Important Changes

1. Like-kind exchanges of personal property.
   For transfers of property after June 8, 1997, in tax years ending after that date, personal property used predominantly in the United States and personal property used predominantly outside the United States are not like-kind property under the like-kind exchange rules. For more information, see Special rule for foreign personal property exchanges under Like-Kind Exchanges in chapter 1.

2. Maximum tax rates on capital gains.
   For some sales and exchanges after May 6, 1997, the maximum tax rate on the net capital gain is reduced. For more information, see Maximum Tax Rates on Net Capital Gain in chapter 3.

Postponement of gain on condemnations.
   For condemnations occurring after June 8, 1997, you cannot postpone reporting gain if you acquire replacement property or stock from a related party and your gains from involuntary conversions total more than $100,000 for the year. For details, see Buying replacement property from a related party under Condemnations in chapter 1.
Introduction
This publication explains the tax rules that apply when you dispose of property. It covers:

- How to figure a gain or loss,
- Whether your gain or loss is ordinary or capital,
- How to treat a capital gain and or loss,
- How to treat your gain or loss when you dispose of business property, and
- How to report a gain or loss.

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:

- Most transactions involving stocks, bonds, options, forward and futures contracts, and similar investments, discussed in chapter 4 of Publication 550, Investment Income and Expenses,
- Sale of your main home, discussed in Publication 523, Selling Your Home,
- Installment sales, discussed in Publication 537, Installment Sales, and
- Transfers of property at death, discussed in Publication 559, Survivors, Executors, and Administrators.

Disposing of property. You dispose of property when:

- 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, or
- You give property away.

Forms to file. When you dispose of property, you will usually have to file one or more of the following forms:

- Schedule D (Form 1040), Capital Gains and Losses.
- Form 4797, Sales of Business Property.
- Form 8824, Like-Kind Exchanges.

Chapter 5 illustrates how to fill out Form 4797 and Form 8824.

1. Gain or Loss

Topics
This chapter discusses:

- Sales and exchanges
- Abandonments
- Foreclosures and repossessions
- Involuntary conversions
- Nontaxable exchanges
- Transfers between spouses
- Rollover of capital gain

Useful Items
You may want to see:

- Publication
  - 523 Selling Your Home
  - 537 Installment Sales
  - 547 Casualties, Disasters, and Thefts (Business and Nonbusiness)
  - 550 Investment Income and Expenses
  - 551 Basis of Assets
  - 908 Bankruptcy Tax Guide

- Form (and Instructions)
  - Schedule D (Form 1040) Capital Gains and Losses
  - 4797 Sales of Business Property
  - 8824 Like-Kind Exchanges

See chapter 6 for information about getting these publications and forms.

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

Sale of home. Report the sale, exchange, or other disposition of your main home on Form 2119, Sale of Your Home. If you have a gain, you may be able to postpone paying tax on all or part of it, or you may be able to exclude all or part of it. For information, get Publication 523, Selling Your Home.

If your home was used partly for rental, see Property Used Partly for Business or Rental, later in this chapter.

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 or 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. For more information on leases, see chapter 7 in Publication 535, Business Expenses.

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.

Copyrights. Payments you receive for granting the exclusive use or right to exploit a copyright throughout its life in a particular medium are treated as received from the sale.

Related parties. In tax years beginning after August 5, 1997, an executor and a beneficiary of an estate may be treated as related parties under the related party rules. For more information, see Sales and Exchanges Between Related Parties in chapter 2.

Rollover of gain from the sale of qualified small business stock. For sales after August 5, 1997, you may be able to roll over a capital gain from the sale of qualified small business stock into other qualified small business stock. For more information, see Rollover of Capital Gain in chapter 1.

Nonqualified preferred stock received in a nontaxable exchange. For exchanges after June 8, 1997, nonqualified preferred stock received in an exchange of stock for stock, or of property for stock in a controlled corporation, is treated as other property rather than stock. See Corporate Stock, under Other Nontaxable Exchanges in chapter 1.

Exclusion of gain from DC Zone assets. Beginning in 1998, if you acquire a District of Columbia Enterprise Zone (DC Zone) asset and hold it more than 5 years, you will not have to include any qualified capital gain from its sale or exchange in your gross income. This exclusion applies to an interest in, or property of, certain businesses operating in the District of Columbia. For more information, see Publication 553, Highlights of 1997 Tax Changes.

