

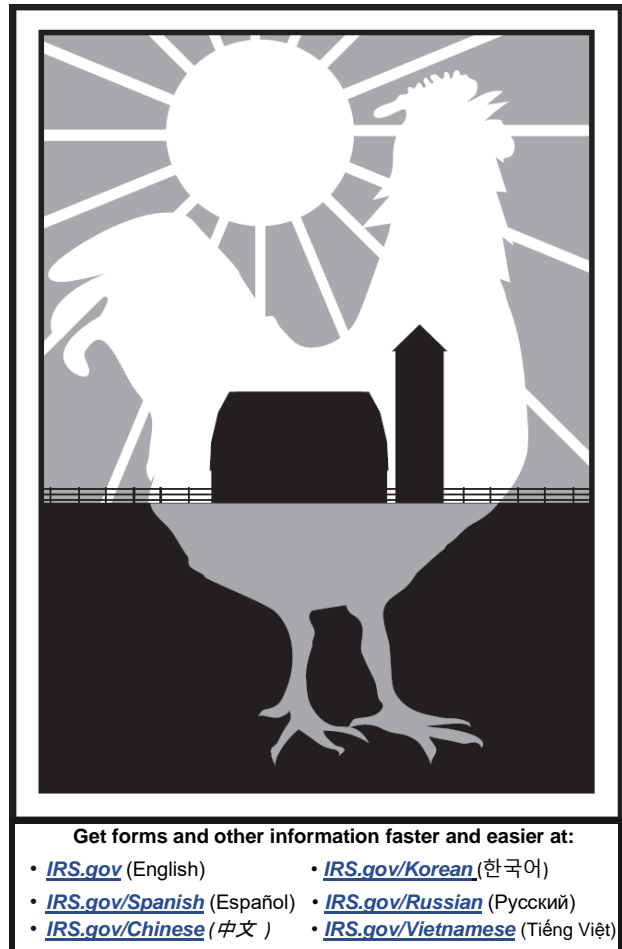
Publication 225

Farmers Tax Guide

For use in preparing

2024 Returns

Volume 6 of 11



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Real property. You depreciate real property, such as residential rental property or nonresidential real property, using the straight line method under either GDS or ADS.

Switching to straight line. If you use a declining balance method, you switch to the straight line method in the year it provides an equal or greater deduction. If you use the MACRS percentage tables, discussed later under *How Is the Depreciation Deduction Figured*, you do not need to determine in which year your deduction is greater using the straight line method. The tables have the switch to the straight line method built into their rates.

Fruit or nut trees and vines. Depreciate trees and vines bearing fruits or nuts under GDS using the straight line method over a 10-year recovery period, or under ADS using the straight line method over a 20-year period.

ADS required for some farmers. If you are not considered a small business taxpayer, you may be required to limit your business interest expense deduction under section 163(j) of the Internal Revenue Code.

However, farming businesses may elect to not be subject to the section 163(j) limitations. If you elect not to limit interest expense, you must use ADS to depreciate any property with a recovery period of 10 years or more. Also, you are not entitled to claim the special depreciation allowance for that property. See chapter 4 for a discussion of interest rules.

If you elect not to apply the uniform capitalization rules to any plant shown in Table 6-1 of chapter 6 and produced in your farming business, you must use ADS for all property you place in service in any year the election is in effect. See chapter 6 for a discussion of the application of the uniform capitalization rules to farm property.

Electing a different method. As shown in the Depreciation Table, you can elect a different method for depreciation for certain types of property. You must make the election by the due date of the return (including extensions) for the year you placed the property in service. However, if you timely filed your return for the year without making the election, you can still make the election by filing an amended return within 6 months of the due date of your return (excluding extensions). Attach the election to the amended return and write "Filed pursuant to section 301.9100-2" on the election statement. File the amended return at the same address you filed the original return. Once you make the election, you cannot change it.



If you elect to use a different method for one item in a property class, you must apply the same method to all property in that class placed in service during

the year of the election. However, you can make the election on a property-by-property basis for residential rental and nonresidential real property.

Straight line election. Instead of using the declining balance method, you can elect to use the straight line method over the GDS recovery period. Make the election by entering "S/L" under column (f) in Part III of Form 4562.

ADS election. As explained earlier under *Which Depreciation System (GDS or ADS) Applies*, you can elect to use ADS even though your property may come under GDS. ADS uses the straight line method of depreciation over the ADS recovery periods, which are generally longer than the GDS recovery periods. The ADS recovery periods for many assets used in the business of farming are listed in Table 7-1. Additional ADS recovery periods for other classes of property may be found in the Table of Class

Lives and Recovery Periods in Appendix B of Pub. 946.

How Is the Depreciation Deduction Figured?

To figure your depreciation deduction under MACRS, you first determine the depreciation system, property class, placed-in-service date, basis amount, recovery period, convention, and depreciation method that applies to your property. Then you are ready to figure your depreciation deduction. You can figure it in one of two ways.

- You can use the percentage tables provided by the IRS.
- You can figure your own deduction without using the tables.



Figuring your own MACRS deduction will generally result in a slightly different amount than using the tables.

See Using the MACRS Percentage Tables and Figuring the Deduction Without Using the Tables under How is the Depreciation Deduction Figured in chapter 4 of Pub. 946, for details on how to figure your depreciation deduction under MACRS.

Figuring the Deduction for Property Acquired in a Nontaxable Exchange

If your property has a carryover basis because you acquired it in an exchange or involuntary conversion of other property or in a nontaxable transfer, you generally figure depreciation for the property as if the exchange, conversion, or transfer had not occurred.

Property acquired in a like-kind exchange or involuntary conversion. You must generally depreciate the carryover basis of MACRS property acquired in a like-kind exchange or involuntary conversion over the remaining recovery period of the property exchanged or involuntarily converted. You also generally continue to use the same depreciation method and convention used for the exchanged or involuntarily converted property. This applies only to acquired property with the same or a shorter recovery period and the same or more accelerated depreciation method than the property exchanged or involuntarily converted. The excess basis, if any, of the acquired MACRS property is treated as newly placed-in-service MACRS property.

Election out. You can elect not to use the above rules. The election, if made, applies to both the acquired property and the exchanged or involuntarily converted

property. If you make the election, figure depreciation by treating the carryover basis and excess basis, if any, for the acquired property as if placed in service the later of the date you acquired it, or the time of the disposition of the exchanged or involuntarily converted property. For depreciation purposes, the adjusted basis of the exchanged or involuntarily converted property is treated as if it were disposed of at the time of the exchange or conversion.

When to make the election. You must make the election on a timely filed return (including extensions) for the year of replacement. Once made, the election may not be revoked without IRS consent.

For more information and special rules, see chapter 4 of Pub. 946.

