Publication 544

Sales and Other Dispositions of Assets

For use in preparing
2023 Returns

Volume 1 of 5

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Future Developments

For the latest information about developments related to Pub. 544, such as legislation enacted after it was published, go to *IRS.gov/Pub544.*

Important Reminders

Dispositions of U.S. real property interests by foreign persons. If you are a foreign person or firm and you sell or otherwise dispose of a U.S. real property interest, the buyer (or other transferee) may have to withhold income tax on the amount you receive for the property (including cash, the fair market value of other property, and any assumed liability). Corporations, partnerships, trusts, and estates may also have to withhold on certain U.S. real property interests they distribute to you. You must report these dispositions and distributions and any income tax withheld on your U.S. income tax return.

For more information on dispositions of U.S. real property interests, see Pub. 519, U.S. Tax Guide for Aliens. Also, see Pub. 515, Withholding of Tax on Nonresident Aliens and Foreign Entities.

Foreign source income. If you are a U.S. citizen with income from dispositions of property outside the United States (foreign income), you must report all such income on your tax return unless it is exempt from U.S. law. You must report the income whether you reside inside or outside the United States and whether or not you receive a Form 1099 from the foreign payor.

Photographs of missing children. The Internal Revenue Service is a proud partner with the *National Center for Missing & Exploited Children® (NCMEC)*. Photographs of missing children selected by the Center may appear in this publication on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling 800-THE-LOST (800-843-5678) if you recognize a child.

Introduction

You dispose of property when any of the following occur.

- You sell property.
- You exchange property for other property.
- Your property is condemned or disposed of under threat of condemnation.
- Your property is repossessed.
- You abandon property.
- You give property away.

This publication explains the tax rules that apply when you dispose of property, including when you dispose of only a portion of certain property. It discusses the following topics.

- How to figure a gain or loss on the sale, exchange, and other disposition of property.

- Whether your gain or loss is ordinary or capital.
- How to treat your gain or loss when you dispose of business property.
- How to report a gain or loss on your tax return.

This publication also explains whether your gain is taxable or your loss is deductible.

This publication does not discuss certain transactions covered in other IRS publications. These include the following.

- Most transactions involving stocks, bonds, options, forward and futures contracts, and similar investments. See chapter 4 of Pub. 550, Investment Income and Expenses.
- Sale of your main home. See Pub. 523, Selling Your Home.
- Installment sales. See Pub. 537, Installment Sales.

- Transfers of property at death. See Pub. 559, Survivors, Executors, and Administrators.

Note. Although the discussions in this publication refer mainly to individuals, many of the rules discussed also apply to taxpayers other than individuals. However, the rules for property held for personal use usually apply to individual taxpayers.

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Gain or Loss

Topics

This chapter discusses:

- Sales and exchanges
- Abandonments
- Foreclosures and repossessions
- Involuntary conversions
- Nontaxable exchanges
- Transfers to spouse

- Rollovers, exclusions, and deferrals of certain capital gains

Useful Items

You may want to see:

Publication

- ☐ **523** Selling Your Home
- ☐ **537** Installment Sales
- ☐ **547** Casualties, Disasters, and Thefts
- ☐ **550** Investment Income and Expenses
- ☐ **551** Basis of Assets
- ☐ **908** Bankruptcy Tax Guide
- ☐ **4681** Canceled Debts, Foreclosures, Repossessions, and Abandonments (for Individuals)

Form (and Instructions)

- ☐ **Schedule D (Form 1040)** Capital Gains and Losses

- ☐ **1040** U.S. Individual Income Tax Return
- ☐ **1040-X** Amended U.S. Individual Income Tax Return
- ☐ **1099-A** Acquisition or Abandonment of Secured Property
- ☐ **1099-C** Cancellation of Debt
- ☐ **4797** Sales of Business Property
- ☐ **8824** Like-Kind Exchanges
- ☐ **8949** Sales and Other Dispositions of Capital Assets

See *How To Get Tax Help* for information about getting publications and forms.

Sales and Exchanges

A sale is a transfer of property for money or a mortgage, note, or other promise to pay money. An exchange is a transfer of property for other property or services. Property sold or exchanged may include the sale of a portion of a Modified Accelerated Cost Recovery System (MACRS) asset (discussed later).

The following discussions describe the kinds of transactions that are treated as sales or exchanges and explain how to figure gain or loss.

Sale or lease. Some agreements that seem to be leases may really be conditional sales contracts. The intention of the parties to the agreement can help you distinguish between a sale and a lease.

There is no test or group of tests to prove what the parties intended when they made the agreement. You should consider each agreement based on its own facts and circumstances.

Cancellation of a lease. Payments received by a tenant for the cancellation of a lease are treated as an amount realized from the sale of property. Payments received by a landlord (lessor) for the cancellation of a lease are essentially a substitute for rental payments and are taxed as ordinary income in the year in which they are received.

Copyright. Payments you receive for granting the exclusive use of (or right to exploit) a copyright throughout its life in a particular medium are treated as received from the sale of property. It does not matter if the payments are a fixed amount or a percentage of receipts from the sale, performance, exhibition, or publication of the copyrighted work, or an amount based on the number of copies sold, performances given, or exhibitions made. Also, it does not matter if the payments are made over the same period as that covering the grantee's use of the copyrighted work.

If the copyright was used in your trade or business and you held it longer than a year, the gain or loss may be a section 1231 gain or loss. For more information, see *Section 1231 Gains and Losses* in chapter 3.

Easement. The amount received for granting an easement is subtracted from the basis of the property. If only a specific part of the entire tract of property is affected by the easement, only the basis of that part is reduced by the amount received. If it is impossible or impractical to separate the basis of the part of the property on which the easement is granted, the basis of the whole property is reduced by the amount received.

Any amount received that is more than the basis to be reduced is a taxable gain. The transaction is reported as a sale of property.

