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MEMORANDUM FOR BLAKE FERGUSON
ASSISTANT DISTRICT COUNSEL
NORTH - SOUTH CAROLINA DISTRICT

FROM: Lewis J. Fernandez
Deputy Assistant Chief Counsel
(Income Tax & Accounting)

SUBJECT: Information Reporting - Condemnation of Real Property

This responds to your assistance request of June 8, 1999, concerning information reporting for payments made by a state's highway department for real property taken pursuant to the exercise of eminent domain powers.

ISSUE:

In a real property condemnation, when a state's lump-sum payment to a landowner includes both the proceeds of the condemnation and an interest component, what information returns must be filed?

CONCLUSION:

Under § 6045 of the Internal Revenue Code, the state must report the proceeds of a non-exempted transaction on Form 1099-S. Under § 6041, the interest component should be reported on Form 1099-MISC.

FACTS:

You state that whenever there is a delay between the time the state takes possession of condemned real property and the time payment is made, the state pays interest to the seller in addition to the condemnation price. Awards of interest average about \$20,000. The state follows a procedure of issuing Form 1099-S at year-end showing the lump-sum payment without breaking the payment into its component parts of condemnation proceeds and interest.

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LAW AND ANALYSIS:

Condemnation Proceeds:

Section 6045(e)(1) requires the real estate reporting person, defined in § 6045(e)(2), to file an information return with respect to a real estate transaction and to furnish the seller with a payee statement. The amount to be reported is the gross proceeds. Section 1.6045-4 of the Income Tax Regulations. The prescribed form is Form 1099-S.

Although § 1.6045-4(c) excepts certain transactions and types of property from reporting requirements, a real estate transaction is not excepted merely because it arises from an exercise of eminent domain powers. However, under § 6045(e)(5) a sale or exchange of a residence is excepted from reporting if certain conditions are met. These conditions relate to use as a principal residence for the requisite length of time, exclusion of gain under § 121, amount of selling price, written assurances, etc. See Rev. Proc. 98-20, 1998-7 I.R.B. 32.

Thus, unless a real estate transaction is excepted from the reporting requirements of § 6045 by § 6045(e)(5) or by § 1.6045-4(c), the real estate reporting person is required to file a Form 1099-S reporting the gross proceeds and other required information, and to furnish the seller with the payee statement.

Interest Payments:

The interest component of a condemnation award is not part of the gross proceeds of the sale of the property. It is an additional payment that is necessary to give owners of condemned property the full equivalent of the value of the property at the time it was taken.

In Kieselbach v. Commissioner, 317 U.S. 399 (1943), 1943 C.B. 1008, the Court considered whether stated interest paid on a condemnation award for the period between the date title passed and the date of final payment was part of sales price (capital gain) or ordinary income. The Court concluded that it was ordinary income, either interest or a payment to meet the constitutional requirement of just compensation, but not part of the capital gain from the sale. See also Crews v. Commissioner, T.C.M. 1964-64.

Under § 61(a)(4) interest is includable in gross income. Section 1.61-7(a) states that interest income includes the interest portion of a condemnation award. Section 6049 requires every person who makes payments of interest of \$10 or more in any calendar year to file an information return. The interest you inquire about, however, does not meet the definition of interest under § 6049. See § 6049(b) and § 1.6049-5(a).

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Section 6041(a) provides that all persons engaged in a trade or business and making payment in the course of that trade or business to another person of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income (other than certain payments not here relevant) of \$600 or more in any taxable year must render a true and accurate return under regulations prescribed by the Secretary setting forth the amount of those gains, profits, and income, and the name and address of the recipient of the payment. Governmental agencies are subject to the reporting requirements of § 6041. Section 1.6041-1(b) and (g). Section 1.6041-1(c) states that income is fixed when it is to be paid in amounts definitely predetermined and that income is determinable whenever there is a basis of calculation by which the amount to be paid may be ascertained.

Although interest may be paid to give the owner full value for the property taken, it is not part of the sale price, as discussed above. However, the interest payments are fixed and determinable income at the time of payment. Therefore, the reporting requirements of § 6041(a) apply to such payments of \$600 or more in a taxable year.¹ The form on which the interest must be reported is Form 1099-MISC..

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This memorandum is for your general information and is advisory only. It is not intended to be conclusive as to the tax consequences for any specific taxpayer. If we can be of further assistance, please contact CC:DOM:IT&A:2 at 202-622-4920..

¹Although § 1.6041-3(j) provides an exemption from the reporting requirements of § 6041(a) for certain state payments, this exemption applies only to obligations that are issued in exercise of the state's borrowing power. U.S. Trust Co. of New York v. Anderson, 65 F.2d 575 (2d Cir. 1933), cert. denied, 290 U.S. 683 (1933).