Property acquired in a nontaxable transfer. You must depreciate MACRS property acquired by a corporation or partnership in certain nontaxable transfers

over the property's remaining recovery period in the transferor's hands, as if the transfer had not occurred. You must continue to use the same depreciation method and convention as the transferor. You can depreciate the part of the property's basis in excess of its carried-over basis (the transferor's adjusted basis in the property) as newly purchased MACRS property. For information on the kinds of nontaxable transfers covered by this rule, see chapter 4 of Pub. 946.

How Do You Use General Asset Accounts?

To make it easier to figure MACRS depreciation, you can group separate assets into one or more general asset accounts (GAAs). You can then depreciate all the assets in each account as a single asset. Each account must include only assets of the same recovery period, depreciation method, and convention. You cannot include an asset if

you use it in both a personal activity and a trade or business (or for the production of income) in the year in which you first placed it in service.

After you have set up a GAA, you generally figure the depreciation for it by using the applicable depreciation method, recovery period, and convention for the assets in the GAA. For each GAA, record the depreciation allowance in a separate depreciation reserve account.

There are additional rules for grouping assets in a GAA, figuring depreciation for a GAA, disposing of GAA assets, and terminating GAA treatment. Special rules apply in determining the basis and figuring the depreciation deduction for MACRS property in a GAA acquired in a like-kind exchange or involuntary conversion. For more details, see Regulations section 1.168(i)-1 (as in effect for tax years beginning after December 31, 2013). Also, see chapter 4 of Pub. 946.

When Do You Recapture MACRS Depreciation?

When you dispose of property you depreciated using MACRS, any gain on the disposition is generally recaptured (included in income) as ordinary income up to the amount of the depreciation previously allowed or allowable for the property. For more information on depreciation recapture, see chapter 9. Also, see chapter 4 of Pub. 946.

Additional Rules for Listed Property

Listed property includes cars and other property used for transportation, property used for entertainment, and certain computers.

Deductions for listed property (other than certain leased property) are subject to the following special rules and limits.

- Deduction for employees.
- Business-use requirement.

- Passenger automobile limits and rules.

What Is Listed Property?

Listed property is any of the following.

- Passenger automobiles weighing 6,000 pounds or less.
- Any other property used for transportation, unless it is an excepted vehicle.
- Property generally used for entertainment, recreation, or amusement.
- Certain aircraft.

Passenger automobiles. A passenger automobile is any 4-wheeled vehicle made primarily for use on public streets, roads, and highways and rated at 6,000 pounds or less of unloaded gross vehicle weight (6,000 pounds or less of gross vehicle weight for trucks and vans). It includes any part, component, or other item physically attached to the automobile or usually included in the

purchase price of an automobile. Electric passenger automobiles are vehicles produced by an original equipment manufacturer and designed to run primarily on electricity.

Note. A truck or van that is a qualified nonpersonal use vehicle is not considered a passenger automobile. See *Qualified nonpersonal use vehicles* under *Passenger Automobiles* in chapter 5 of Pub. 946 for the definition of qualified nonpersonal use vehicles.



For most vehicles, the gross vehicle weight rating can generally be found on the driver door post of the vehicle.

Other property used for transportation.

This includes trucks, buses, boats, airplanes, motorcycles, and other vehicles used for transporting persons or goods.

Excepted vehicles. Other property used for transportation does not include the following vehicles.

- Tractors and other special-purpose farm vehicles.
- Bucket trucks (cherry pickers), dump trucks, flatbed trucks, and refrigerated trucks.
- Combines, cranes and derricks, and forklifts.
- Any vehicle designed to carry cargo with a loaded gross vehicle weight of over 14,000 pounds.

For more information, see chapter 5 of Pub. 946.

What Is the Business-Use Requirement?

You can claim the section 179 expense deduction for listed property and depreciate listed property using GDS and a declining balance method, if the property meets the

business-use requirement. To meet this requirement, listed property must be used predominantly (more than 50% of its total use) for qualified business use. To determine whether the business-use requirement is met, you must allocate the use of any item of listed property used for more than one purpose during the year among its various uses.

Do the Passenger Automobile Limits Apply?

The depreciation deduction (including the section 179 expense deduction) you can claim for a passenger automobile each year is limited. The passenger automobile limits are the maximum depreciation amounts you can deduct for a passenger automobile. They are based on the date you placed the vehicle in service. See chapter 5 of Pub. 946 for tables that show the maximum depreciation deduction for passenger automobiles. Also, see the Instructions for Form 4562.

For information about deducting expenses for the business use of your passenger automobile, see chapter 4 of Pub. 463.

Deductions for passenger automobiles acquired in a trade-in. Special rules apply in figuring the depreciation for a passenger automobile received in a like-kind exchange or involuntary conversion. See chapter 5 of Pub. 946 and Regulations section 1.168(i)-6(d)(3).

Depletion

Depletion is the using up of natural resources by mining, quarrying, drilling, or cutting. The depletion deduction allows an owner or operator to account for the reduction of a product's reserves.

Who Can Claim Depletion?

If you have an economic interest in mineral property or standing timber (defined below), you can take a deduction for depletion. More than one person can have an economic

interest in the same mineral deposit or timber.

You have an economic interest if both the following apply.

- You have acquired by investment any interest in mineral deposits or standing timber.
- You have a legal right to income from the extraction of the mineral or the cutting of the timber, to which you must look for a return of your capital investment.

A contractual relationship that allows you an economic or monetary advantage from products of the mineral deposit or standing timber is not, in itself, an economic interest. A production payment carved out of, or retained on the sale of, mineral property is not an economic interest.

Mineral property is each separate interest you own in each mineral deposit in each separate tract or parcel of land. You can treat two or

more separate interests as one property or as separate properties. See section 614 of the Internal Revenue Code and the related regulations for rules on how to treat separate mineral interests.

Timber property is your economic interest in standing timber in each tract or block representing a separate timber account.

Figuring Depletion

There are two ways of figuring depletion.

- Cost depletion.
- Percentage depletion.

For mineral property, you must generally use the method that gives you the larger deduction. For standing timber, you must use cost depletion.

Cost Depletion

To figure cost depletion, you must first determine the following.

- The property's basis for depletion.
- The total recoverable units of mineral in the property's natural deposit.
- The number of units of mineral sold during the tax year.

You must estimate or determine recoverable units (tons, barrels, board feet, thousands of cubic feet, or other measure) using the current industry method and the most accurate and reliable information you can obtain.

Basis for depletion. To figure the property's basis for depletion, subtract all of the following from the property's adjusted basis.

1. Amounts recoverable through:
2. Depreciation deductions,
 - a. Deferred expenses (including deferred exploration and development costs), and

- b. Deductions other than depletion.
 - c. The residual value of land and improvements at the end of operations.
- 3. The cost or value of land acquired for purposes other than mineral production.