If you transfer a perpetual easement for consideration and do not keep any beneficial interest in the part of the property affected by the easement, the transaction will be treated as a sale of property. However, if you make a qualified conservation contribution of a restriction or easement granted in perpetuity, it is treated as a charitable contribution and not a sale or exchange, even though you keep a beneficial interest in the property affected by the easement.

If you grant an easement on your property (for example, a right-of-way over it) under condemnation or threat of condemnation, you are considered to have made a forced

sale, even though you keep the legal title. Although you figure gain or loss on the easement in the same way as a sale of property, the gain or loss is treated as a gain or loss from a condemnation. See *Gain or Loss From Condemnations*, later.

Property transferred to satisfy debt. A transfer of property to satisfy a debt is an exchange.

Note's maturity date extended. The extension of a note's maturity date may be treated as an exchange of the outstanding note for a new and materially different note.

If so, that exchange may result in a gain or loss to the holder of the note. Generally, an extension will be treated as a taxable exchange of the outstanding note for a new and materially different note only if the changes in the terms of the note are significant. Each case must be determined on its own facts. For more information, see Treasury Regulations section 1.1001-3.

Transfer on death. The transfer of property of a decedent to an executor or administrator of the estate, or to the heirs or beneficiaries, is not a sale or exchange or other disposition. No taxable gain or deductible loss results from the transfer.

Bankruptcy. Generally, a transfer (other than by sale or exchange) of property from a debtor to a bankruptcy estate is not treated as a disposition. Consequently, the transfer does not generally result in gain or loss. For more information, see Pub. 908, Bankruptcy Tax Guide.

Gain or Loss From Sales and Exchanges

You usually realize gain or loss when property is sold or exchanged. A gain is the amount you realize from a sale or exchange of property that is more than its adjusted basis. A loss occurs when the adjusted basis of the property is more than the amount you realize on the sale or exchange.

Table 1-1. **How To Figure Whether You Have a Gain or Loss**

IF your...	**THEN you have a...**
adjusted basis is more than the amount realized,	loss.
amount realized is more than the adjusted basis,	gain.

Basis. You must know the basis of your property to determine whether you have a gain or loss from its sale or other disposition. The basis of property you buy is usually its cost. However, if you acquired the property by gift, inheritance, or in some way other than buying it, you must use a basis other than its cost. See *Basis Other Than Cost* in Pub. 551.

Inherited property. If you inherited property and received a Schedule A (Form 8971) that indicates that the property increased the estate tax liability of the decedent, use a basis consistent with the final estate tax value of the property to determine your initial basis in the property. Calculate a basis consistent with the final estate tax value by starting with the reported value and then making any allowed adjustments. See the Instructions for Form 8971. Also, see the Instructions for Form 8949 for details on how to figure the basis and make any adjustments. In addition, see the Instructions for Form 8949 and the Instructions for Form 8971 for penalties that may apply for inconsistent basis reporting.

Adjusted basis. The adjusted basis of property is your original cost or other basis increased by certain additions and decreased by certain deductions. Increases to basis include costs of any improvements having a useful life of more than 1 year. Decreases to basis include depreciation and casualty losses. In the sale or exchange of a portion of a MACRS asset (discussed later), the adjusted basis of the disposed portion of the asset is used to figure gain or loss. For more details and additional examples, see *Adjusted Basis* in Pub. 551.

Amount realized. The amount you realize from a sale or exchange is the total of all the money you receive plus the fair market value (defined below) of all property or services you receive. The amount you realize also includes any of your liabilities that were assumed by the buyer and any liabilities to which the property you transferred is subject, such as real estate taxes or a mortgage.

Fair market value. Fair market value is the price at which the property would change hands between a buyer and a seller when both have reasonable knowledge of all the necessary facts and neither is being forced to buy or sell. If parties with adverse interests place a value on property in an arm's-length transaction, that is strong evidence of fair market value. If there is a stated price for services, this price is treated as the fair market value unless there is evidence to the contrary.

Example 1. You used a building in your business that cost you $70,000. You made certain permanent improvements at a cost of $20,000 and deducted depreciation totaling $10,000. You sold the building for $100,000 plus property having a fair market value of

$20,000. The buyer assumed your real estate taxes of $3,000 and a mortgage of $17,000 on the building. The selling expenses were $4,000. Your gain on the sale is figured as follows.

Amount realized:		
Cash.....................	$100,000	
Fair market value of property received........	20,000	
Real estate taxes assumed by buyer.......	3,000	
Mortgage assumed by buyer.....................	17,000	
Total.....................	140,000	
Minus: Selling expenses.......	(4,000)	$136,000

Adjusted basis:

Cost of building.........	$70,000	
Improvements...........	20,000	
Total.....................	$90,000	
Minus: Depreciation....	(10,000)	
Adjusted basis............		$80,000
Gain on sale............		**$56,000**

Example 2. You own a building that cost you $120,000. You use the building in your business. The building is a MACRS asset. You replaced the old elevator in the building and sold it for $1,000. You determine the cost of the portion of the building attributable to the old elevator is $5,000. Depreciation deducted on the old elevator portion of the building was $2,500 before its sale. The sale of the

elevator is a sale of a portion of a MACRS asset, the building. Your loss on the sale of the elevator is figured as follows.

Amount realized:	
Cash..............................	$1,000
Adjusted basis:	
Cost of elevator........................	$5,000
Minus: Depreciation................	(2,500)
Adjusted basis.........................	$2,500
Loss on sale..........................	**$1,500**

Example 3. You own a bulldozer that cost you $30,000. You use the bulldozer in your business. The bulldozer is a MACRS asset. You replaced the old bucket on the bulldozer and sold it for $800. You determine the cost of the portion of the bulldozer attributable to

the old bucket is $4,000. Depreciation deducted on the old bucket portion of the bulldozer was $3,800 before its sale. The sale of the bucket is a sale of a portion of a MACRS asset, the bulldozer. Your gain on the sale of the bucket is figured as follows.