Important Reminders

Investing in small business stock. Beginning in 1998, investments in certain small business stock held more than 5 years will qualify for a special tax benefit. If you sell or exchange the stock at a gain, only one-half of the gain will be subject to federal income tax. For information on qualifying stock, see chapter 4 of Publication 550, Investment Income and Expenses.

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, 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.


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 by U.S. law. This is true whether you reside inside or outside the United States and whether or not you receive a Form 1099 from the foreign payor.
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. Nor does it matter if they are paid 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 for more than a year, the gain or loss is a section 1231 gain or loss. For more information, see Section 1231 Gains and Losses in chapter 4.

Easements. Granting or selling an easement is usually not a sale of property. Instead, the amount received for the easement is subtracted from the basis of the property. If only a part of the entire tract of property is permanently 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 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.

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

Extended note maturity date. The extension of a note’s maturity date is not treated as an exchange of an outstanding note for a new and different note. Nor is it a closed and completed transaction on which gain or loss is figured. This treatment will not apply when changes in the term of the note are significant as to amount virtually to the issuance of a new security. Also, each case must be determined by its own facts.

Transfers on death. The transfer of property to an executor or administrator on the death of an individual is not a sale or exchange.

Bankruptcy. Generally, a transfer of property from a debtor to a bankruptcy estate is not treated as a sale or exchange. For more information, see The Bankruptcy Estate in Publication 908.

Gain or Loss From Sales and Exchanges

Gain or loss is usually realized when property is sold or exchanged. A gain is the excess of the amount you realize from a sale or exchange of property over its adjusted basis. A loss is the excess of the adjusted basis of the property over the amount you realize.

Table 1-1. How To Figure a Gain or Loss

<table>
<thead>
<tr>
<th>If:</th>
<th>Then:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjusted basis is more than amount realized</td>
<td>You have a loss</td>
</tr>
<tr>
<td>Amount realized is more than adjusted basis</td>
<td>You have a gain</td>
</tr>
</tbody>
</table>

Basis. The cost or purchase price of property is usually its basis for figuring the gain or loss from its sale or other disposition. However, if you got the property by gift, inheritance, or in some way other than buying it, you must use a basis other than its cost. See Other Basis in Publication 551.

Adjusted basis. The adjusted basis of property is its original cost or other basis plus certain additions, and minus certain deductions such as depreciation and casualty losses. See Adjusted Basis in Publication 551. In determining gain or loss, the cost of transferring property to a new owner, such as selling expenses, is added to the adjusted basis of the property.

Amount realized. The amount you realize from a sale or exchange is the total of all money you receive plus the fair market value of all property or services you receive. The amount you receive 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.

If the liabilities relate to an exchange of multiple properties, see Multiple Property Exchanges, and its discussion Treatment of Liabilities, later.

Fair market value. Fair market value (FMV) 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 has 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 FMV. If there is a stated price for services, this price is treated as the FMV, unless there is evidence to the contrary.

Example. In your business, you used a building 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:

<table>
<thead>
<tr>
<th>Amount realized:</th>
<th>$140,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash..................</td>
<td>$100,000</td>
</tr>
<tr>
<td>FMV of property received</td>
<td>20,000</td>
</tr>
<tr>
<td>Real estate taxes (assumed by buyer)</td>
<td>3,000</td>
</tr>
<tr>
<td>Mortgage (assumed by buyer)</td>
<td>17,000</td>
</tr>
<tr>
<td>Adjusted basis:</td>
<td>$80,000</td>
</tr>
<tr>
<td>Cost of building</td>
<td>$70,000</td>
</tr>
<tr>
<td>Improvements</td>
<td>20,000</td>
</tr>
<tr>
<td>Total</td>
<td>$80,000</td>
</tr>
<tr>
<td>Minus: Depreciation</td>
<td>10,000</td>
</tr>
<tr>
<td>Adjusted basis</td>
<td>$80,000</td>
</tr>
<tr>
<td>Plus: Selling expenses</td>
<td>4,000</td>
</tr>
<tr>
<td>Adjusted basis</td>
<td>$84,000</td>
</tr>
</tbody>
</table>

Gain on sale: $56,000

Amount recognized. Your gain or loss realized from a sale or exchange of property is usually a recognized gain or loss for tax purposes. 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 disposition of property held for personal use is not deductible.