Adjusted basis. The adjusted basis of your property is your original cost or other basis, plus certain additions and improvements, and minus certain deductions such as depletion allowed or allowable and casualty losses. Your adjusted basis can never be less than zero. See Pub. 551 for more information on adjusted basis.

Total recoverable units. The total recoverable units is the sum of the following.

- The number of units of mineral remaining at the end of the year (including units recovered but not sold).

- The number of units of mineral sold during the tax year (determined under your method of accounting, as explained next).

You must estimate or determine recoverable units (tons, pounds, ounces, barrels, thousands of cubic feet, or other measure) of mineral products using the current industry method and the most accurate and reliable information you can obtain. You must include ores and minerals that are developed, in sight, blocked out, or assured. You must also include probable or prospective ores or minerals that are believed to exist based on good evidence.

Number of units sold. You determine the number of units sold during the tax year based on your method of accounting. Use the following table to make this determination.

IF you use...	THEN the units sold during the year are...
the cash method of accounting	the units sold for which you receive payment during the tax year (regardless of the year of sale).
An accrual method of accounting	the units sold based on your inventories.

The number of units sold during the tax year does not include any units for which depletion deductions were allowed or allowable in earlier years.

Figuring the cost depletion deduction.

Once you have figured your property's basis for depletion, the total recoverable units, and the number of units sold during the tax year, you can figure your cost depletion deduction by taking the following steps.

Step	Action	Result
1	Divide your property's basis for depletion by total recoverable units.	Rate per unit.
2	Multiply the rate per unit by units sold during the tax year.	Cost depletion deduction.

Cost depletion for ground water in Ogallala Formation. Farmers who extract ground water from the Ogallala Formation for irrigation are allowed cost depletion. Cost depletion is allowed when it can be demonstrated the ground water is being depleted and the rate of recharge is so low that, once extracted, the water would be lost to the taxpayer and immediately succeeding generations. To figure your cost depletion deduction, use the guidance provided in Revenue Procedure 66-11 in Cumulative Bulletin 1966-1.

Timber Depletion

Depletion takes place when you cut standing timber (including Christmas trees). You can figure your depletion deduction when the quantity of cut timber is first accurately measured in the process of exploitation.

Figuring the timber depletion deduction.

To figure your cost depletion allowance, multiply the number of units of standing timber cut by your depletion unit.

Timber units. When you acquire timber property, you must make an estimate of the quantity of marketable timber that exists on the property. You measure the timber using board feet, log scale, cords, or other units. If you later determine that you have more or less units of timber, you must adjust the original estimate.

Depletion units. You figure your depletion unit each year by taking the following steps.

1. Determine your cost or the adjusted basis of the timber on hand at the beginning of the year.
2. Add to the amount determined in (1) the cost of any timber units acquired during the year and any additions to capital.

3. Figure the number of timber units to take into account by adding the number of timber units acquired during the year to the number of timber units on hand in the account at the beginning of the year and then adding (or subtracting) any correction to the estimate of the number of timber units remaining in the account.
4. Divide the result of (2) by the result of (3). This is your depletion unit.

When to claim timber depletion. Claim your depletion allowance as a deduction in the year of sale or other disposition of the products cut from the timber, unless you elect to treat the cutting of timber as a sale or exchange, as explained in chapter 8. Include allowable depletion for timber products not sold during the tax year the timber is cut as a cost item in the closing inventory of timber products for the year. The inventory is your

basis for determining gain or loss in the tax year you sell the timber products.

Form T (Timber). Complete and attach Form T (Timber) to your income tax return if you are claiming a deduction for timber depletion, electing to treat the cutting of timber as a sale or exchange, or making an outright sale of timber. See the Instructions for Form T (Timber).

Example. You bought a farm that included standing timber. This year you determined that the standing timber could produce 300,000 units when cut. At that time, the adjusted basis of the standing timber was \$24,000. You then cut and sold 27,000 units. (You did not elect to treat the cutting of the timber as a sale or exchange.) Your depletion for each unit for the year is \$0.08 ($\$24,000 \div 300,000$). Your deduction for depletion is \$2,160 ($27,000 \times \0.08). If you had cut 27,000 units but sold only 20,000 units during the year, your depletion for each unit

would have remained at \$0.08. However, your depletion deduction would have been \$1,600 ($20,000 \times \0.08) for this year and you would have included the balance of \$560 ($7,000 \times \0.08) in the closing inventory for the year.

Percentage Depletion

You can use percentage depletion on certain mines, wells, and other natural deposits. You cannot use the percentage method to figure depletion for standing timber, soil, sod, dirt, or turf.

To figure percentage depletion, you multiply a certain percentage, specified for each mineral, by your gross income from the property during the year. You can find a complete list of the percentages in section 613(b) of the Internal Revenue Code. The basis of your property must be reduced by the amount of percentage depletion deducted.

Taxable income limit. The percentage depletion deduction cannot be more than 50% (100% for oil and gas property) of your taxable income from the property figured without the depletion deduction and the domestic production activities deduction.

The following rules apply when figuring your taxable income from the property for purposes of the taxable income limit.

- Do not deduct any net operating loss deduction from the gross income from the property.
- Corporations do not deduct charitable contributions from the gross income from the property.
- If, during the year, you disposed of an item of section 1245 property used in connection with the mineral property, reduce any allowable deduction for mining expenses by the part of any gain you must report as ordinary income that is

allocable to the mineral property. See Regulations section 1.613-5(b)(1) for information on how to figure the ordinary gain allocable to the property.

Amortization

Amortization is a method of recovering (deducting) certain capital costs over a fixed period of time. It is similar to the straight line method of depreciation. The amortizable costs discussed in this section include the startup costs of going into business, reforestation costs, the costs of pollution control facilities, and the costs of section 197 intangibles. See the Instructions for Form 4562 for more information on these topics.

Business Startup Costs

When you go into business, treat all costs you incur to get your business started as capital expenses. Capital expenses are a part of your basis in the business. Generally, you recover costs for particular assets through

depreciation deductions. However, you generally cannot recover other costs until you sell the business or otherwise go out of business.

Startup costs are costs for creating an active trade or business or investigating the creation or acquisition of an active trade or business. Startup costs include any amounts paid or incurred in connection with any activity engaged in for profit and for the production of income before the trade or business begins, in anticipation of the activity becoming an active trade or business.

You can elect to currently deduct a limited amount of business startup costs paid or incurred after October 22, 2004. See *Capital Expenses* in chapter 4. If this election is made, any costs that are not currently deducted can be amortized.

Amortization period. The amortization period for business startup costs paid or incurred before October 23, 2004, is 60

months or more. For startup costs paid or incurred after October 22, 2004, the amortization period is 180 months. The period starts with the month your active trade or business begins.

Reporting requirements. To amortize your startup costs that are not currently deductible under the election to deduct, complete Part VI of Form 4562 and attach a statement containing any required information. See the Instructions for Form 4562.