Amount realized:	
Cash................................	$800
Adjusted basis:	
Cost of bucket.........................	$4,000
Minus: Depreciation.....................	(3,800)
Adjusted basis.........................	$200
Gain on sale..........................	**$600**

Amount recognized. Your gain or loss realized from a sale or exchange of property is usually a recognized gain or loss for tax purposes. This includes a gain or loss realized from a sale or exchange of a portion of a MACRS asset. Recognized gains must be included in gross income. Recognized losses are deductible from gross income.

However, your gain or loss realized from certain exchanges of property is not recognized for tax purposes. See *Nontaxable Exchanges*, later. Also, a loss from the sale or other disposition of property held for personal use is not deductible, except in the case of a casualty or theft loss.

Interest in property. The amount you realize from the disposition of a life interest in property, an interest in property for a set number of years, or an income interest in a trust is a recognized gain under certain circumstances. If you received the interest as a gift, inheritance, or in a transfer from a spouse or former spouse incident to a divorce, the amount realized is a recognized gain. Your basis in the property is disregarded. This rule does not apply if all interests in the property are disposed of at the same time.

Example 1. Your parent dies and leaves the farm to you for life with a remainder interest to your younger sibling. You decide to sell your life interest in the farm. The entire amount you receive is a recognized gain. Your basis in the farm is disregarded.

Example 2. The facts are the same as in *Example 1*, except that your sibling joins you in selling the farm. The entire interest in the property is sold, so your basis in the farm is not disregarded. Your gain or loss is the difference between your share of the sales price and your adjusted basis in the farm.

Canceling a sale of real property. If you sell real property under a sales contract that allows the buyer to return the property for a full refund and the buyer does so, you may not have to recognize gain or loss on the sale. If the buyer returns the property in the same tax year of sale, no gain or loss is recognized. This cancellation of the sale in the same tax year it occurred places both you and the buyer in the same positions you were in before the sale. If the buyer returns the property in a later tax year, you must recognize gain (or loss, if allowed) in the year of the sale. When the property is returned in a later tax year, you acquire a new basis in the property. That basis is equal to the amount you pay to the buyer.

Bargain Sale

If you sell or exchange property for less than fair market value with the intent of making a gift, the transaction is partly a sale or exchange and partly a gift. You have a gain if the amount realized is more than your adjusted basis in the property. However, you do not have a loss if the amount realized is less than the adjusted basis of the property.

Bargain sales to charity. A bargain sale of property to a charitable organization is partly a sale or exchange and partly a charitable contribution. If a charitable deduction for the contribution is allowable, you must allocate your adjusted basis in the property between the part sold and the part contributed based on the fair market value of each. The adjusted basis of the part sold is figured as follows.

$$\text{Adjusted basis ofentire property} \times \frac{\text{Amount realized(fair market value of part sold)}}{\text{Fair market value of entireproperty}}$$

Adjusted basis of Amount realized entire property × (fair market value of part sold)

Fair market value of entire property

Based on this allocation rule, you will have a gain even if the amount realized is not more than your adjusted basis in the property. This allocation rule does not apply if a charitable contribution deduction is not allowable.

See Pub. 526 for information on figuring your charitable contribution.

Example. You sold property with a fair market value of $10,000 to a charitable organization for $2,000 and are allowed a deduction for your contribution. Your adjusted basis in the property is $4,000. Your gain on the sale is $1,200, figured as follows.

Sales price.............................	$2,000
Minus: Adjusted basis of part sold ($4,000 × ($2,000 ÷ $10,000))......	(800)
Gain on the sale.......................	**$1,200**

Property Used Partly for Business or Rental

Generally, if you sell or exchange property you used partly for business or rental purposes and partly for personal purposes, you must figure the gain or loss on the sale or exchange separately for the business or rental part and the personal-use part. You must subtract depreciation you took or could have taken from the basis of the business or rental part. However, see the special rule, later, for a home used partly for business or rental. You must allocate the selling price, selling expenses, and the basis of the property between the business or rental part and the personal part.

Gain or loss on the business or rental part of the property may be a capital gain or loss or an ordinary gain or loss, as discussed in chapter 3 under *Section 1231 Gains and Losses.* You cannot deduct a loss on the personal part. Any gain or loss on the part of the home used for business is an ordinary gain or loss, as applicable, reportable on Form 4797. Any gain or loss on the part producing income for which the underlying activity does not rise to the level of a trade or business is a capital gain or loss, as applicable. However, see *Disposition of depreciable property not used in trade or business* in chapter 4.

Home used partly for business or rental. If you use property partly as a home and partly for business or to produce rental income, the computation and treatment of any gain on the sale depends partly on whether the business or rental part of the property is considered within your home or not. See *Business or Rental Use of Home* in Pub. 523.

Property Changed to Business or Rental Use

You cannot deduct a loss on the sale of property you purchased or constructed for use as your home and used as your home until the time of sale.

You can deduct a loss on the sale of property you acquired for use as your home but changed to business or rental property and used as business or rental property at the time of sale. However, if the adjusted basis of the property at the time of the change was more than its fair market value, the loss you can deduct is limited.

Figure the loss you can deduct as follows.

1. Use the lesser of the property's adjusted basis or fair market value at the time of the change.
2. Add to (1) the cost of any improvements and other increases to basis since the change.
3. Subtract from (2) depreciation and any other decreases to basis since the change.

4. Subtract the amount you realized on the sale from the result in (3). If the amount you realized is more than the result in (3), treat this result as zero.

The result in (4) is the loss you can deduct.

Example. You changed your main home to rental property 5 years ago. At the time of the change, the adjusted basis of your home was $75,000 and the fair market value was $70,000. This year, you sold the property for $55,000. You made no improvements to the property but you have depreciation expenses of $12,620 over the 5 prior years. Although your loss on the sale is $7,380 [($75,000 − $12,620) − $55,000], the amount you can deduct as a loss is limited to $2,380, figured as follows.

