are treated as a separate contract and are considered partial annuities. A portion of an annuity, endowment, or life insurance contract may be annuitized, provided that the annuitization period is for 10 years or more or for the lives of one or more individuals. The investment in the contract is allocated between the part of the contract from which amounts are received as an annuity and the part of the contract from which amounts are not received as an annuity.

Exchanges of contracts not included in this list, such as an annuity contract for an endowment contract, or an annuity or endowment contract for a life insurance contract, are taxable.

Demutualization of Life Insurance Companies

A life insurance company may change from a mutual company to a stock company. This is commonly called demutualization. If you were a policyholder or annuitant of the mutual company, you may have received either stock in the stock company or cash in exchange for your equity interest in the mutual company.

If the demutualization transaction qualifies as a tax-free reorganization under section 368(a)(1) of the Internal Revenue Code, no gain or loss is recognized on the exchange. Your holding period for the new stock includes the period you held an equity interest in the mutual company as a policyholder or annuitant.

If the demutualization transaction does not qualify as a tax-free reorganization under section 368(a)(1) of the Internal Revenue Code, you must recognize a capital gain or loss. Your holding period for the stock does not include the period you held an equity interest in the mutual company.

If you received cash in exchange for your equity interest, you must recognize a capital gain. If you held an equity interest for more than 1 year, your gain is long term.

U.S. Treasury Notes or Bonds

You can trade certain issues of U.S. Treasury obligations for other issues, designated by the Secretary of the Treasury, with no gain or loss recognized on the trade.

See the discussion in chapter 1 under *U.S. Treasury Bills, Notes, and Bonds* for information about income from these investments.

Transfers Between Spouses

Generally, no gain or loss is recognized on a transfer of property from an individual to (or in trust for the benefit of) a spouse or, if incident to a divorce, a former spouse. This nonrecognition rule does not apply in the following situations.

- The recipient spouse or former spouse is a nonresident alien.
- Property is transferred in trust and liability exceeds basis. Gain must be recognized to the extent the amount of the liabilities assumed by the trust, plus any liabilities on the property, exceed the adjusted basis of the property.

- An installment obligation is transferred in trust. For information on the disposition of an installment obligation, see Pub. 537.
- Certain stock redemptions, which are taxable to a spouse under the tax law, a divorce or separation instrument, or a valid written agreement, discussed in Regulations section 1.1041-2.

Any transfer of property to a spouse or former spouse on which gain or loss is not recognized is treated by the recipient as a gift and is not considered a sale or exchange. The recipient's basis in the property will be the same as the adjusted basis of the giver immediately before the transfer. This carryover basis rule applies whether the adjusted basis of the transferred property is less than, equal to, or greater than either its fair market value at the time of transfer or any consideration paid by the recipient. This rule applies for purposes of determining loss as well as gain. Any gain recognized on a transfer in trust increases the basis.

A transfer of property is incident to a divorce if the transfer occurs within 1 year after the date on which the marriage ends, or if the transfer is related to the ending of the marriage. For more information, see *Property Settlements* in Pub. 504, Divorced or Separated Individuals.

Related Party Transactions

Special rules apply to the sale or trade of property between related parties.

Gain on Sale or Trade of Depreciable Property

Your gain from the sale or trade of property to a related party may be ordinary income, rather than capital gain, if the property can be depreciated by the party receiving it. See chapter 2 in Pub. 544 for more information.

Like-Kind Exchanges

Generally, if you trade business or investment real property for other business or investment real property of a like kind, no gain or loss is recognized. See *Like-Kind Exchanges* under *Nontaxable Trades*, earlier.

This rule also applies to trades of real property between related parties, defined next under *Losses on Sales or Trades of Property*. However, if either you or the related party disposes of the like-kind property within 2 years after the trade, you both must report any gain or loss not recognized on the original trade on your return for the year in which the later disposition occurs. This rule generally does not apply to:

- Dispositions due to the death of either related party,
- Involuntary conversions (see chapter 1 of Pub. 544), or

- Trades and later dispositions whose main purpose is not the avoidance of federal income tax.

If a property holder's risk of loss on the property is substantially diminished during any period, that period is not counted in determining whether the property was disposed of within 2 years. The property holder's risk of loss is substantially diminished by:

- The holding of a put on the property,
- The holding by another person of a right to acquire the property, or
- A short sale or any other transaction.

Losses on Sales or Trades of Property

You cannot deduct a loss on the sale or trade of property, other than a distribution in complete liquidation of a corporation, if the transaction is directly or indirectly between you and the following related parties.

- Members of your family. This includes only your brothers and sisters, half-brothers and half-sisters, spouse, ancestors (parents, grandparents, etc.), and lineal descendants (children, grandchildren, etc.).
- A partnership in which you directly or indirectly own more than 50% of the capital interest or the profits interest.
- A corporation in which you directly or indirectly own more than 50% in value of the outstanding stock (see *Constructive ownership of stock*, later).
- A tax-exempt charitable or educational organization directly or indirectly controlled, in any manner or by any method, by you or by a member of your family, whether or not this control is legally enforceable.

In addition, a loss on the sale or trade of property is not deductible if the transaction is directly or indirectly between the following related parties.