Reforestation Costs

You can elect to currently deduct a limited amount of qualifying reforestation costs for each qualified timber property. See *Capital Expenses* in chapter 4. You can elect to amortize over 84 months any amount not deducted. There is no annual limit on the amount you can elect to amortize.

Reforestation costs are the direct costs of planting or seeding for forestation or reforestation.

Qualifying costs. Qualifying costs include only those costs you must otherwise capitalize and include in the adjusted basis of the property. They include costs for the following items.

- Site preparation.
- Seeds or seedlings.
- Labor.
- Tools.
- Depreciation on equipment used in planting and seeding.

If the government reimburses you for reforestation costs under a cost-sharing program, you can amortize these costs only if you include the reimbursement in your income.

Qualified timber property. Qualified timber property is property that contains trees in significant commercial quantities. It can be a woodlot or other site that you own or lease.

The property qualifies only if it meets all the following requirements.

- It is located in the United States.
- It is held for the growing and cutting of timber you will either use in or sell for use in the commercial production of timber products.
- It consists of at least 1 acre planted with tree seedlings in the manner normally used in forestation or reforestation.

Qualified timber property does not include property on which you have planted shelter belts or ornamental trees, such as Christmas trees.

Amortization period. The 84-month amortization period starts on the first day of the first month of the second half of the tax year you incur the costs (July 1 for a calendar year taxpayer), regardless of the month you actually incur the costs. You can claim amortization deductions for no more than 6

months of the first and last (eighth) tax years of the period.

How to make the election. To elect to amortize qualifying reforestation costs, enter your deduction in Part VI of Form 4562. Attach a statement containing any required information. See the Instructions for Form 4562.

Generally, you must make the election on a timely filed return (including extensions) for the year in which you incurred the costs. However, if you timely filed your return for the year without making the election, you can still make the election by filing an amended return within 6 months of the due date of your return (excluding extensions). Attach Form 4562 and the statement to the amended return and write "Filed pursuant to section 301.9100-2" on Form 4562. File the amended return at the same address you filed the original return.

Section 197 Intangibles

You must generally amortize over 15 years the capitalized costs of section 197 intangibles you acquired after August 10, 1993. You must amortize these costs if you hold the section 197 intangible in connection with your farming business or in an activity engaged in for the production of income. Your amortization deduction each year is the applicable part of the intangible's adjusted basis (for purposes of determining gain), figured by amortizing it ratably over 15 years (180 months). You are not allowed any other depreciation or amortization deduction for an amortizable section 197 intangible.

Section 197 intangibles include the following assets.

- Goodwill.
- Patents.
- Copyrights.

- Designs.
- Formulas.
- Licenses.
- Permits.
- Covenants not to compete.
- Franchises.
- Trademarks.

See section 197 of the Internal Revenue Code for more information, including a complete list of assets that are section 197 intangibles and special rules.

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8.

Gains and Losses

Introduction

This chapter explains how to figure, and report on your tax return, your gain or loss on the disposition of your property or debt and whether such gain or loss is ordinary or capital. Ordinary gain is taxed at the same rates as wages and interest income, while net capital gain is generally taxed at a lower rate. This chapter discusses dispositions such as sales and exchanges (including like-kind exchanges and sales of capital and noncapital assets); hedging transactions; sale of livestock; cutting timber; sale of a farm; and cancellation of debt from foreclosures, repossessions, and abandonments.

Topics

This chapter discusses:

- Sales and exchanges
- Ordinary or capital gain or loss

Useful Items

You may want to see:

Publication

- ☐ **334** Tax Guide for Small Business
- ☐ **523** Selling Your Home
- ☐ **544** Sales and Other Dispositions of Assets
- ☐ **550** Investment Income and Expenses
- ☐ **908** Bankruptcy Tax Guide

Form (and Instructions)

- ☐ **982** Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment)
- ☐ **Sch D (Form 1040)** Capital Gains and Losses

- ☐ **Sch F (Form 1040)** Profit or Loss From Farming
- ☐ **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
- ☐ **8960** Net Investment Income Tax—Individuals, Estates, and Trusts
- ☐ **8995** Qualified Business Income Deduction Simplified Computation
- ☐ **8995-A** Qualified Business Income Deduction

See [How To Get Tax Help](#) for information about getting publications and forms.

Sales and Exchanges

If you sell, exchange, or otherwise dispose of your property, you usually have a gain or a loss. This section explains certain rules for

determining whether any gain you have is taxable and whether any loss you have is deductible.

A sale is a transfer of property for money or a mortgage, a 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 MACRS asset. For details, see *Partial Dispositions of MACRS Property* in chapter 1 of Pub. 544.

Determining Gain or Loss

You usually realize a gain or loss when you sell or exchange property. If the amount you realize from a sale or exchange of property is more than its adjusted basis, you have a gain. If the adjusted basis of the property is more than the amount you realize, you have a loss.

Basis and adjusted basis. The basis of property you buy is usually its cost. The adjusted basis of the property is the basis plus certain additions and minus certain deductions. See chapter 6 for more information about basis and adjusted basis.

Amount realized. The amount you realize from a sale or exchange is the total of all money you receive plus the fair market value (FMV) (defined in chapter 6) of all property or services you receive. The amount you realize also includes any of your liabilities assumed by the buyer and any liabilities to which the property you transferred is subject, such as real estate taxes or a mortgage.

If the liabilities relate to an exchange of multiple properties, see *Multiple Property Exchanges* in chapter 1 of Pub. 544.

Amount recognized. Your gain or loss realized from a sale or exchange of certain property is usually a recognized gain or loss for tax purposes. A recognized gain is a gain

you must include in gross income and report on your income tax return. A recognized loss is a loss you deduct from gross income.

However, your gain or loss realized from the exchange of certain property may not be recognized for tax purposes. See Like-Kind Exchanges next. Also, a loss from the disposition of property held for personal use is not deductible.

Like-Kind Exchanges

Generally, if you exchange real property you use in your business or hold for investment solely for other business or investment real property of a like kind, you do not recognize the gain or loss from the exchange. However, if you also receive non-like-kind property or money as part of the exchange, you recognize gain to the extent of the value of the other property or money you received in the exchange. You do not recognize any losses. In general, your gain or loss will not be recognized until you sell or otherwise dispose

of the property you receive in the exchange. See Qualifying property, later, for details and exceptions.

The exchange of property for the same kind of property is the most common type of nontaxable exchange. To qualify for treatment as a like-kind exchange, the property traded and the property received must be both of the following (discussed later).

- Qualifying property.
- Like-kind property.

For more information on like-kind exchanges, see Pub. 544.

Multiple-party transactions. The like-kind exchange rules also apply to property exchanges that involve three- and four-party transactions. Any part of these multiple-party transactions can qualify as a like-kind exchange if it meets all the requirements described in this section.