Lesser of adjusted basis or fair market value at time of the change...........................	$70,000

Plus: Cost of any improvements and any other additions to basis after the change..................	-0-
70,000	
Minus: Depreciation and any other decreases to basis after the change........................	(12,620)
	57,380
Minus: Amount you realized from the sale..........	(55,000)
Deductible loss....................	**$2,380**

Gain. If you have a gain on the sale, you must generally recognize the full amount of the gain. You figure the gain by subtracting your adjusted basis from your amount realized, as described earlier.

You may be able to exclude all or part of the gain if you owned and lived in the property as your main home for at least 2 years during the 5-year period ending on the date of sale. However, you may not be able to exclude the part of the gain allocated to any period of nonqualified use.

For more information, including special rules that apply if the home sold was acquired in a like-kind exchange, see Pub. 523. Also, see *Like-Kind Exchanges*, later.

Partial Dispositions of MACRS Property

You may elect to recognize a partial disposition of a MACRS asset, and report the gain, loss, or other deduction on a timely filed return, including extensions, for the year of the disposition. In some cases, however, you are required to report the gain or loss on the partial disposition of a MACRS asset (see *Required partial dispositions*, later). MACRS assets include buildings (and their structural components) and other tangible depreciable property placed in service after 1986 that is used in a trade or business or for the production of income.

For more information on partial dispositions of MACRS property, see Treasury Regulations section 1.168(i)-8(d).

Partial disposition election. If you elect to recognize a partial disposition of a MACRS asset, report the gain or loss (if any) on Form 4797, Part I, II, or III, as applicable. See the Instructions for Form 4797.

Required partial dispositions. Report the gain or loss (if any) on the following partial dispositions of MACRS assets on Form 4797, Part I, II, or III, as applicable.

- Sale of a portion of a MACRS asset.
- Involuntary conversion of a portion of a MACRS asset, other than from a casualty or theft.

- Like-kind exchange of a portion of a MACRS asset (Form 4797, line 5 or 16).

Abandonments

The abandonment of property is a disposition of property. You abandon property when you voluntarily and permanently give up possession and use of the property with the intention of ending your ownership but without passing it on to anyone else. Generally, abandonment is not treated as a sale or exchange of the property. If the amount you realize (if any) is more than your adjusted basis, then you have a gain. If your adjusted basis is more than the amount you realize (if any), then you have a loss.

Loss from abandonment of business or investment property is deductible as a loss. A loss from an abandonment of business or investment property that is not treated as a sale or exchange is generally an ordinary loss. This rule also applies to leasehold improvements the lessor made for the lessee that were abandoned. Loss from abandonment of a portion of a MACRS asset is deductible, if you make a partial disposition election.

Partial disposition election. You make a partial disposition election by reporting the loss (or gain) on your timely filed original tax return, including extensions, for the tax year in which the portion of a MACRS asset is abandoned. If you make a partial disposition election for an asset included in one of the asset classes 00.11 through 00.4 of Revenue Procedure 87-56, you must classify the replacement portion under the same asset class as the disposed portion of the asset. The adjusted basis of the disposed portion of the asset is used to figure gain or loss. See *Adjusted Basis* in Pub. 551 for more details and examples.

If the property is foreclosed on or repossessed in lieu of abandonment, gain or loss is figured as discussed later under *Foreclosures and Repossessions*. The abandonment loss is deducted in the tax year in which the loss is sustained.

If the abandoned property is secured by debt, special rules apply. The tax consequences of abandonment of property that is secured by debt depend on whether you are personally liable for the debt (recourse debt) or you are not personally liable for the debt (nonrecourse debt). For more information, including examples, see chapter 3 of Pub. 4681.

You cannot deduct any loss from abandonment of your home or other property held for personal use only.

Cancellation of debt. If the abandoned property secures a debt for which you are personally liable and the debt is canceled, you may realize ordinary income equal to the canceled debt. This income is separate from any loss realized from abandonment of the property.

You must report this income on your tax return unless one of the following applies.

- The cancellation is intended as a gift.
- The debt is qualified farm debt.
- The debt is qualified real property business debt.
- You are insolvent or bankrupt.
- The debt is qualified principal residence indebtedness.

File Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment), to report the income exclusion.

Forms 1099-A and 1099-C. If you abandon property that secures a loan and the lender knows the property has been abandoned, the lender should send you Form 1099-A showing information you need to figure your loss from the abandonment. However, if your debt is canceled and the lender must file Form 1099-C, the lender may include the information about the abandonment on that form instead of on Form 1099-A, and send you Form 1099-C only. The lender must file Form 1099-C and send you a copy if the amount of debt canceled is $600 or more and the lender is a financial institution, credit union, federal government agency, or any organization that has a significant trade or business of lending money. For abandonments of property and debt cancellations occurring in 2023, these forms should be sent to you by January 31, 2024.

Foreclosures and Repossessions

If you do not make payments you owe on a loan secured by property, the lender may foreclose on the loan or repossess the property. The foreclosure or repossession is treated as a sale or exchange from which you may realize a gain or loss. This is true even if you voluntarily return the property to the lender. You may realize ordinary income from the cancellation of debt if the loan balance is more than the fair market value of the property.

Buyer's (borrower's) gain or loss. You figure and report gain or loss from a foreclosure or repossession in the same way as gain or loss from a sale or exchange. The gain or loss is the difference between your adjusted basis in the transferred property and the amount realized. See *Gain or Loss From Sales and Exchanges*, earlier.

TIP *You can use Table 1-2 to figure your gain or loss from a foreclosure or repossession.*

Amount realized on a nonrecourse debt. If you are not personally liable for repaying the debt (nonrecourse debt) secured by the transferred property, the amount you realize includes the full debt canceled by the transfer. The full canceled debt is included even if the fair market value of the property is less than the canceled debt.