- A grantor and fiduciary, or the fiduciary and beneficiary, of any trust.
- Fiduciaries of two different trusts, or the fiduciary and beneficiary of two different trusts, if the same person is the grantor of both trusts.
- A trust fiduciary and a corporation of which more than 50% in value of the outstanding stock is directly or indirectly owned by or for the trust, or by or for the grantor of the trust.
- A corporation and a partnership if the same persons own more than 50% in value of the outstanding stock of the corporation and more than 50% of the capital interest or the profits interest in the partnership.

- Two S corporations if the same persons own more than 50% in value of the outstanding stock of each corporation.
- Two corporations, one of which is an S corporation, if the same persons own more than 50% in value of the outstanding stock of each corporation.
- An executor and a beneficiary of an estate (except in the case of a sale or trade to satisfy a monetary bequest).
- Two corporations that are members of the same controlled group (under certain conditions, however, these losses are not disallowed but must be deferred).
- Two partnerships if the same persons own, directly or indirectly, more than 50% of the capital interests or the profit interests in both partnerships.

Multiple property sales or trades. If you sell or trade to a related party a number of blocks of stock or pieces of property in a lump sum, you must figure the gain or loss separately for each block of stock or piece of property. The gain on each item may be taxable. However, you cannot deduct the loss on any item. Also, you cannot reduce gains from the sales of any of these items by losses on the sales of any of the other items.

Indirect transactions. You cannot deduct your loss on the sale of stock through your broker if, under a prearranged plan, a related party buys the same stock you had owned. This does not apply to a trade between related parties through an exchange that is purely coincidental and is not prearranged.

Constructive ownership of stock. In determining whether a person directly or indirectly owns any of the outstanding stock of a corporation, the following rules apply.

Rule 1. Stock directly or indirectly owned by or for a corporation, partnership, estate, or trust is considered owned proportionately by or for its shareholders, partners, or beneficiaries.

Rule 2. An individual is considered to own the stock directly or indirectly owned by or for his or her family. Family includes only brothers and sisters, half-brothers and half-sisters, spouse, ancestors, and lineal descendants.

Rule 3. An individual owning, other than by applying rule 2, any stock in a corporation is considered to own the stock directly or indirectly owned by or for his or her partner.

Rule 4. When applying rule 1, 2, or 3, stock constructively owned by a person under rule 1 is treated as actually owned by that person. But stock constructively owned by an individual under rule 2 or rule 3 is not again treated as owned by that individual for applying either rule 2 or rule 3 to make another person the constructive owner of the stock.

Property received from a related party. If you sell or trade at a gain property you acquired from a related party, you recognize the gain only to the extent that it is more than the loss previously disallowed to the related party. This rule applies only if you are the original transferee and you acquired the property by purchase or exchange. This rule does not apply if the related party's loss was disallowed because of the wash sale rules, described later under *Wash Sales*.

If you sell or trade at a loss property you acquired from a related party, you cannot recognize the loss that was not allowed to the related party.

Example 1. Your brother sells you stock for $7,600. His cost basis is $10,000. Your brother cannot deduct the loss of $2,400. Later, you sell the same stock to an unrelated party for $10,500, realizing a gain of $2,900.

Your reportable gain is $500 (the $2,900 gain minus the $2,400 loss not allowed to your brother).

Example 2. If, in *Example 1*, you sold the stock for $6,900 instead of $10,500, your recognized loss is only $700 (your $7,600 basis minus $6,900). You cannot deduct the loss that was not allowed to your brother.

Capital Gains and Losses

Terms you may need to know (see Glossary):

- Call
- Commodity future
- Conversion transaction
- Forward contract
- Limited partner
- Listed option
- Nonequity option

Options dealer

Put

Regulated futures contract

Section 1256 contract

Straddle

Wash sale

This section discusses the tax treatment of gains and losses from different types of investment transactions.

Character of gain or loss. You need to classify your gains and losses as either ordinary or capital gains or losses. You then need to classify your capital gains and losses as either short term or long term. If you have long-term gains and losses, you must identify your 28% rate gains and losses. If you have a net capital gain, you must also identify any unrecaptured section 1250 gain.

The correct classification and identification helps you figure the limit on capital losses and the correct tax on capital gains. For information about determining whether your capital gain or loss is short term or long term, see *Holding Period*, later. For information about 28% rate gain or loss and unrecaptured section 1250 gain, see *Capital Gain Tax Rates*, later.

Capital or Ordinary Gain or Loss

If you have a taxable gain or a deductible loss from a transaction, it may be either a capital gain or loss or an ordinary gain or loss, depending on the circumstances. Generally, a sale or trade of a capital asset (defined next) results in a capital gain or loss. A sale or trade of a noncapital asset generally results in ordinary gain or loss. Depending on the circumstances, a gain or loss on a sale or trade of property used in a trade or business may be treated as either capital or ordinary, as explained in Pub. 544. In some situations, part of your gain or loss may be a capital gain or loss, and part may be an ordinary gain or loss.

Capital Assets and Noncapital Assets

For the most part, everything you own and use for personal purposes, pleasure, or investment is a capital asset. Some examples are:

- Stocks or bonds held in your personal account;
- A house owned and used by you and your family;
- Household furnishings;
- A car used for pleasure or commuting;
- Coin or stamp collections;
- Gems and jewelry; and
- Gold, silver, or any other metal.

Any property you own is a capital asset, except the following noncapital assets.