Receipt of title from third party. If you receive property in a like-kind exchange and the other party who transfers the property to you does not give you the title, but a third party does, you can still treat this transaction as a like-kind exchange if it meets all the requirements.

Basis of property received. If you receive property in a like-kind exchange, generally the basis of the property will be the same as the basis of the property you gave up. See chapter 6 for more information on basis.

Money paid. If, in addition to giving up like-kind property, you pay money in a like-kind exchange, the basis of the property received is the basis of the property given up, increased by the money paid.

Example. You own farmland with a barn. The combined adjusted basis of the properties is \$70,000 and the FMV is \$150,000. You are interested in another tract of farmland, with a larger barn, worth \$200,000. You exchange

your existing property and \$50,000 in cash for the new property. Your basis in the new property is \$120,000 (\$70,000 adjusted basis in your old property plus \$50,000 in cash paid).

Reporting the exchange. Report the exchange of like-kind property, even though no gain or loss is recognized, on Form 8824. The Instructions for Form 8824 explain how to report the details of the exchange.

If you have any recognized gain because you received money or unlike property, report it on Schedule D (Form 1040) or Form 4797, whichever applies. You may also have to report the recognized gain as ordinary income because of depreciation recapture on Form 4797. See chapter 9 for more information.

Qualifying property. In a like-kind exchange, both the real property you give up and the real property you receive must be held by you for investment or for productive use in your trade or business. The

nonrecognition rules for like-kind exchanges apply only to exchanges of real property (as defined in Treasury Regulations section 1.1031(a)-3). The following are examples of property that may qualify.

- Land and improvements to land.
- Unsevered natural products of land.
- Water and air space superjacent to land.
- An intangible interest in real property including fee ownership; co-ownership; a leasehold; an option to acquire real property; an easement; and stock in a cooperative housing corporation.
- Real property that, on the date it is transferred in an exchange, is real property under the law of the state or local jurisdiction in which that property is located.

Nonqualifying property. The rules for like-kind exchanges do not apply to exchanges of the following property.

- Real property used for personal purposes, such as your home.
- Real property held primarily for sale.
- Any personal or intangible property.

You may have a nontaxable exchange under other rules. See *Other Nontaxable Exchanges* in chapter 1 of Pub. 544.

Special rule for stock in a mutual ditch, reservoir, or irrigation company. For purposes of real property, stock in a mutual ditch, reservoir, or irrigation company is treated as real property if both of the following conditions are met at the time of the trade.

1. The mutual ditch, reservoir, or irrigation company is an organization described in section 501(c)(12)(A) of

the Internal Revenue Code (determined without regard to the percentage of its income that is collected from its members for the purpose of meeting losses and expenses).

2. The shares in the company have been recognized by the highest court of the state in which the company was organized or by applicable state statute as constituting or representing real property or an interest in real property.

Like-kind property. To qualify as a nontaxable exchange, the properties exchanged must be of like kind. Like-kind properties are properties of the same nature or character, even if they differ in grade or quality. Generally, real property exchanged for real property qualifies as an exchange of like-kind property. For example, an exchange of city property for farm property or improved

property for unimproved property is a like-kind exchange.

Note. Whether you engaged in a like-kind exchange depends on an analysis of each asset involved in the exchange.

Partially nontaxable exchange. If, in addition to like-kind property, you receive money or unlike property in an exchange on which you realize gain, you have a partially nontaxable exchange. You are taxed on the gain you realize, but only to the extent of the money and the FMV of the unlike property you receive. If you realize a loss on the exchange, no loss is deductible. However, see *Unlike property given up* below.

Example 1. You trade farmland that cost \$130,000 for \$10,000 cash and other land to be used in farming with an FMV of \$150,000. You have a realized gain of \$30,000 (\$150,000 FMV of new land + \$10,000 cash – \$130,000 basis of old farmland = \$30,000 realized gain). However, only \$10,000, the

cash received, is recognized gain (included in income).

Example 2. Assume the same facts as in *Example 1*, except that, instead of money, you received a tractor with an FMV of \$10,000. Your recognized gain is still limited to \$10,000, the value of the tractor (the unlike property).

Example 3. Assume in *Example 1* that the FMV of the land you received was only \$115,000. You have a realized loss of \$5,000 (\$115,000 FMV + \$10,000 cash – \$130,000 basis of old farmland = \$5,000 loss). However, your \$5,000 loss is not recognized.

Unlike property given up. If, in addition to like-kind property, you give up unlike property, you must recognize gain or loss on the unlike property you give up. The gain or loss is the difference between the FMV of the unlike property and the adjusted basis of the unlike property.

Liabilities. If, in a like-kind exchange, you transfer property subject to debt, the debt transferred is considered the same as the receipt of unlike property. For purposes of figuring your realized gain, add any liabilities assumed by the other party to your amount realized. Subtract any liabilities of the other party that you assume from your amount realized. For more information, see *Partial Nontaxable Exchanges* in chapter 1 of Pub. 544.

Like-kind exchanges between related persons. Special rules apply to like-kind exchanges between related persons. These rules affect both direct and indirect exchanges. Under these rules, if either person disposes of the property within 2 years after the exchange, the exchange is disqualified from nonrecognition treatment. The gain or loss on the original exchange must be recognized as of the date of the later disposition. The 2-year holding period begins

on the date of the last transfer of property that was part of the like-kind exchange.

Related persons. Under these rules, related persons include, for example, you and a member of your family (spouse, sibling, parent, child, etc.), you and a corporation in which you have more than 50% ownership, you and a partnership in which you directly or indirectly own more than a 50% interest of the capital or profits, and two partnerships in which you directly or indirectly own more than 50% of the capital interests or profits.

For the complete list of related persons, see *Related persons* in chapter 2 of Pub. 544.



If you transfer property using a qualified intermediary involving related persons, see Multiple-party transactions involving related persons in chapter 1 of Pub. 544.

Example. You own real property used in your business. Your sibling owns real property used in their business. In December 2023, you exchanged your property plus \$15,000 for your sibling's property. At that time, the FMV of your real property was \$200,000 and its adjusted basis was \$65,000. The FMV of your sibling's real property was \$215,000 and its adjusted basis was \$70,000. You realized a gain of \$135,000 (the \$215,000 FMV of the real property received, minus the \$15,000 you paid, minus your \$65,000 adjusted basis in the property). Your sibling realized a gain of \$145,000 (the \$200,000 FMV of your real property, plus the \$15,000 you paid, minus their \$70,000 adjusted basis in the property).

However, because this was a like-kind exchange and you received no cash or non-like-kind property in the exchange, you recognize no gain on the exchange. Your basis in the real property you received is \$80,000 (the \$65,000 adjusted basis of the

real property given up plus the \$15,000 you paid). Your sibling recognizes gain only to the extent of the money they received, \$15,000. The basis in the real property received was \$70,000 (the \$70,000 adjusted basis of the real property exchanged minus the \$15,000 received, plus the \$15,000 gain recognized).