Example 1. You bought a new car for $15,000. You paid $2,000 down and borrowed the remaining $13,000 from the dealer's credit company. You are not personally liable for the loan (nonrecourse debt), and pledge the new car as security. The credit company repossessed the car because you stopped making loan payments. The balance due after taking into account the payments you made was $10,000. The fair market value of the car when repossessed was $9,000. The amount you realized on the repossession is $10,000. That is the outstanding amount of the debt canceled by the repossession, even though the car's fair market value is less than $10,000. You figure your gain or loss on the repossession by comparing the amount realized ($10,000) with your adjusted basis ($15,000). You have a $5,000 nondeductible loss.

Example 2. You paid $200,000 for your home. You paid $15,000 down and borrowed the remaining $185,000 from a bank. You are not personally liable for the loan (nonrecourse debt), and pledge the house as security. The bank foreclosed on the loan because you stopped making payments. When the bank foreclosed on the loan, the balance due was $180,000, the fair market value of the house was $170,000, and your adjusted basis was $175,000 due to a casualty loss you had deducted. The amount you realized on the foreclosure is $180,000, the balance due and debt canceled by the foreclosure. You figure your gain or loss by comparing the amount realized ($180,000) with your adjusted basis ($175,000). You have a $5,000 realized gain.

Amount realized on a recourse debt. If you are personally liable for the debt (recourse debt), the amount realized on the foreclosure or repossession includes the lesser of:

- The outstanding debt immediately before the transfer reduced by any amount for which you remain personally liable immediately after the transfer, or
- The fair market value of the transferred property.

You are treated as receiving ordinary income from the canceled debt for the part of the debt that is more than the fair market value. The amount realized does not include the canceled debt that is your income from cancellation of debt. See *Cancellation of debt*, later.

Seller's (lender's) gain or loss on repossession. If you finance a buyer's purchase of property and later acquire an interest in it through foreclosure or repossession, you may have a gain or loss on the acquisition. For more information, see *Repossession* in Pub. 537.

Cancellation of debt. If property that is repossessed or foreclosed on secures a debt for which you are personally liable (recourse debt), you must generally report as ordinary income the amount by which the canceled debt is more than the fair market value of the property. This income is separate from any gain or loss realized from the foreclosure or repossession. Report the income from cancellation of a debt related to a business or rental activity as business or rental income.

TIP *You can use Table 1-2 to figure your income from cancellation of debt.*

You must report this income on your tax return unless one of the following applies.

- The cancellation is intended as a gift.
- The debt is qualified farm debt.

- The debt is qualified real property business debt.
- You are insolvent or bankrupt.
- The debt is qualified principal residence indebtedness.

File Form 982 to report the income exclusion.

Example 1. Assume the same facts as in Example 1 under *Amount realized on a nonrecourse debt*, earlier, except you are personally liable for the car loan (recourse debt). In this case, the amount you realize is $9,000. This is the lesser of the canceled debt ($10,000) or the car's fair market value ($9,000). You figure your gain or loss on the repossession by comparing the amount realized ($9,000) with your adjusted basis ($15,000). You have a $6,000 nondeductible loss. You are also treated as receiving ordinary income from cancellation of debt. That income is $1,000 ($10,000 − $9,000). This is the part of the canceled debt not included in the amount realized.

Table 1-2. **Worksheet for Foreclosures and Repossessions** *Keep for Your Records*

Part 1. Use Part 1 to figure your ordinary income from the cancellation of debt upon foreclosure or repossession. Complete this part only if you were personally liable for the debt. Otherwise, go to Part 2.	
1. Enter the amount of outstanding debt immediately before the transfer of property reduced by any amount for which you remain personally liable after the transfer of property . . .	______
2. Enter the fair market value of the transferred property . . .	______
3. Ordinary income from cancellation of debt upon foreclosure or repossession.* Subtract line 2 from line 1. If less than zero, enter -0- . . .	______
Part 2. Figure your gain or loss from foreclosure or repossession.	
4. If you completed Part 1, enter the **smaller** of line 1 or line 2. If you did not complete Part 1, enter the outstanding debt immediately before the transfer of property . . .	______
5. Enter any proceeds you received from the foreclosure sale . . .	______
6. Add lines 4 and 5 . . .	______
7. Enter the adjusted basis of the transferred property . . .	______
8. Gain or loss from foreclosure or repossession. Subtract line 7 from line 6 . . .	______

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Example 2. Assume the same facts as in *Example 2* under *Amount realized on a nonrecourse debt*, earlier, except you are personally liable for the loan (recourse debt).

* The income may not be taxable. See *Cancellation of debt*.

In this case, the amount you realize is $170,000. This is the lesser of the canceled debt ($180,000) or the fair market value of the house ($170,000). You figure your gain or loss on the foreclosure by comparing the amount realized ($170,000) with your adjusted basis ($175,000). You have a $5,000 nondeductible loss. You are also treated as receiving ordinary income from cancellation of debt. (The debt is not exempt from tax as discussed under *Cancellation of debt*, earlier.) That income is $10,000 ($180,000 − $170,000). This is the part of the canceled debt not included in the amount realized.

Forms 1099-A and 1099-C. A lender who acquires an interest in your property in a foreclosure or repossession should send you Form 1099-A showing the information you need to figure your gain or loss. However, if the lender also cancels part of your debt and must file Form 1099-C, the lender may include the information about the foreclosure or repossession on that form instead of on Form 1099-A and send you Form 1099-C only. The lender must file Form 1099-C and send you a copy if the amount of debt canceled is $600 or more and the lender is a financial institution, credit union, federal government agency, or any organization that has a significant trade or business of lending money. For foreclosures or repossessions occurring in 2023, these forms should be sent to you by January 31, 2024.