1. Property held mainly for sale to customers or property that will physically become a part of the merchandise for sale to customers. For an exception, see *Capital asset treatment for self-created musical works*, later.
2. Depreciable property used in your trade or business, even if fully depreciated.
3. Real property used in your trade or business.
4. A patent; invention, model, or design (whether or not patented); a secret formula or process; a copyright; a literary, musical, or artistic composition; a letter or memorandum; or similar property, held by:
    a. A person whose personal efforts created such property;

    b. In the case of a letter, memorandum, or similar property, a person for whom such property was prepared or produced; or
    c. Acquired under circumstances (for example, by gift) entitling you to the basis of the person who created the property or for whom it was prepared or produced.

For an exception to this rule, see *Capital asset treatment for self-created musical works*, later.

5. Accounts or notes receivable acquired in the ordinary course of a trade or business for services rendered or from the sale of property described in (1).
6. U.S. Government publications, including the Congressional Record, that you received:

   a. From the U.S. Government (or any governmental agency) for an amount other than the normal sales price, or
   b. Under circumstances (such as by gift) that entitle you to the basis of someone who received the publication for an amount other than the normal sales price.
7. Certain commodities derivative financial instruments held by commodities derivatives dealers. For more information, see section 1221 of the Internal Revenue Code.
8. Hedging transactions, but only if the transaction is clearly identified as a hedging transaction before the close of the day on which it was acquired, originated, or entered into. For more information, see the definition of hedging transaction, earlier, and the discussion of hedging transactions under *Commodity Futures*, later.

9. Supplies of a type you regularly use or consume in the ordinary course of your trade or business.

Investment property. Investment property is a capital asset. Any gain or loss from its sale or trade is generally a capital gain or loss.

Gold, silver, stamps, coins, gems, etc. These are capital assets except when they are held for sale by a dealer. Any gain or loss from their sale or trade is generally a capital gain or loss.

Stocks, stock rights, and bonds. All of these, including stock received as a dividend, are capital assets except when they are held for sale by a securities dealer. However, see *Losses on Section 1244 (Small Business) Stock* and *Losses on Small Business Investment Company Stock*, later.

Personal use property. Property held for personal use only, rather than for investment, is a capital asset, and you must report a gain from its sale as a capital gain. However, you cannot deduct a loss from selling personal use property.

Capital asset treatment for self-created musical works. You can elect to treat musical compositions and copyrights in musical works as capital assets when you sell or exchange them if:

- Your personal efforts created the property, or
- You acquired the property under circumstances (for example, by gift) entitling you to the basis of the person who created the property or for whom it was prepared or produced.

You must make a separate election for each musical composition (or copyright in a musical work) sold or exchanged during the tax year. Make the election by the due date (including extensions) of the income tax return for the tax year of the sale or exchange. Make the election on Form 8949 and Schedule D (Form 1040) by treating the sale or exchange as the sale or exchange of a capital asset, according to Form 8949 and Schedule D (Form 1040) and their separate instructions.

You can revoke the election if you have IRS approval. To get IRS approval, you must submit a request for a letter ruling under the appropriate IRS revenue procedure. See, for example, Revenue Procedure 2020-1, available at *IRS.gov/irb/2020-01_IRB#REV-PROC-2020-1*.

Alternatively, you are granted an automatic 6-month extension from the due date of your income tax return (excluding extensions) to revoke the election, provided you timely file your income tax return, and within this 6-month extension period, you file Form 1040-X that treats the sale or exchange as the sale or exchange of property that is not a capital asset.

Discounted Debt Instruments

Treat your gain or loss on the sale, redemption, or retirement of a bond or other debt instrument originally issued at a discount or bought at a discount as capital gain or loss, except as explained in the following discussions.

Short-term government obligations. Treat gains on short-term federal, state, or local government obligations (other than tax-exempt obligations) as ordinary income up to your ratable share of the acquisition discount. This treatment applies to obligations with a fixed maturity date of not more than 1 year from the date of issue. Acquisition discount is the stated redemption price at maturity minus your basis in the obligation.

However, do not treat these gains as income to the extent you previously included the discount in income. See *Discount on Short-Term Obligations* in chapter 1 for more information.

Short-term nongovernment obligations. Treat gains on short-term nongovernment obligations as ordinary income up to your ratable share of OID. This treatment applies to obligations with a fixed maturity date of not more than 1 year from the date of issue.

However, to the extent you previously included the discount in income, you do not have to include it in income again. See *Discount on Short-Term Obligations* in chapter 1 for more information.

Tax-exempt state and local government bonds. If these bonds were originally issued at a discount before September 4, 1982, or you acquired them before March 2, 1984, treat your part of OID as tax-exempt interest. To figure your gain or loss on the sale or trade of these bonds, reduce the amount realized by your part of OID.

If the bonds were issued after September 3, 1982, and acquired after March 1, 1984, increase the adjusted basis by your part of OID to figure gain or loss. For more information on the basis of these bonds, see *Discounted tax-exempt obligations*, earlier in this chapter.

Any gain from market discount is usually taxable on disposition or redemption of tax-exempt bonds. If you bought the bonds before May 1, 1993, the gain from market discount is capital gain. If you bought the bonds after April 30, 1993, the gain from market discount is ordinary income.

You figure market discount by subtracting the price you paid for the bond from the sum of the original issue price of the bond and the amount of accumulated OID from the date of issue that represented interest to any earlier holders. For more information, see _Market Discount Bonds_ in chapter 1.