Life estates, etc. 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 taxable gain if you got the interest as a gift, inheritance, or in a transfer from a spouse or former spouse if incident to a divorce. 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 father dies, and leaves his farm to you for life with a remainder interest to your younger brother. You decide to sell your life interest in the farm. The entire amount you receive is a taxable gain. Your basis in the farm is disregarded.

Example 2. The facts are the same as in Example 1, except that your brother joins you in selling the farm. Because the entire interest in the property is sold, 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 year of sale, no gain or loss is recognized. This cancellation of the sale in the same 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, however, you must recognize gain (or loss, if allowed) in the year of the sale. When the property is returned in a later year, you acquire a new basis in the property. That basis is equal to the amount you pay to the buyer.

Bargain Sales as Gifts

If you sell or exchange property for less than its 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 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 an amount equal to:

\[
\text{Adjusted basis} \times \frac{\text{Amount realized}}{\text{Fair market value of part sold}}
\]

Because of 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 deduction for the contribution is not allowable. See Publication 526, Charitable Contributions, for information on figuring the amount of 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 the contribution of $2,000. The adjusted basis of the property is $10,000. 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

If you sell or exchange property that you used in part for business or rental purposes and in part for personal purposes, you must figure the gain or loss on the sale or exchange as though you had sold two separate pieces of property. You must divide the selling price, selling expenses, and the basis of the property between the business or rental part and the personal part. You must subtract depreciation you took or could have taken from the adjusted basis of the business or rental 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 4 under Section 1221 Gains and Losses. Any gain on the personal part of the property is a capital gain. You cannot deduct a loss on the personal part.

Example. You sold a condominium in 1997 for $57,000. You bought the property in 1988 for $30,000. You used two-thirds of it as your home and rented out the other third. You claimed depreciation of $3,272 for the rental part during the time you owned the property. You made no improvements to the property. Your expenses of selling the condominium were $3,600. You figure your gain or loss as follows:

<table>
<thead>
<tr>
<th>Rental Personal</th>
<th>1/3</th>
<th>2/3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Selling price</td>
<td>$19,000</td>
<td>$38,000</td>
</tr>
<tr>
<td>Less selling expenses</td>
<td>1,200</td>
<td>2,400</td>
</tr>
<tr>
<td>Adjusted basis (sales price)</td>
<td>$17,800</td>
<td>$35,600</td>
</tr>
<tr>
<td>Basis</td>
<td>$10,000</td>
<td>$20,000</td>
</tr>
<tr>
<td>Less depreciation</td>
<td>3,272</td>
<td>6,544</td>
</tr>
<tr>
<td>Adjusted basis</td>
<td>$6,728</td>
<td>$13,456</td>
</tr>
<tr>
<td>Gain (line 3 minus line 6)</td>
<td>$11,072</td>
<td>$16,544</td>
</tr>
</tbody>
</table>

Loss Limit on Sale of Property Changed to Business or Rental Use

You cannot deduct a loss on the sale of property you acquired 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 converted 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 conversion was more than its fair market value, the amount of loss you can deduct is limited.

Determine the amount of loss you can deduct as follows:

1. Choose the smaller of the property's adjusted basis or fair market value at the time of conversion.
2. Add to (1) the cost of any improvements and other increases to basis since the time of conversion.
3. Subtract from (2) depreciation and any other decreases to basis since the time of conversion.
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 amount of loss you can deduct.

Example. Five years ago, you converted your main home to rental property. At the time of conversion, 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 expense of $12,620 over the five prior years. 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:

Smaller of adjusted basis or fair market value at time of conversion ............. $70,000
Plus: Cost of any improvements and any other additions to basis after the conversion ................................................................. 0
$70,000
Minus: Depreciation and any other decreases to basis after the conversion .... 12,620
$57,380
Minus: Amount you realized from the sale ................................ 55,000
Deductible loss ........................................... $2,380

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

Example. Ann abandoned her home that she purchased for $200,000. At the time she abandoned the house, her mortgage balance was $185,000. She has a nondeductible loss of $200,000 (the adjusted basis). If the bank later forecloses on the loan or repossesses the house, she will have to figure her gain or loss as discussed later under Foreclosures and Repossessions.