Involuntary Conversions

An involuntary conversion occurs when your property is destroyed, stolen, condemned, or disposed of under the threat of condemnation and you receive other property or money in payment, such as insurance or a condemnation award. Involuntary conversions are also called involuntary exchanges.

Gain or loss from an involuntary conversion of your property is usually recognized for tax purposes unless the property is your main home. You report the gain or deduct the loss on your tax return for the year you realize it. You cannot deduct a loss from an involuntary conversion of property you held for personal use unless the loss resulted from a casualty or theft.

However, depending on the type of property you receive, you may not have to report a gain on an involuntary conversion. Generally, you do not report the gain if you receive property that is similar or related in service or use to the converted property. Your basis for the new property is the same as your basis for the converted property. This means that the gain is deferred until a taxable sale or exchange occurs.

If you receive money or property that is not similar or related in service or use to the involuntarily converted property and you buy qualifying replacement property within a certain period of time, you can elect to postpone reporting the gain on the property purchased.

If a portion of a MACRS asset you own is involuntarily converted and gain is not recognized in whole or in part, the partial disposition rules in Treasury Regulations section 1.168(i)-8 apply.

This publication explains the treatment of a gain or loss from a condemnation or disposition under the threat of condemnation. If you have a gain or loss from the destruction or theft of property, see Pub. 547.

Condemnations

A condemnation is the process by which private property is legally taken for public use without the owner's consent. The property may be taken by the federal government, a state government, a political subdivision, or a private organization that has the power to legally take it. The owner receives a condemnation award (money or property) in exchange for the property taken. A condemnation is like a forced sale, the owner being the seller and the condemning authority being the buyer.

Example. A local government authorized to acquire land for public parks informed you that it wished to acquire your property. After the local government took action to condemn your property, you went to court to keep it. But, the court decided in favor of the local government, which took your property and paid you an amount fixed by the court. This is a condemnation of private property for public use.

Threat of condemnation. A threat of condemnation exists if a representative of a government body or a public official authorized to acquire property for public use informs you that the government body or official has decided to acquire your property. You must have reasonable grounds to believe that, if you do not sell voluntarily, your property will be condemned.

The sale of your property to someone other than the condemning authority will also qualify as an involuntary conversion, provided you have reasonable grounds to believe that your property will be condemned. If the buyer of this property knows at the time of purchase that it will be condemned and sells it to the condemning authority, this sale also qualifies as an involuntary conversion.

Reports of condemnation. A threat of condemnation exists if you learn of a decision to acquire your property for public use through a report in a newspaper or other news medium, and this report is confirmed by a representative of the government body or public official involved. You must have reasonable grounds to believe that they will take necessary steps to condemn your property if you do not sell voluntarily. If you relied on oral statements made by a government representative or public official, the IRS may ask you to get written confirmation of the statements.

Example. Your property lies along public utility lines. The utility company has the authority to condemn your property. The company informs you that it intends to acquire your property by negotiation or condemnation. A threat of condemnation exists when you receive the notice.

Related property voluntarily sold. A voluntary sale of your property may be treated as a forced sale that qualifies as an involuntary conversion if the property had a substantial economic relationship to property of yours that was condemned. A substantial economic relationship exists if together the properties were one economic unit. You must also show that the condemned property could not reasonably or adequately be replaced. You can elect to postpone reporting the gain by buying replacement property. See *Postponement of Gain*, later.

Gain or Loss From Condemnations

If your property was condemned or disposed of under the threat of condemnation, figure your gain or loss by comparing the adjusted basis of your condemned property with your net condemnation award.

If your net condemnation award is more than the adjusted basis of the condemned property, you have a gain. You can postpone reporting gain from a condemnation if you buy replacement property. If only part of your property is condemned, you can treat the cost of restoring the remaining part to its former usefulness as the cost of replacement property. See *Postponement of Gain*, later.

If your net condemnation award is less than your adjusted basis, you have a loss. If your loss is from property you held for personal use, you cannot deduct it. You must report any deductible loss in the tax year it happened.

TIP *You can use Part 2 of Table 1-3 to figure your gain or loss from a condemnation award.*

Main home condemned. If you have a gain because your main home is condemned, you can generally exclude the gain from your income as if you had sold or exchanged your home. You may be able to exclude up to $250,000 of the gain (up to $500,000 if married filing jointly). For information on this exclusion, see Pub. 523. If your gain is more than you can exclude but you buy replacement property, you may be able to postpone reporting the rest of the gain. See *Postponement of Gain*, later.

Condemnation award. A condemnation award is the money you are paid or the value of other property you receive for your condemned property. The award is also the amount you are paid for the sale of your property under threat of condemnation.

Payment of your debts. Amounts taken out of the award to pay your debts are considered paid to you. Amounts the government pays directly to the holder of a mortgage or lien against your property are part of your award, even if the debt attaches to the property and is not your personal liability.

Example. The state condemned your property for public use. The award was set at $200,000. The state paid you only $148,000 because it paid $50,000 to your mortgage holder and $2,000 accrued real estate taxes. You are considered to have received the entire $200,000 as a condemnation award.

Interest on award. If the condemning authority pays you interest for its delay in paying your award, it is not part of the condemnation award. You must report the interest separately as ordinary income.

Payments to relocate. Payments you receive to relocate and replace housing because you have been displaced from your home, business, or farm as a result of federal or federally assisted programs are not part of the condemnation award. Do not include them in your income. Replacement housing payments used to buy new property are included in the property's basis as part of your cost.

Net condemnation award. A net condemnation award is the total award you received, or are considered to have received, for the condemned property minus your expenses of obtaining the award. If only a part of your

property was condemned, you must also reduce the award by any special assessment levied against the part of the property you retain. This is discussed later under *Special assessment retained out of award*.