A loss on the sale or other disposition of a tax-exempt state or local government bond is deductible as a capital loss.

Redeemed before maturity. If a state or local bond issued before June 9, 1980, is redeemed before it matures, the OID is not taxable to you.

If a state or local bond issued after June 8, 1980, is redeemed before it matures, the part of OID earned while you hold the bond is not taxable to you. However, you must report the unearned part of OID as a capital gain.

Example. On July 1, 2011, the date of issue, you bought a 20-year, 6% municipal bond for $800. The face amount of the bond was $1,000. The $200 discount was OID. At the time the bond was issued, the issuer had no intention of redeeming it before it matured.

The bond was callable at its face amount beginning 10 years after the issue date.

The issuer redeemed the bond at the end of 11 years (July 1, 2022) for its face amount of $1,000 plus accrued annual interest of $60. The OID earned during the time you held the bond, $73, is not taxable. The $60 accrued annual interest is also not taxable. However, you must report the unearned part of OID, $127 ($200 − $73), as a capital gain.

Long-term debt instruments issued after 1954 and before May 28, 1969 (or before July 2, 1982, if a government instrument). If you sell, trade, or redeem for a gain one of these debt instruments, the part of your gain that is not more than your ratable share of OID at the time of sale or redemption is ordinary income. The rest of the gain is capital gain. If, however, there was an intention to call the debt instrument before maturity, all of your gain that is not more than the entire OID is treated as ordinary income at the time of the sale. This treatment of taxable gain also applies to corporate instruments issued after May 27, 1969, under a written commitment that was binding on May 27, 1969, and at all times thereafter.

Long-term debt instruments issued after May 27, 1969 (or after July 1, 1982, if a government instrument). If you hold one of these debt instruments, you must include a part of OID in your gross income each year you own the instrument. Your basis in that debt instrument is increased by the amount of OID that you have included in your gross income. See *Original Issue Discount (OID)* in chapter 1.

If you sell or trade the debt instrument before maturity, your gain is a capital gain. However, if at the time the instrument was originally issued there was an intention to call it before its maturity, your gain is generally ordinary income to the extent of the entire

OID reduced by any amounts of OID previously includible in your income. In this case, the rest of the gain is capital gain.

An intention to call a debt instrument before maturity means there is a written or oral agreement or understanding not provided for in the debt instrument between the issuer and original holder that the issuer will redeem the debt instrument before maturity. In the case of debt instruments that are part of an issue, the agreement or understanding must be between the issuer and the original holders of a substantial amount of the debt instruments in the issue.

Example 1. On February 9, 2021, you bought at original issue for $7,600, Jones Corporation's 10-year, 5% bond which has a stated redemption price at maturity of $10,000. On February 13, 2022, you sold the bond for $9,040. Assume you have included $334 of OID in your gross income (including the amount accrued for 2022) and increased your basis in the bond by that amount. Your basis is now $7,934. If at the time of the original issue there was no intention to call the bond before maturity, your gain of $1,106 ($9,040 amount realized minus $7,934 adjusted basis) is capital gain.

Example 2. If, in *Example 1*, at the time of original issue there was an intention to call the bond before maturity, your entire gain is ordinary income. You figure this as follows:

1.	Entire OID ($10,000 stated redemption price at maturity minus $7,600 issue price)	$2,400
2.	Minus: Amount previously included in income	334
3.	Maximum amount of ordinary income	$2,066

Because the amount in (3) is more than your gain of $1,106, your entire gain is ordinary income.

Market discount bonds. If the debt instrument has market discount and you chose to include the discount in income as it accrued, increase your basis in the debt instrument by the accrued discount to figure capital gain or loss on its disposition. If you did not choose to include the discount in income as it accrued, you must report gain as ordinary interest income up to the instrument's accrued market discount. See *Market Discount Bonds* in chapter 1. The rest of the gain is capital gain.

However, a different rule applies if you dispose of a market discount bond that was:

- Issued before July 19, 1984; and
- Purchased by you before May 1, 1993.

In that case, any gain is treated as interest income up to the amount of your deferred interest deduction for the year you dispose of the bond. The rest of the gain is capital gain. (The limit on the interest deduction for market discount bonds is discussed in chapter 3 under *When To Deduct Investment Interest*.)

Report the sale or trade of a market discount bond in Form 8949, Part I or Part II, whichever is appropriate. Use the table How To Complete Form 8949, Columns (f) and (g) in the Instructions for Form 8949 to help you figure the amounts to report for a sale or trade of a market discount bond. Also report the amount of accrued market discount in column (g) as interest income on Schedule B (Form 1040), line 1, and identify it as "Accrued Market Discount."

TIP *Report your sales or trades of a market discount bond on Form 8949 with the correct box checked for these transactions. See Form 8949 and the Instructions for Form 8949.*

Retirement of debt instrument. Any amount you receive on the retirement of a debt instrument is treated in the same way as if you had sold or traded that instrument.

Notes of individuals. If you hold an obligation of an individual issued with OID after March 1, 1984, you must generally include the OID in your income currently, and your gain or loss on its sale or retirement is generally capital gain or loss. An exception to this treatment applies if the obligation is a loan between individuals and all the following requirements are met.

- The lender is not in the business of lending money.

- The amount of the loan, plus the amount of any outstanding prior loans, is $10,000 or less.
- Avoiding federal tax is not one of the principal purposes of the loan.