Cancellation of debt. If the abandoned property secures a loan for which you are personally liable and the debt is canceled, you will realize ordinary income equal to the amount of canceled debt. This income is separate from any loss realized from abandonment of the property. Report income from cancellation of a debt related to a business or rental activity as business or rental income. Report income from cancellation of a nonbusiness debt as miscellaneous income on line 21, Form 1040.

However, income from cancellation of debt is not taxed if:

- The cancellation is intended as a gift,
- The debt is qualified farm indebtedness (see chapter 4 of Publication 225, Farmer's Tax Guide),
- The debt is qualified real property indebtedness (see chapter 5 of Publication 334, Tax Guide for Small Business), or
- You are insolvent or bankrupt (see Publication 908, Bankruptcy Tax Guide).

Forms 1099–A and 1099–C. If your abandoned property 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. 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, or federal government agency. For abandonsment of property and debt cancellations occurring in 1997, these forms should be sent to you by February 2, 1998.

Abandonments

The abandonment of property is a disposition of property. Loss from abandonment of business or investment property is deductible as an ordinary loss, even if the property is a capital asset. The loss is the amount of the property's adjusted basis when abandoned. This rule also applies to leasehold improvements or lessor made for the lessee that were abandoned after June 12, 1996. However, if the property is later foreclosed on or repossessed, gain or loss is figured as discussed later. The abandonment loss is taken in the tax year in which the loss is sustained.

Foreclosures and Repossessions

If the borrower (buyer) does not make payments due on a loan secured by property, the lender (mortgagee or creditor) may foreclose on the mortgage or repossess the property. The foreclosure or repossession is treated as a sale or exchange from which the borrower may realize gain or loss. This is true even if the property is voluntarily returned to the lender. The borrower may also realize ordinary income from cancellation of debt, if the loan balance is more than the property's fair market value.

Gain or loss on foreclosure or repossession. The borrower's gain or loss from the foreclosure or repossession described...
earlier is generally figured and reported in the same way as gain or loss from a sale or exchange. The gain or loss is the difference between the borrower's adjusted basis in the transferred property and the amount realized. See Gain or Loss From Sales and Exchanges, earlier. 

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

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

**Example 1.** In 1994, Chris purchased a new car for $15,000. He paid $2,000 down and borrowed the remaining $13,000 from the dealer's credit company. Chris is not personally liable on the loan (nonrecourse), but pledges the new car as security. In 1997, the credit company repossessed the car because he stopped making loan payments. The balance due after taking into account the payments Chris made was $10,000. The car's fair market value when repossessed was $9,000. The amount Chris realized on the repossession is $10,000. That amount is the debt canceled by the repossession, even though he is not personally liable for the loan and the car's fair market value is less than $10,000. Chris figures his gain or loss on the repossession by comparing the amount realized ($10,000) with his adjusted basis ($15,000). He has a $5,000 nondeductible loss.

**Example 2.** In 1992, Ann paid $200,000 for her home. She paid $15,000 down and borrowed the remaining $185,000 from a bank. Ann is not personally liable on the loan (nonrecourse), but pledges the house as security. In 1997, the bank foreclosed on the loan because Ann stopped making loan payments. When the bank foreclosed on the loan, the balance due was $180,000 and the fair market value of the house was $170,000. The amount Ann realized on the foreclosure is $180,000, the debt canceled by the foreclosure. She figures her gain or loss by comparing the amount realized ($180,000) with her adjusted basis ($200,000). She has a $20,000 nondeductible loss.

Amount realized on a recourse debt. If the borrower is personally liable for the debt (recourse debt), the amount realized on the foreclosure or repossession does not include the amount of the canceled debt that is income to the borrower from cancellation of debt. However, if the fair market value of the transferred property is less than the canceled debt, the amount realized by the borrower includes the canceled debt up to the fair market value of the property. The borrower is treated as receiving ordinary income from the canceled debt for that part of the debt not included in the amount realized. See Cancellation of debt.

**Example 1.** Assume the same facts as in the previous Example 1 except that Chris is personally liable for the car loan (recourse debt). In this case, the amount he realizes is $9,000. This is the amount of the canceled debt ($10,000) up to the car's fair market value ($9,000). Chris figures his gain or loss on the repossession by comparing the amount realized ($9,000) with his adjusted basis ($15,000). He has a $6,000 nondeductible loss. He is 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.