In 2024, you sold the real property you received to a third party for \$220,000. Because you sold property you acquired from a related party (your sibling) within 2 years after the exchange with your sibling, that exchange is disqualified from nonrecognition treatment and the deferred gain must be recognized on your 2024 return. On your 2024 tax return, you must report your \$135,000 gain on the 2023 exchange. You must also report the gain on the 2024 sale on your 2024 return. Additionally, for 2024, your sibling must report a gain of \$130,000, which is the \$145,000 gain on the 2023 exchange, minus the \$15,000 recognized in 2023. Your

sibling's adjusted basis in the property is increased to \$200,000 (\$70,000 basis plus the \$130,000 gain recognized).

Exceptions to the rules for related persons. The following property dispositions are excluded from these rules.

- Dispositions due to the death of either related person.
- Involuntary conversions.
- Dispositions where it is established to the satisfaction of the IRS that neither the exchange nor the disposition has, as a main purpose, the avoidance of federal income tax.

Multiple property exchanges. Under the like-kind exchange rules, you must generally make a property-by-property comparison to figure your recognized gain and the basis of the property you receive in the exchange. However, for exchanges of multiple properties, you do not make a property-by-

property comparison if you do either of the following.

- Transfer and receive properties in two or more exchange groups.
- Transfer or receive more than one property within a single exchange group.

For more information, see *Multiple Property Exchanges* in chapter 1 of Pub. 544.

Deferred exchange. A deferred exchange for like-kind property may qualify for nonrecognition of gain or loss. A deferred exchange is an exchange in which you transfer property you use in business or hold for investment and later receive like-kind property you will use in business or hold for investment. The property you receive is replacement property. The transaction must be an exchange of property for property rather than a transfer of property for money used to buy replacement property. In addition, the replacement property will not be

treated as like-kind property unless certain identification and receipt requirements are met.

For more information, see *Deferred Exchange* in chapter 1 of Pub. 544.

Transfer to Spouse

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 a former spouse if incident to divorce. This rule does not apply in the following situations.

- Your spouse or former spouse is a nonresident alien (unless special elections have been made).
- Certain transfers in trust.
- Certain stock redemptions under a divorce or separation instrument or a valid written agreement.

For more information and special rules for transfers of property incident to divorce, see *Property Settlements* in Pub. 504, Divorced or Separated Individuals.

Any transfer of property to a spouse or former spouse on which gain or loss is not recognized 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 FMV at the time of transfer or any consideration paid by the recipient. This rule applies for determining loss as well as gain. Any gain recognized on a transfer in trust increases the basis.

Ordinary or Capital Gain or Loss

Generally, you will have a capital gain or loss if you sell or exchange a capital asset

(defined below). You may also have a capital gain if your section 1231 transactions result in a net gain. See Section 1231 Gains and Losses in chapter 9.

To figure your net capital gain or loss, you must classify your gains and losses as either ordinary or capital, and your capital gains or losses as either short term or long term.

Your net capital gains may be taxed at a lower tax rate than ordinary income. See Capital Gains Tax Rates, later. Your deduction for a net capital loss may be limited. See Treatment of Capital Losses, later.

Capital Assets

Almost everything you own and use for personal purposes, pleasure, or investment is a capital asset.

The following items are examples of capital assets.

- A home owned and occupied by you and your family.
- Household furnishings.
- A car used for pleasure. If your car is used both for pleasure and for farm business, it is partly a capital asset and partly a noncapital asset, defined later.
- Stocks and bonds. However, there are special rules for gains on qualified small business stock. For more information on this subject, see *Gains on Qualified Small Business Stock and Losses on Section 1244 (Small Business) Stock* in chapter 4 of Pub. 550.

Personal-use property. Gain from a sale or exchange of personal-use property is a capital gain and is taxable. Loss from the sale or exchange of personal-use property is not deductible. You can deduct a loss relating to

personal-use property only if it results from a casualty or theft. For information on casualties and thefts, see chapter 11.

Long and Short Term

Where you report a capital gain or loss depends on how long you own the asset before you sell or exchange it. The time you own an asset before disposing of it is the holding period.

If you hold a capital asset 1 year or less, the gain or loss resulting from its disposition is short term. Report it in Part I of Form 8949, and/or Schedule D (Form 1040), as applicable. If you hold a capital asset longer than 1 year, the gain or loss resulting from its disposition is long term. Report it in Part II of Form 8949 and/or Schedule D, as applicable. See the Instructions for Form 8949 and the Instructions for Schedule D (Form 1040) for more information, including when Form 8949 is required. Also see chapter 4 of Pub. 544.

Holding period. To figure if you held property longer than 1 year, start counting on the day after the day you acquired the property. The day you disposed of the property is part of your holding period.

Example. If you bought an asset on June 19, 2023, you should start counting on June 20, 2023. If you sold the asset on June 19, 2024, your holding period is not longer than 1 year, but if you sold it on June 20, 2024, your holding period is longer than 1 year.

Livestock. See Holding period under Livestock, later.

Inherited property. If you inherit property, you are considered to have held the property longer than 1 year, regardless of how long you actually held it. This rule does not apply to livestock used in a farm business. See Holding period under Livestock, later.

Nonbusiness bad debt. A nonbusiness bad debt is a short-term capital loss, deductible in the year the debt becomes worthless. See chapter 4 of Pub. 550.

Nontaxable exchange. If you acquire an asset in exchange for another asset and your basis for the new asset is figured, in whole or in part, by using your basis in the old property, the holding period of the new property includes the holding period of the old property. That is, it begins on the same day as your holding period for the old property.

Gift. If you receive a gift of property and your basis in it is figured using the donor's basis, your holding period includes the donor's holding period.

Real property. To figure how long you held real property, start counting on the day after you received title to it or, if earlier, on the day after you took possession of it and assumed the burdens and privileges of ownership.

However, taking 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.

Figuring Net Gain or Loss

The totals for short-term capital gains and losses and the totals for long-term capital gains and losses must be figured separately.

Net short-term capital gain or loss.

Combine your short-term capital gains and losses. Do this by adding all of your short-term capital gains. Then add all of your short-term capital losses. Subtract the lesser total from the greater. The difference is your net short-term capital gain or loss.

Net long-term capital gain or loss. Follow the same steps to combine your long-term capital gains and losses. The result is your net long-term capital gain or loss.

Net gain. If the total of your capital gains is more than the total of your capital losses, the difference is taxable. However, part of your gain (but not more than your net capital gain) may be taxed at a lower rate than the rate of tax on your ordinary income. See Capital Gains Tax Rates, later.

Net loss. If the total of your capital losses is more than the total of your capital gains, the difference is deductible. But there are limits on how much loss you can deduct and when you can deduct it. See Treatment of Capital Losses next.