If the exception applies, or the obligation was issued before March 2, 1984, you do not include the OID in your income currently. When you sell or redeem the obligation, the part of your gain that is not more than your accrued share of OID at that time is ordinary income. The rest of the gain, if any, is capital gain. Any loss on the sale or redemption is capital loss.

Bearer Obligations

You cannot deduct any loss on an obligation required to be in registered form that is instead held in bearer form. In addition, any gain on the sale or other disposition of the obligation is ordinary income. However, if the issuer was subject to a tax when the obligation was issued, then you can deduct any loss, and any gain may qualify for capital gain treatment.

Obligations required to be in registered form. Any obligation must be in registered form unless:

- It is issued by a natural person,
- It is not of a type offered to the public,
- It has a maturity at the date of issue of not more than 1 year, or
- It was issued before 1983.

Deposit in Insolvent or Bankrupt Financial Institution

If you lose money you have on deposit in a bank, credit union, or other financial institution that becomes insolvent or bankrupt, you may be able to deduct your loss in one of two ways.

- Casualty loss.
- Nonbusiness bad debt (short-term capital loss).

CAUTION *You can no longer claim any miscellaneous itemized deductions, including the deduction for an ordinary loss on deposits in insolvent or bankrupt financial institutions.*

Casualty loss. If you can reasonably estimate your loss, you can treat the estimated loss as a casualty loss in the current year.

If you claim a casualty loss, attach Form 4684 to your return. Each loss must be reduced by $100. The amount of your casualty loss may be limited. See Pub. 547. You cannot choose this method if:

- You own at least 1% of the financial institution,
- You are an officer of the institution, or

- You are related to such an owner or officer. You are related if you and the owner or officer are “related parties,” as defined earlier under *Related Party Transactions*, or if you are the aunt, uncle, nephew, or niece of the owner or officer.

If the actual loss that is finally determined is more than the amount you deducted as an estimated loss, you can claim the excess loss as a nonbusiness bad debt. If the actual loss is less than the amount deducted as an estimated loss, you must include in income (in the final determination year) the excess loss claimed. See *Recoveries* in Pub. 525.

Nonbusiness bad debt. If you do not choose to deduct your estimated loss as a casualty loss or an ordinary loss, you wait until the year the amount of the actual loss is determined and deduct it as a nonbusiness bad debt in that year. Report it as a short-term capital loss on Form 8949, Part I, line 1, as explained under *How to* *report bad debts*, later.

Sale of Annuity

The part of any gain on the sale of an annuity contract before its maturity date that is based on interest accumulated on the contract is ordinary income.

Conversion Transactions

Generally, all or part of a gain on a conversion transaction is treated as ordinary income. This applies to gain on the disposition or other termination of any position you held as part of a conversion transaction you entered into after April 30, 1993.

A conversion transaction is any transaction that meets both of these tests.

1. Substantially all of your expected return from the transaction is due to the time value of your net investment. In other words, the return on your

investment is, in substance, like interest on a loan.

2. The transaction is one of the following.
    a. A straddle as defined under *Straddles*, later, but including any set of offsetting positions on stock established before October 22, 2004.
    b. Any transaction in which you acquire property (whether or not actively traded) at substantially the same time that you contract to sell the same property, or substantially identical property, at a price set in the contract.
    c. Any other transaction that is marketed or sold as producing capital gains from a transaction described in (1).

Amount treated as ordinary income. The amount of gain treated as ordinary income is the smaller of:

- The gain recognized on the disposition or other termination of the position, or
- The “applicable imputed income amount.”

Applicable imputed income amount. Figure this amount as follows.

1. Figure the amount of interest that would have accrued on your net investment in the conversion transaction for the period ending on the earlier of:
    a. The date you dispose of the position, or
    b. The date the transaction stops being a conversion transaction.

To figure this amount, use an interest rate equal to 120% of the “applicable rate,”

defined later.

2. Subtract from (1) the amount treated as ordinary income from any earlier

disposition or other termination of a position held as part of the same conversion transaction.

Applicable rate. If the term of the conversion transaction is indefinite, the applicable rate is the federal short-term rate in effect under section 6621(b) during the period of the conversion transaction, compounded daily.

In all other cases, the applicable rate is the “applicable federal rate” determined as if the conversion transaction were a debt instrument and compounded semiannually.

The rates discussed above are published by the IRS in the Internal Revenue Bulletin. The Internal Revenue Bulletin is available through IRS.gov. You can also find applicable federal rates in the Index of Applicable Federal Rates (AFR) Rulings at *https://apps.IRS.gov/app/picklist/list/federalRates.html*.

See chapter 5, *How To Get Tax Help*, for information on contacting the IRS.

Net investment. To determine your net investment in a conversion transaction, include the fair market value of any position at the time it becomes part of the transaction. This means your net investment will generally be the total amount you invested, less any amount you received for entering into the position (for example, a premium you received for writing a call).

Position with built-in loss. A special rule applies when a position with a built-in loss becomes part of a conversion transaction. A built-in loss is any loss you would have realized if you had disposed of or otherwise terminated the position at its fair market value at the time it became part of the conversion transaction.

When applying the conversion transaction rules to a position with a built-in loss, use the position's fair market value at the time it became part of the transaction. But, when you dispose of or otherwise terminate the position in a transaction in which you recognize gain or loss, you must recognize the built-in loss. The conversion transaction rules do not affect whether the built-in loss is treated as an ordinary or capital loss.