Table 1-3. **Worksheet for Condemnations**

Keep for Your Records

Part 1. Gain from severance damages. If you did not receive severance damages, skip Part 1 and go to Part 2.	
1. Enter gross severance damages received	
2. Enter your expenses in getting severance damages	
3. Subtract line 2 from line 1. If less than zero, enter -0-	
4. Enter any special assessment on remaining property taken out of your award	
5. Net severance damages. Subtract line 4 from line 3. If less than zero, enter -0-	
6. Enter the adjusted basis of the remaining property	
7. Gain from severance damages. Subtract line 6 from line 5. If less than zero, enter -0-	
8. Refigured adjusted basis of the remaining property. Subtract line 5 from line 6. If less than zero, enter -0-	
Part 2. Gain or loss from condemnation award.	
9. Enter the gross condemnation award received	
10. Enter your expenses in getting the condemnation award	
11. If you completed Part 1, and line 4 is more than line 3, subtract line 3 from line 4. If you did not complete Part 1, but a special assessment was taken out of your award, enter that amount. Otherwise, enter -0-	
12. Add lines 10 and 11	
13. Net condemnation award. Subtract line 12 from line 9	
14. Enter the adjusted basis of the condemned property	
15. Gain from condemnation award. If line 14 is more than line 13, enter -0-. Otherwise, subtract line 14 from line 13 and skip line 16	
16. Loss from condemnation award. Subtract line 13 from line 14 (***Note:*** *You cannot deduct the amount on line 16 if the condemned property was held for personal use.*)	
Part 3. Postponed gain from condemnation. (Complete only if line 7 or line 15 is more than zero and you bought qualifying replacement property or made expenditures to restore the usefulness of your remaining property.)	
17. If you completed Part 1, and line 7 is more than zero, enter the amount from line 5. Otherwise, enter -0-	
18. If line 15 is more than zero, enter the amount from line 13. Otherwise, enter -0-	
19. Add lines 17 and 18. If the condemned property was your main home, subtract from this total the gain you excluded from your income and enter the result	
20. Enter the total cost of replacement property and any expenses to restore the usefulness of your remaining property	
21. Subtract line 20 from line 19. If less than zero, enter -0-	
22. If you completed Part 1, add lines 7 and 15. Otherwise, enter the amount from line 15. If the condemned property was your main home, subtract from this total the gain you excluded from your income and enter the result	
23. Recognized gain. Enter the **smaller** of line 21 or line 22	
24. Postponed gain. Subtract line 23 from line 22. If less than zero, enter -0-	

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Severance damages. Severance damages are not part of the award paid for the property condemned. They are paid to you if part of your property is condemned and the value of the part you keep is decreased because of the condemnation.

For example, you may receive severance damages if your property is subject to flooding because you sell flowage easement rights (the condemned property) under threat of condemnation. Severance damages may also be given to you if, because part of your property is condemned for a highway, you must replace fences, dig new wells or ditches, or plant trees to restore your remaining property to the same usefulness it had before the condemnation.

The contracting parties should agree on the specific amount of severance damages in writing. If this is not done, all proceeds from the condemning authority are considered awarded for your condemned property.

You cannot make a completely new allocation of the total award after the transaction is completed. However, you can show how much of the award both parties intended for severance damages. The severance damages part of the award is determined from all the facts and circumstances.

Example. You sold part of your property to the state under threat of condemnation. The contract you and the condemning authority signed showed only the total purchase price. It did not specify a fixed sum for severance damages. However, at settlement, the condemning authority gave you closing papers showing clearly the part of the purchase price that was for severance damages. You may treat this part as severance damages.

Treatment of severance damages. Your net severance damages are treated as the amount realized from an involuntary conversion of the remaining part of your property. Use them to reduce the basis of the remaining property. If the amount of severance damages is based on damage to a specific part of the property you kept, reduce the basis of only that part by the net severance damages.

If your net severance damages are more than the basis of your retained property, you have a gain. You may be able to postpone reporting the gain. See *Postponement of Gain*, later.

You can use Part 1 of Table 1-3 to figure any gain from severance damages and to refigure the adjusted basis of the remaining part of your property.

Net severance damages. To figure your net severance damages, you first must reduce your severance damages by your expenses in obtaining the damages. You then reduce them by any special assessment (described later) levied against the remaining part of the property and retained from the award by the condemning authority. The balance is your net severance damages.

Expenses of obtaining a condemnation award and severance damages. Subtract the expenses of obtaining a condemnation award, such as legal, engineering, and appraisal fees, from the total award. Also, subtract the expenses of obtaining severance damages, which may include similar expenses, from the severance damages paid to you. If you cannot determine which part of your expenses is for each part of the condemnation proceeds, you must make a proportionate allocation.

Example. You receive a condemnation award and severance damages. One-fourth of the total was designated as severance damages in your agreement with the condemning authority. You had legal expenses for the entire condemnation proceeding. You cannot determine how much of your legal expenses is for each part of the condemnation proceeds. You must allocate one-fourth of your legal expenses to the severance damages and the other three-fourths to the condemnation award.

Special assessment retained out of award. When only part of your property is condemned, a special assessment levied against the remaining property may be retained by the governing body from your condemnation award. An assessment may be levied if the remaining part of your property benefited by the improvement resulting from the condemnation. Examples of improvements that may cause a special assessment are widening a street and installing a sewer.

To figure your net condemnation award, you must reduce the amount of the award by the assessment retained from the award.

Example. To widen the street in front of your home, the city condemned a 25-foot deep strip of your land. You were awarded $5,000 for this and spent $300 to get the award. Before paying the award, the city levied a special assessment of $700 for the street improvement against your remaining property. The city then paid you only $4,300. Your net award is $4,000 ($5,000 total award minus $300 expenses in obtaining the award and $700 for the special assessment retained).

If the $700 special assessment was not retained from the award and you were paid $5,000, your net award would be $4,700 ($5,000 − $300). The net award would not change, even if you later paid the assessment from the amount you received.

Severance damages received. If severance damages are included in the condemnation proceeds, the special assessment retained from the severance damages is first used to reduce the severance damages. Any balance of the special assessment is used to reduce the condemnation award.