Treatment of Capital Losses

If your capital losses are more than your capital gains, you must claim the difference even if you do not have ordinary income to offset it. For taxpayers other than corporations, the yearly limit on the capital loss you can deduct is \$3,000 (\$1,500 if you are married and file a separate return). If your other income is low, you may not be

able to use the full \$3,000. The part of the \$3,000 you cannot use becomes part of your capital loss carryover (discussed next).

Capital loss carryover. Generally, you have a capital loss carryover if either of the following situations applies to you.

- Your net loss on Schedule D (Form 1040) is more than the yearly limit.
- Your taxable income is less than zero.

If either of these situations applies to you for 2024, see *Capital Losses* under *Reporting Capital Gains and Losses* in chapter 4 of Pub. 550 to figure the amount you can carry over to 2025.



To figure your capital loss carryover from 2024 to 2025, you will need a copy of your 2024 Form 1040 or Form 1040-SR and Schedule D (Form 1040).

Capital Gains Tax Rates

The tax rates that apply to a net capital gain are generally lower than the tax rates that apply to other income. These lower rates are called the maximum capital gains rates.

The term “net capital gain” means the amount by which your net long-term capital gain for the year is more than your net short-term capital loss.

See Schedule D (Form 1040) and the Instructions for Schedule D (Form 1040). Also see Pub. 550.

Noncapital Assets

Generally, noncapital assets include property such as inventory and depreciable property used in a trade or business. A list of properties that are not capital assets is provided in the Instructions for Schedule D (Form 1040). Noncapital assets used in farming are discussed below.

Property held for sale in the ordinary course of your farm business. Property you hold mainly for sale to customers, such as livestock, poultry, livestock products, and crops, is a noncapital asset. Gain or loss from sales or other dispositions of this property is reported on Schedule F (Form 1040) (not on Schedule D (Form 1040) or Form 4797). The treatment of this property is discussed in chapter 3.

Land and depreciable properties. Land and depreciable property you use in farming are not capital assets. Noncapital assets also include livestock held for draft, breeding, dairy, or sporting purposes. However, your gains and losses from sales and exchanges of your farmland and depreciable properties must be considered together with certain other transactions to determine whether the gains and losses are treated as capital or ordinary gains and losses. The sales of these

business assets are reported on Form 4797. See chapter 9 for more information.

Hedging

Hedging transactions are transactions that you enter into in the normal course of business primarily to manage the risk of interest rate or price changes, or currency fluctuations, with respect to borrowings, ordinary property, or ordinary obligations. Ordinary property or obligations are those that cannot produce capital gain or loss if sold or exchanged.

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. The holder of an option on a futures contract has the right (but not the obligation) for a specified period of time to enter into a futures contract to buy or sell at a particular price. A forward contract is much different from a

futures contract because its terms are not standardized and it is not exchange traded.

Businesses may enter into commodity futures contracts or forward contracts and may acquire options on commodity futures contracts as either of the following.

- Hedging transactions.
- Transactions that are not hedging transactions.

Futures transactions with exchange-traded commodity futures contracts that are not hedging transactions generally result in capital gain or loss and are subject to the mark-to-market rules discussed in Pub. 550. There is a limit on the amount of capital losses you can deduct each year. Hedging transactions are not subject to the mark-to-market rules and the deduction for hedging losses is not limited.

If, as a farmer-producer, to protect yourself from the risk of unfavorable price fluctuations, you enter into commodity forward contracts, futures contracts, or options on futures contracts and the contracts cover an amount of the commodity within your range of production, the transactions are generally considered hedging transactions. They can take place at any time you have the commodity under production, have it on hand for sale, or reasonably expect to have it on hand.

The gain or loss on the termination of these hedges is generally ordinary gain or loss. Farmers who file their income tax returns on the cash method report any profit or loss on the hedging transaction on Schedule F, line 8.

Gains or losses from hedging transactions that hedge supplies of a type regularly used or consumed in the ordinary course of your trade or business may be ordinary gains or losses. Examples include fuel and feed.



If you have numerous transactions in the commodity futures market during the year, you must be able to show which transactions are hedging transactions. Clearly identify a hedging transaction 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 speculation transactions.

Retain the identification of each hedging transaction with your books and records. Also, identify the item(s) or aggregate risk that is being hedged in your records. Although the identification of the hedging transaction must be made before the end of the day it was entered into, you have 35 days after entering into the transaction to identify the hedged item(s) or risk.

For more information on the tax treatment of futures and options contracts, see *Commodity Futures* and *Section 1256 Contracts Marked to Market* in Pub. 550.

Accounting methods for hedging

transactions. The accounting method you use for a hedging transaction must clearly reflect income. This means that your accounting method must reasonably match the timing of income, deduction, gain, or loss from a hedging transaction with the timing of income, deduction, gain, or loss from the item or items being hedged. There are requirements and limits on the method you can use for certain hedging transactions. See Regulations section 1.446-4(e) for those requirements and limits.

Hedging transactions must be accounted for under the rules stated above unless the transaction is subject to mark-to-market accounting under section 475 or you use an

accounting method other than the following methods.

1. Cash method.
2. Farm-price method.
3. Unit-livestock-price method.

Once you adopt a method, you must apply it consistently and must have IRS approval before changing it.

Your books and records must describe the accounting method used for each type of hedging transaction. They must also contain any additional identification necessary to verify the application of the accounting method you used for the transaction. You must make the additional identification no more than 35 days after entering into the hedging transaction.

Example of a hedging transaction. You are a calendar year taxpayer and file your income tax returns on the cash method. On July 2,

you anticipate a yield of 50,000 bushels of corn this year. The December futures price is \$5.75 a bushel, but there are indications that by harvest time the price will drop. To protect yourself against a drop in the price, you enter into the following hedging transaction. You sell 10 December futures contracts of 5,000 bushels each for a total of 50,000 bushels of corn at \$5.75 a bushel.

The price did not drop as anticipated but rose to \$6 a bushel. In November, you sell your crop at a local elevator for \$6 a bushel. You also close out your futures position by buying 10 December contracts for \$6 a bushel. You paid a broker's commission of \$1,400 (\$70 per contract) for the complete in-and-out position in the futures market.

The result is that the price of corn rose 25 cents a bushel and the actual selling price is \$6 a bushel. Your loss on the hedge is 25 cents a bushel. In effect, the net selling price of your corn is \$5.75 a bushel.

Report the results of your futures transactions and your sale of corn separately on Schedule F. See the Instructions for Schedule F (Form 1040).

The loss on your futures transactions is \$13,900, figured as follows.

July 2—Sold December corn futures (50,000 bu. @ \$5.75)	\$287,500
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November 6—Bought December corn futures (50,000 bu. @ \$6 plus \$1,400 broker's commission)	<u>301,400</u>
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Futures loss	<u>(\$13,900)</u>
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This loss is reported as a negative figure on Schedule F, Part I, line 8, as other income.