Netting rule for certain conversion transactions. Before determining the amount of gain treated as ordinary income, you can net certain gains and losses from positions of the same conversion transaction. To do this, you have to dispose of all the positions within a 14-day period that is within a single tax year. You cannot net the built-in loss against the gain.

You can net gains and losses only if you identify the conversion transaction as an identified netting transaction on your books and records. Each position of the conversion transaction must be identified before the end of the day on which the position becomes part of the conversion transaction. For conversion transactions entered into before February 20, 1996, this requirement is met if the identification was made by that date.

Options dealers and commodities traders. These rules do not apply to options dealers and commodities traders.

How to report. Use Form 6781 to report conversion transactions. See the instructions for lines 11 and 13 of Form 6781.

Commodity Futures

A commodity futures contract is a standardized, exchange-traded contract for the sale or purchase of a fixed amount of a commodity at a future date for a fixed price.

If the contract is a regulated futures contract, the rules described earlier under *Section 1256 Contracts Marked to Market* apply to it.

The termination of a commodity futures contract generally results in capital gain or loss unless the contract is a hedging transaction.

Hedging transaction. A futures contract that is a hedging transaction generally produces ordinary gain or loss. A futures contract is a hedging transaction if you enter into the contract in the ordinary course of your business primarily to manage the risk of interest rate or price changes or currency fluctuations on borrowings, ordinary property, or ordinary obligations. (Generally, ordinary property or obligations are those that cannot produce capital gain or loss under any circumstances.) For example, the offset or exercise of a futures contract that protects against price changes in your business inventory results in an ordinary gain or loss.

For more information about hedging transactions, see Regulations section 1.1221-2. Also, see *Hedging Transactions* under

Section 1256 Contracts Marked to Market, earlier.

RECORDS If you have multiple transactions in the commodity futures market during the year, the burden of proof is on you to show which transactions are hedging transactions. Clearly identify any hedging transactions on your books and records before the end of the day you entered into the transaction. It may be helpful to have separate brokerage accounts for your hedging and nonhedging transactions. For specific requirements concerning identification of hedging transactions and the underlying item, items, or aggregate risk being hedged, see Regulations section 1.1221-2(f).

Gains From Certain Constructive Ownership Transactions

If you have a gain from a constructive ownership transaction entered into after July 11, 1999, involving a financial asset (discussed later) and the gain would normally be treated as long-term capital gain, all or part of the gain may be treated instead as ordinary income. In addition, if any gain is treated as ordinary income, your tax is increased by an interest charge.

Constructive ownership transactions. The following are constructive ownership transactions.

- A notional principal contract in which you have the right to receive all or substantially all of the investment yield on a financial asset and you are obligated to reimburse all or substantially all of any decline in value of the financial asset.
- A forward or futures contract to acquire a financial asset.
- The holding of a call option and writing of a put option on a financial asset at

substantially the same strike price and maturity date.

This provision does not apply if all the positions are marked to market. Marked-to-market rules for section 1256 contracts are discussed in detail under *Section 1256 Contracts Marked to Market*, earlier.

Financial asset. A financial asset, for this purpose, is any equity interest in a pass-through entity. Pass-through entities include partnerships, S corporations, trusts, regulated investment companies, and REITs.

Amount of ordinary income. Long-term capital gain is treated as ordinary income to the extent it is more than the net underlying long-term capital gain. The net underlying long-term capital gain is the net capital gain you would have realized if you acquired the asset for its fair market value on the date the constructive ownership transaction was opened and sold the asset for its fair market value on the date the transaction was closed.

If you do not establish the amount of net underlying long-term capital gain by clear and convincing evidence, it is treated as zero.

More information. For more information about constructive ownership transactions, see section 1260 of the Internal Revenue Code.

Losses on Section 1244 (Small Business) Stock

Subject to the limitations discussed under *Ordinary loss limit*, later, you can deduct as an ordinary loss, rather than as a capital loss, a loss on the sale, trade, or worthlessness of section 1244 stock. Report the loss on Form 4797, line 10. Any loss in excess of the amounts described in *Ordinary loss limit*, later, should be reported on Form 8949.

Any gain on section 1244 stock is a capital gain if the stock is a capital asset in your hands. Do not offset gains against losses that are within the ordinary loss limit, explained later in this discussion, even if the transactions are in stock of the same company. Report the gain on Form 8949.

If you must figure a net operating loss, any ordinary loss from the sale of section 1244 stock is a business loss.

Ordinary loss limit. The amount you can deduct as an ordinary loss is limited to $50,000 each year. On a joint return, the limit is $100,000, even if only one spouse has this type of loss. If your loss is $110,000 and your spouse has no loss, you can deduct $100,000 as an ordinary loss on a joint return. The remaining $10,000 is a capital loss.

Section 1244 (small business) stock. This is stock issued for money or property (other than stock and securities) in a domestic small business corporation. During its 5 most recent tax years before the loss, this corporation must have derived more than 50% of its gross receipts from other than royalties, rents, dividends, interest, annuities, and gains from sales and trades of stocks or securities. If the corporation was in existence for at least 1 year, but less than 5 years, the 50% test applies to the tax years ending before the loss. If the corporation was in existence less than 1 year, the 50% test applies to the entire period the corporation was in existence before the day of the loss. However, if the corporation's deductions (other than the net operating loss and dividends received deductions) were more than its gross income during this period, this 50% test does not apply.