**Example 2.** Assume the same facts as in Example 2 above except that Ann is personally liable for the loan (recourse debt). In this case, the amount she realizes is $170,000. This is the amount of the canceled debt ($180,000) up to the house's fair market value ($170,000). Ann figures her gain or loss on the foreclosure by comparing the amount realized ($170,000) with her adjusted basis ($200,000). She has a $30,000 nondeductible loss. She is also treated as receiving ordinary income from cancellation of debt. That income is $10,000 ($180,000–$170,000). This is the part of the canceled debt not included in the amount realized.

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 Publication 537.

Cancellation of debt. If property that is repossessed or foreclosed upon secures a debt for which you are personally liable (recourse debt), you generally must report, as ordinary income, the amount by which the canceled debt exceeds 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. Report the income from cancellation of a nonbusiness debt as miscellaneous income on line 21, Form 1040.

**Table 1-2. Worksheet for Foreclosures and Repossessions**

(Keep for your records)

<table>
<thead>
<tr>
<th>Part 1.</th>
<th>Figure your income from cancellation of debt. (Note: If you are not personally liable for the debt, you do not have income from cancellation of debt. Skip Part 1 and go to Part 2.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Enter the amount of debt cancelled by the transfer of property.</td>
</tr>
<tr>
<td>2.</td>
<td>Enter the fair market value of the transferred property.</td>
</tr>
<tr>
<td>3.</td>
<td>Income from cancellation of debt.* Subtract line 2 from line 1. If less than zero, enter zero.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Part 2.</th>
<th>Figure your gain or loss from foreclosure or repossession.</th>
</tr>
</thead>
<tbody>
<tr>
<td>4.</td>
<td>Enter the smaller of line 1 or line 2. (If you are not personally liable for the debt, enter the amount of debt cancelled by the transfer of property.)</td>
</tr>
<tr>
<td>5.</td>
<td>Enter the adjusted basis of the transferred property.</td>
</tr>
<tr>
<td>6.</td>
<td>Gain or loss from foreclosure or repossession. Subtract line 5 from line 4.</td>
</tr>
</tbody>
</table>

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

However, income from cancellation of debt is not taxed if:

- The cancellation is intended as a gift,
- The debt is qualified farm indebtedness (see chapter 4 of Publication 225, Farmer's Tax Guide),
- The debt is qualified real property indebtedness (see chapter 5 of Publication 334, Tax Guide for Small Business), or
- You are insolvent or bankrupt (see Publication 908, Bankruptcy Tax Guide).

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 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. 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, or federal government agency. For foreclosures or repossessions occurring in 1997, these forms should be sent to you by February 2, 1998.

**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. 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 it 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. You do not report the gain if you receive property that is similar or related in service or use to the property you are losing. If your income from the new property is the same as your basis for the converted property. The gain on the involuntary conversion 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 specified period of time, you can choose to postpone reporting the gain.

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 Publication 547.

**Condemnations**

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 told 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 tells 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 owner of your property to someone other than the condemning authority qualifies 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 is being 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 Internal Revenue Service 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. They notify you that they intend to acquire your property by negotiation or condemnation. A threat of condemnation exists when you receive their 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 choose 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 Table1-3 to figure your gain or loss from a condemnation award.

**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 paid directly to the holder of a mortgage or other lien (claim) 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 receive 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 taken out of award.

**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 amount of the severance damages and put that in writing. If this is not done, all proceeds from the condemning authority are considered awarded for your condemned property.