The proceeds from your corn sale at the local elevator are \$300,000 (50,000 bu. × \$6). Report it on Schedule F, Part I, line 2, as income from sales of products you raised.

Assume you were right and the price went down 25 cents a bushel. In effect, you would still net \$5.75 a bushel, figured as follows.

Sold cash corn, per bushel	\$5.50
Gain on hedge, per bushel	<u>.25</u>
Net price, per bushel	<u>\$5.75</u>

The gain on your futures transactions would have been \$11,100, figured as follows.

July 2—Sold December corn futures (50,000 bu. @ \$5.75) . .	\$287,500
November 6—Bought December corn futures (50,000 bu. @ \$5.50 plus \$1,400 broker's commission)	<u>276,400</u>
Futures gain.	<u>\$11,100</u>

The \$11,100 is reported on Schedule F, Part I, line 8, as other income.

The proceeds from the sale of your corn at the local elevator, \$275,000 (50,000 bu. x \$5.50), are reported on Schedule F, Part I, line 2, as income from sales of products you raised.

Livestock

This part discusses the sale or exchange of livestock used in your farm business. Gain or loss from the sale or exchange of this livestock may qualify as a section 1231 gain or loss. However, any part of the gain that is ordinary income from the recapture of depreciation is not included as section 1231 gain. See chapter 9 for more information on section 1231 gains and losses and the recapture of depreciation under section 1245.



The rules discussed here do not apply to the sale of livestock held primarily for sale to customers. The sale of this livestock is reported on Schedule F. See chapter 3 for more information.

Also, special rules apply to sales or exchanges caused by weather-related conditions. See Sales Caused by Weather-Related Conditions in chapter 3 for more information.

Holding period. The sale or exchange of livestock used in your farm business (defined below) qualifies as a section 1231 transaction if you held the livestock for 12 months or more (24 months or more for horses and cattle).

Livestock. For section 1231 transactions, livestock includes cattle, hogs, horses, mules, donkeys, sheep, goats, fur-bearing animals, and other mammals. Also, for section 1231 transactions, livestock does not include chickens, turkeys, pigeons, geese, emus,

ostriches, rheas, or other birds, fish, frogs, reptiles, etc.

Livestock used in farm business. If livestock is held primarily for draft, breeding, dairy, or sporting purposes, it is considered to be used in your farm business. The purpose for which an animal is held is ordinarily determined by a farmer's actual use of the animal. An animal is not held for draft, breeding, dairy, or sporting purposes merely because it is suitable for that purpose, or because it is held for sale to other persons for use by them for that purpose. However, a draft, breeding, dairy, or sporting purpose may be present if an animal is disposed of within a reasonable time after it is prevented from its intended use or made undesirable as a result of an accident, disease, drought, or unfitness of the animal.

Example 1. You discover an animal that you intend to use for breeding purposes is sterile. You dispose of it within a reasonable time. This animal was held for breeding purposes.

Example 2. You retire and sell your entire herd, including young animals that you would have used for breeding or dairy purposes had you remained in business. These young animals were held for breeding or dairy purposes. Also, if you sell young animals to reduce your breeding or dairy herd because of drought, these animals are treated as having been held for breeding or dairy purposes. See *Sales Caused by Weather-Related Conditions* in chapter 3.

Example 3. You are in the business of raising hogs for slaughter. Customarily, before selling your sows, you obtain a single litter of pigs that you will raise for sale. You sell the brood sows after obtaining the litter. Even though you hold these brood sows for ultimate sale to customers in the ordinary course of your

business, they are considered to be held for breeding purposes.

Example 4. You are in the business of raising registered cattle for sale to others for use as breeding cattle. The business practice is to breed the cattle before sale to establish their fitness as registered breeding cattle. Your use of the young cattle for breeding purposes is ordinary and necessary for selling them as registered breeding cattle. Such use does not demonstrate that you are holding the cattle for breeding purposes, but rather you are holding them primarily for sale to customers. However, those cattle you held as additions or replacements to your own breeding herd to produce calves are considered to be held for breeding purposes, even though they may not actually have produced calves. The same applies to hog and sheep breeders.

Example 5. You breed, raise, and train horses for racing purposes. Every year, you cull horses from your racing stable. In 2024,

you decided that to prevent your racing stable from getting too large to be effectively operated, you must cull six horses that had been raced at public tracks in 2023. These horses are all considered held for sporting purposes.

Figuring gain or loss on the cash method.

Farmers or ranchers who use the cash method of accounting figure their gain or loss on the sale of livestock used in their farming business as follows.

Raised livestock. Gain on the sale of raised livestock is generally the gross sales price reduced by any expenses of the sale.

Expenses of sale include sales commissions, freight or hauling from farm to commission company, and other similar expenses. The basis of the animal sold is zero if the costs of raising it were deducted during the years the animal was being raised. However, if you are required to use the accrual accounting

method, see Uniform Capitalization Rules in chapter 6.

Purchased livestock. The gross sales price minus your adjusted basis and any expenses of sale is the gain or loss.

Example. A farmer sold a breeding cow on January 8, 2024, for \$1,250. Expenses of the sale were \$125. The cow was bought July 2, 2020, for \$1,300. Depreciation (not less than the amount allowable) was \$1,225.

Gross sales price		\$1,250
Cost (basis)	\$1,300	
Minus: Depreciation deduction	<u>1,225</u>	
Unrecovered cost (adjusted basis)	\$ 75	
Expense of sale	<u>125</u>	<u>200</u>
Gain realized		<u>\$1,050</u>

Converted Wetland and Highly Erodible Cropland

Special rules apply to dispositions of land converted to farming use after March 1, 1986. Any gain realized on the disposition of converted wetland or highly erodible cropland is treated as ordinary income. Any loss on the disposition of such property is treated as a long-term capital loss.

Converted wetland. This is generally land that was drained or filled to make the production of agricultural commodities possible. It includes converted wetland held by the person who originally converted it or held by any other person who used the converted wetland at any time after conversion for farming.

A wetland (before conversion) is land that meets all the following conditions.

- It is mostly soil that, in its undrained condition, is saturated, flooded, or ponded

long enough during a growing season to develop an oxygen-deficient state that supports the growth and regeneration of plants growing in water.

- It is saturated by surface or groundwater at a frequency and duration sufficient to support mostly plants that are adapted for life in saturated soil.
- It supports, under normal circumstances, mostly plants that grow in saturated soil.

Highly erodible cropland. This is cropland subject to erosion that you used at any time for farming purposes other than grazing animals. Generally, highly erodible cropland is land currently classified by the Department of Agriculture as Class IV, VI, VII, or VIII under its classification system. Highly erodible cropland also includes land that would have an excessive average annual erosion rate in relation to the soil loss tolerance level, as determined by the Department of Agriculture.