The corporation must have been largely an operating company for ordinary loss treatment to apply.

If the stock was issued before July 19, 1984, the stock must be common stock. If issued after July 18, 1984, the stock may be either common or preferred. For more information about the requirements of a small business corporation or the qualifications of section 1244 stock, see section 1244 of the Internal Revenue Code and its regulations.

The stock must be issued to the person taking the loss. You must be the original owner of the stock to be allowed ordinary loss treatment. To claim a deductible loss on stock issued to your partnership, you must have been a partner when the stock was issued and have remained so until the time of the loss. You add your distributive share of the partnership loss to any individual section 1244 stock loss you may have before applying the ordinary loss limit.

Stock distributed by partnership. If your partnership distributes the stock to you, you cannot treat any later loss on that stock as an ordinary loss.

Stock sold through underwriter. Stock sold through an underwriter is not section 1244 stock unless the underwriter only acted as a selling agent for the corporation.

Stock dividends and reorganizations.

Stock you receive as a stock dividend qualifies as section 1244 stock if:

- You receive it from a small business corporation in which you own stock, and
- The stock you own meets the requirements when the stock dividend is distributed.

If you trade your section 1244 stock for new stock in the same corporation in a reorganization that qualifies as a recapitalization or that is only a change in identity, form, or place of organization, the new stock is section 1244 stock if the stock you trade meets the requirements when the trade occurs.

If you hold section 1244 stock and other stock in the same corporation, not all of the stock you receive as a stock dividend or in a reorganization will qualify as section 1244 stock. Only that part based on the section 1244 stock you hold will qualify.

Example. Your basis for 100 shares of X common stock is $1,000. These shares qualify as section 1244 stock. If, as a nontaxable stock dividend, you receive 50 more shares of common stock, the basis of which is determined from the 100 shares you own, the 50 shares are also section 1244 stock.

If you also own stock in the corporation that is not section 1244 stock when you receive the stock dividend, you must divide the shares you receive as a dividend between the section 1244 stock and the other stock. Only the shares from the former can be section 1244 stock.

Contributed property. To determine ordinary loss on section 1244 stock you receive in a trade for property, you have to reduce the basis of the stock if:

- The adjusted basis (for figuring loss) of the property, immediately before the trade, was more than its fair market value; and
- The basis of the stock is determined by the basis of the property.

Reduce the basis of the stock by the difference between the adjusted basis of the property and its fair market value at the time of the trade. You reduce the basis only to figure the ordinary loss.

Do not reduce the basis of the stock for any other purpose.

Example. You transfer property with an adjusted basis of $1,000 and a fair market value of $250 to a corporation for its section 1244 stock. The basis of your stock is $1,000, but to figure the ordinary loss under these rules, the basis of your stock is $250 ($1,000 − $750). If you later sell the section 1244 stock for $200, your $800 loss is an ordinary loss of $50 and a capital loss of $750.

Contributions to capital. If the basis of your section 1244 stock has increased, through contributions to capital or otherwise, you must treat this increase as applying to stock that is not section 1244 stock when you figure an ordinary loss on its sale.

Example. You buy 100 shares of section 1244 stock for $10,000. You are the original owner. You later make a $2,000 contribution to capital that increases the total basis of the 100 shares to $12,000. You then sell the 100 shares for $9,000 and have a loss of $3,000. You can deduct only $2,500 ($3,000 × $10,000/$12,000) as an ordinary loss under these rules. The remaining $500 is a capital loss.

Recordkeeping. You must keep records sufficient to show your stock qualifies as section 1244 stock. Your records must also distinguish your section 1244 stock from any other stock you own in the corporation.

Losses on Small Business Investment Company Stock

A small business investment company (SBIC) is one that is licensed and operated under the Small Business Investment Act of 1958.

If you are an investor in SBIC stock, you can deduct as an ordinary loss, rather than a capital loss, a loss from the sale, trade, or worthlessness of that stock. A gain from the sale or trade of that stock is a capital gain. Do not offset your gains and losses, even if they are on stock of the same company.

How to report. You report this type of ordinary loss on Form 4797, Part II, line 10. In addition to the information required by the form, you must include the name and address of the company that issued the stock. If applicable, also include the reason the stock is worthless and the approximate date it became worthless. Report a capital gain from the sale of SBIC stock on Form 8949.

Short sale. If you close a short sale of SBIC stock with other SBIC stock you bought only for that purpose, any loss you have on the sale is a capital loss. See *Short Sales*, later in this chapter, for more information.

Holding Period

If you sold or traded investment property, you must determine your holding period for the property. Your holding period determines whether any capital gain or loss was a short-term or a long-term capital gain or loss.

Long-term or short-term. If you hold investment property more than 1 year, any capital gain or loss is a long-term capital gain or loss. If you hold the property 1 year or less, any capital gain or loss is a short-term capital gain or loss.

To determine how long you held the investment property, begin counting on the date after the day you acquired the property. The day you disposed of the property is part of your holding period.

Example. If you bought investment property on January 31, 2021, and sold it on January 29, 2022, your holding period is not more than 1 year and you have a short-term capital gain or loss. If you sold it on February 6, 2022, your holding period is more than 1 year and you have a long-term capital gain or loss.