You may not make a completely new allocation of the total award after the transaction is completed. However, you may show how much of the award was 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 presented 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
Table 1-3. **Worksheet for Condemnations**
(Keep for your records)

<table>
<thead>
<tr>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>(If you did not receive severance damages, skip Part 1 and go to Part 2.)</td>
</tr>
<tr>
<td>1. Enter the amount of severance damages received</td>
</tr>
<tr>
<td>2. Enter the amount of your expenses in getting severance damages</td>
</tr>
<tr>
<td>3. Subtract line 2 from line 1. If less than zero, enter -0-</td>
</tr>
<tr>
<td>4. Enter the amount of any special assessment on remaining property taken out of your award</td>
</tr>
<tr>
<td>5. Net severance damages. Subtract line 4 from line 3. If less than zero, enter -0-</td>
</tr>
<tr>
<td>6. Enter the adjusted basis of the remaining property</td>
</tr>
<tr>
<td>7. Gain from severance damages. Subtract line 6 from line 5. If less than zero, enter -0-</td>
</tr>
<tr>
<td>8. Figured adjusted basis of the remaining property. Subtract line 5 from line 6. If less than zero, enter -0-</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Part 2. Gain or loss from condemnation award.</th>
</tr>
</thead>
<tbody>
<tr>
<td>9. Enter the amount of the condemnation award received</td>
</tr>
<tr>
<td>10. Enter the amount of your expenses in getting the condemnation award</td>
</tr>
<tr>
<td>11. If you completed Part 1 and line 4 is more than line 3, subtract line 3 from line 4. Otherwise, enter -0-</td>
</tr>
<tr>
<td>12. Add lines 10 and 11</td>
</tr>
<tr>
<td>13. Net condemnation award. Subtract line 12 from line 9</td>
</tr>
<tr>
<td>14. Enter the adjusted basis of the condemned property</td>
</tr>
<tr>
<td>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</td>
</tr>
<tr>
<td>16. Loss from condemnation award. Subtract line 13 from line 14</td>
</tr>
<tr>
<td>(Note: You cannot deduct the amount on line 16 if the condemned property was held for personal use.)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Part 3. Postponed gain from condemnation.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(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.)</td>
</tr>
<tr>
<td>17. If you completed Part 1 and line 7 is more than zero, enter the amount from line 5. Otherwise, enter -0-</td>
</tr>
<tr>
<td>18. If line 15 is more than zero, enter the amount from line 13. Otherwise, enter -0-</td>
</tr>
<tr>
<td>19. Add lines 17 and 18</td>
</tr>
<tr>
<td>20. Enter the total cost of replacement property and any expenditures to restore the usefulness of your remaining property</td>
</tr>
<tr>
<td>21. Subtract line 20 from line 19. If less than zero, enter -0-</td>
</tr>
<tr>
<td>22. If you completed Part 1, add lines 7 and 15. Otherwise, enter the amount from line 15</td>
</tr>
<tr>
<td>23. Recognized gain. Enter the smaller of line 21 or line 22</td>
</tr>
<tr>
<td>24. Postponed gain. Subtract line 23 from line 22. If less than zero, enter -0-</td>
</tr>
</tbody>
</table>

You can use Part I 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 must first reduce your severance damages by your expenses in obtaining the damages. You then reduce them by any special assessment levied against the remaining part of the property if the assessment was taken out of 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 amount of the total award. Also subtract the expenses of obtaining severance damages 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 proceeding. You must allocate one-fourth of your legal expenses to the severance damages and the other three-fourths to the condemnation award.

**Special assessment taken out of award.** When only part of your property is condemned, a special assessment levied against the remaining property may be taken out of 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.

**Example.** To widen the street in front of your home, the city condemned 25 feet 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 minus $700 for the special assessment taken out).

If the $700 special assessment were not taken out of the award, and you were paid $5,000, your net award would be $4,700.
($5,000 minus $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 taken out 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 taken out of 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 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 to obtain the 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:

<table>
<thead>
<tr>
<th>Amount of award received</th>
<th>$12,000</th>
<th>$13,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minus: Legal expenses, $200</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Net condemnation award</td>
<td>$11,900</td>
<td>$11,900</td>
</tr>
<tr>
<td>Minus:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjusted basis of residential part:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1/2 of original cost, $25,000</td>
<td>$12,500</td>
<td>$12,500</td>
</tr>
<tr>
<td>1/2 of cost of roof, $1,000</td>
<td>500</td>
<td>500</td>
</tr>
<tr>
<td>Adjusted basis of residential part</td>
<td>$13,000</td>
<td>$13,000</td>
</tr>
<tr>
<td>Adjusted basis of business part:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1/2 of original cost, $25,000</td>
<td>$12,500</td>
<td>$12,500</td>
</tr>
<tr>
<td>1/2 of cost of roof, $1,000</td>
<td>500</td>
<td>500</td>
</tr>
<tr>
<td>Total</td>
<td>$13,000</td>
<td>$13,000</td>
</tr>
<tr>
<td>Minus: Depreciation</td>
<td>4,600</td>
<td>4,600</td>
</tr>
<tr>
<td>Adjusted basis, business part</td>
<td>$8,400</td>
<td>$8,400</td>
</tr>
<tr>
<td>Loss on residential property</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Gain on business part</td>
<td>$1,100</td>
<td>$1,100</td>
</tr>
<tr>
<td>Total</td>
<td>$1,100</td>
<td>$1,100</td>
</tr>
</tbody>
</table>