Example. You were awarded $4,000 for the condemnation of your property and $1,000 for severance damages. You spent $300 to obtain the severance damages. A special assessment of $800 was retained from the award. The $1,000 severance damages are reduced to zero by first subtracting the $300 expenses and then $700 of the special assessment. Your $4,000 condemnation award is reduced by the $100 balance of the special assessment, leaving a $3,900 net condemnation award.

Part business or rental. If you used part of your condemned property as your home and part as business or rental property, treat each part as a separate property. Figure your gain or loss separately because gain or loss on each part may be treated differently.

Some examples of this type of property are a building in which you live and operate a grocery, and a building in which you live on the first floor and rent out the second floor.

Example. You sold your building for $24,000 under threat of condemnation to a public utility company that had the authority to condemn. You rented half the building and lived in the other half. You paid $25,000 for the building and spent an additional $1,000 for a new roof. You claimed allowable depreciation of $4,600 on the rental half. You spent $200 in legal expenses to obtain the condemnation award. Figure your gain or loss as follows.

	Residential Part	**Business Part**
1) Condemnation award received . . .	$12,000	$12,000
2) Minus: Legal expenses, $200 . . .	(100)	(100)

3) Net condemnation award	$11,900	$11,900
4) Adjusted basis:		
1/2 of original cost, $25,000	$12,500	$12,500
Plus: 1/2 of cost of roof, $1,000	500	500
Total	$13,000	$13,000
5) Minus: Depreciation		(4,600)
6) Adjusted basis, business part .		$8,400
7) (Loss) on residential property	**($1,100)**	
8) Gain on business property .		**$3,500**

The loss on the residential part of the property is not deductible.

Postponement of Gain

Do not report the gain on condemned property if you receive only property that is similar or related in service or use to the condemned property. Your basis for the new property is the same as your basis for the old.

Money or unlike property received. You ordinarily must report the gain if you receive money or unlike property. You can elect to postpone reporting the gain if you buy property that is similar or related in service or use to the condemned property within the replacement period, discussed later. You can also elect to postpone reporting the gain if you buy a controlling interest (at least 80%) in a corporation owning property that is similar or related in service or use to the condemned property. See *Controlling interest in a corporation*, later.

To postpone reporting all the gain, you must buy replacement property costing at least as much as the amount realized for the condemned property. If the cost of the replacement property is less than the amount realized, you must report the gain up to the unspent part of the amount realized.

The basis of the replacement property is its cost reduced by the postponed gain. Also, if your replacement property is stock in a corporation that owns property similar or related in service or use, the corporation will generally reduce its basis in its assets by the amount by which you reduce your basis in the stock. See *Controlling interest in a corporation*, later.

TIP *You can use Part 3 of Table 1-3 to figure the gain you must report and your postponed gain.*

Postponing gain on severance damages. If you received severance damages for part of your property because another part was condemned and you buy replacement property, you can elect to postpone reporting gain. See *Treatment of severance damages*,

earlier. You can postpone reporting all your gain if the replacement property costs at least as much as your net severance damages plus your net condemnation award (if resulting in gain).

You can also make this election if you spend the severance damages, together with other money you received for the condemned property (if resulting in gain), to acquire nearby property that will allow you to continue your business. If suitable nearby property is not available and you are forced to sell the remaining property and relocate in order to continue your business, see *Postponing gain on the sale of related property* next.

If you restore the remaining property to its former usefulness, you can treat the cost of restoring it as the cost of replacement property.

Postponing gain on the sale of related property. If you sell property that is related to the condemned property and then buy replacement property, you can elect to postpone reporting gain on the sale. You must meet the requirements explained earlier under *Related property voluntarily sold*. You can postpone reporting all your gain if the replacement property costs at least as much as the amount realized from the sale plus your net condemnation award (if resulting in gain) plus your net severance damages, if any (if resulting in gain).

Buying replacement property from a related person. Certain taxpayers cannot postpone reporting gain from a condemnation if they buy the replacement property from a related person. For information on related persons, see *Nondeductible Loss* under *Sales and Exchanges Between Related Persons* in chapter 2.

This rule applies to the following taxpayers.

1. C corporations.
2. Partnerships in which more than 50% of the capital or profits interest is owned by C corporations.
3. All others (including individuals, partnerships (other than those in (2)), and S corporations) if the total realized gain for the tax year on all involuntarily converted properties on which there is realized gain of more than $100,000.

For taxpayers described in (3) above, gains cannot be offset with any losses when determining whether the total gain is more than $100,000. If the property is owned by a partnership, the $100,000 limit applies to the partnership and each partner. If the property is owned by an S corporation, the $100,000 limit applies to the S corporation and each shareholder.

Exception. This rule does not apply if the related person acquired the property from an unrelated person within the replacement period.

Advance payment. If you pay a contractor in advance to build your replacement property, you have not bought replacement property unless it is finished before the end of the replacement period (discussed later).

Replacement property. To postpone reporting gain, you must buy replacement property for the specific purpose of replacing your condemned property. You do not have to use the actual funds from the condemnation award to acquire the replacement property. Property you acquire by gift or inheritance does not qualify as replacement property.

Similar or related in service or use. Your replacement property must be similar or related in service or use to the property it replaces.

If the condemned property is real property you held for productive use in your trade or business or for investment (other than property held mainly for sale), like-kind property to be held either for productive use in trade or business or for investment will be treated as property similar or related in service or use. For a discussion of like-kind property, see *Like-Kind Property* under *Like-Kind Exchanges*, later.

Owner-user. If you are an owner-user, similar or related in service or use means that replacement property must function in the same way as the property it replaces.

Example. Your home was condemned and you invested the proceeds from the condemnation in a grocery store. Your replacement property is not similar or related in service or use to the condemned property. To be similar or related in service or use, your replacement property must also be used by you as your home.