Securities traded on an established market. For securities traded on an established securities market, your holding period begins the day after the trade date you bought the securities, and ends on the trade date you sold them.

CAUTION

Do not confuse the trade date with the settlement date, which is the date by which the stock must be delivered and payment must be made.

Example. You are a cash method, calendar year taxpayer. You sold stock on December 31, 2022. According to the rules of the stock exchange, the sale was closed by delivery of the stock and payment of the sale price in January 2023. You received payment of the sale price on that same day. Report your gain or loss on your 2022 return, even though you received the payment in 2023. The gain or loss is long term or short term depending on whether you held the stock more than 1 year. Your holding period ended on December 31.

U.S. Treasury notes and bonds. The holding period of U.S. Treasury notes and bonds sold at auction on the basis of yield starts the day after the Secretary of the Treasury, through news releases, gives notification of acceptance to successful bidders. The holding period of U.S. Treasury notes and bonds sold through an offering on a subscription basis at a specified yield starts the day after the subscription is submitted.

Automatic investment service. In determining your holding period for shares bought by the bank or other agent, full shares are considered bought first and any fractional shares are considered bought last. Your holding period starts on the day after the bank's purchase date. If a share was bought over more than one purchase date, your holding period for that share is a split holding period. A part of the share is considered to have been bought on each date that stock was bought by the bank with the proceeds of available funds.

Nontaxable trades. If you acquire investment property in a trade for other investment property and your basis for the new property is determined, in whole or in part, by your basis in the old property, your holding period for the new property begins on the day following the date you acquired the old property.

Property received as a gift. If you receive a gift of property and your basis is determined by the donor's adjusted basis, your holding period is considered to have started on the same day the donor's holding period started.

If your basis is determined by the fair market value of the property, your holding period starts on the day after the date of the gift.

Inherited property. If you inherited property from someone who died before or after 2010, or from someone who died in 2010 and the executor of the decedent’s estate did not elect to file Form 8939, your capital gain or loss on any later disposition of that property is treated as long-term gain or loss, regardless of how long you held the property. If you acquired the property from someone who died in 2010 and the executor made the election to file Form 8939, see Pub. 4895 to determine your holding period. Pub. 4895 is available at *IRS.gov/pub/irsprior/P4895-2011.pdf*.

Real property bought. To figure how long you have held real property bought under an unconditional contract, begin counting on the day after you received title to it or on the day after you took possession of it and assumed the burdens and privileges of ownership, whichever happened first. However, taking delivery or possession of real property under an option agreement is not enough to start the holding period. The holding period cannot start until there is an actual contract of sale. The holding period of the seller cannot end before that time.

Real property repossessed. If you sell real property but keep a security interest in it, and then later repossess the property under the terms of the sales contract, your holding period for a later sale includes the period you held the property before the original sale and the period after the repossession. Your holding period does not include the time between the original sale and the repossession. That is, it does not include the period during which the first buyer held the property. However, the holding period for any improvements made by the first buyer begins at the time of repossession.

Stock dividends. The holding period for stock you received as a taxable stock dividend begins on the date of distribution.

The holding period for new stock you received as a nontaxable stock dividend begins on the same day as the holding period of the old stock. This rule also applies to stock acquired in a spin-off, which is a distribution of stock or securities in a controlled corporation.

Nontaxable stock rights. Your holding period for nontaxable stock rights includes the holding period of the underlying stock. The holding period for stock acquired through the exercise of stock rights begins on the date the right was exercised.

Section 1256 contracts. Gains or losses on section 1256 contracts open at the end of the year, or terminated during the year, are treated as 60% long term and 40% short term, regardless of how long the contracts were held. See *Section 1256 Contracts Marked to Market*, earlier.

Option exercised. Your holding period for property you acquire when you exercise an option begins the day after you exercise the option.

Wash sales. Your holding period for substantially identical stock or securities you acquire in a wash sale includes the period you held the old stock or securities.

Qualified small business stock. Your holding period for stock you acquired in a tax-free rollover of gain from a sale of qualified small business stock, described later under

Gains on Qualified Small Business Stock, includes the period you held the old stock.

Commodity futures. Your holding period for a commodity received in satisfaction of a commodity futures contract, other than a regulated futures contract subject to Internal Revenue Code section 1256, includes your holding period for the futures contract if you held the contract as a capital asset.

Securities futures contract. Your holding period for a security received in satisfaction of a securities futures contract, other than one that is a section 1256 contract, includes your holding period for the futures contract if you held the contract as a capital asset.

Your holding period for a security received in satisfaction of a securities futures contract to sell, other than one that is a section 1256 contract, is determined by the rules that apply to short sales, discussed later under *Short Sales*.

Loss on mutual fund or REIT stock held 6 months or less. If you hold stock in a mutual fund (or other regulated investment company) or REIT for 6 months or less and then sell it at a loss (other than under a periodic liquidation plan), special rules may apply.

Capital gain distributions received. The loss (after reduction for any exempt-interest dividends you received, as explained later) is treated as a long-term capital loss up to the total of any capital gain distributions you received and your share of any undistributed capital gains. Any remaining loss is short-term capital loss.

Reinvested distributions. If your dividends and capital gain distributions are reinvested in new shares, the holding period of each new share begins the day after that share was purchased. Therefore, if you sell both the new shares and the original shares, you might have both short-term and long-term gains and losses.