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 it. Your basis for the new property is the same as your basis for the old.

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

To postpone 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 amount of the unspent part of the amount realized.

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

Reduce the basis of the replacement property by the amount of postponed gain. Also, if your replacement property for property condemned after August 20, 1996, is stock in a corporation that owns property that is 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.

Choosing to postpone gain. Report your election to postpone your gain, along with all necessary details, on your return for the tax year in which you realize the gain.

If a partnership or a corporation owns the condemned property, only the partnership or corporation can choose to postpone reporting the gain.

Changing your mind. You can change your mind about reporting or postponing the gain at any time before the end of the specified replacement period.

Example. Your property was condemned and you had a gain of $5,000. You reported the gain on your return for the year in which you received it, and paid the tax due. You buy replacement property within the replacement period. You used all but $1,000 of the amount realized from the condemnation to buy the replacement property. You now change your mind and want to postpone the tax on the $4,000 of gain equal to the amount you spent for the replacement property. You should file a claim for refund on Form 1040X. Explain on Form 1040X that you previously reported the entire gain from the condemnation, but you now want to report only the part of the gain ($1,000) equal to the amount of condemnation proceeds not spent for replacement property.

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 choose 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 choice 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 part of your property is condemned, and you sell the related part and buy replacement property, you can choose 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 party. You cannot postpone reporting gains from condemnation if you buy the replacement property from a related party. For information on related parties, see Non-deductible Loss under Sales and Exchanges Between Related Parties in chapter 2.

This rule applies to condemnations occurring:

1) After February 5, 1995, for C corporations and partnerships in which more than 50% of the capital or profits interest is owned by C corporations.

2) After June 8, 1997, for all others (including individuals, partnerships (other than those in (1) above), and S corporations) if the total realized gain for the tax year on all involuntarily converted properties on which there are realized gains is more than $100,000.

For condemnations described in (2) 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 party acquired the property from an unrelated party within the period of time allowed for replacing the condemned property.

Advance payment. You have not purchased replacement property if you pay a contractor in advance to build your replacement property unless it is finished before the end of the replacement period.

Replacement property. To postpone 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 use in your trade or business or for investment (other than property held mainly for sale), but your replacement property is not similar or related in service or use, it will be treated as such if it is like-kind.
property. For a discussion of like-kind property, see Like Property under Like-Kind Exchanges, later.

Leasehold replaced with fee simple property. Fee simple property you will use in your trade or business or for investment can qualify as replacement property that is similar or related in service or use to a condemned leasehold if you use it in the same business and for the identical purpose as the condemned leasehold. If the condemned leasehold is not ready to run when the fee simple property is like-kind property. It can qualify as replacement property regardless of how you use it.

A “fee simple” property interest generally is one in which the owner is entitled to the entire property, with unconditional power to dispose of it during his or her lifetime. A leasehold is property held under a lease, usually for a term of years.

Outdoor advertising display replaced with replacement property. You may make an election to treat an outdoor advertising display as real property. If you make this election and you replace the display with real property in which you hold a different kind of interest, your replacement property can qualify as like-kind property. For example, real property purchased to replace a destroyed billboard and leased property on which the billboard was located qualifies as property of a like kind.

You can make this election only if you did not claim a section 179 deduction for the display. You cannot revoke this election unless you get the consent of the Internal Revenue Service.

An outdoor advertising display is a sign or device rigidly assembled and permanently attached to the ground, a building, or any other permanent structure used for commercial or other advertisement to the public.

Owner-user. If you are an owner-user, similar or related in service or use means that replacement property 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.

Owner-investor. If you are an owner-investor, similar or related in service or use means that any replacement property must have the same relationship of services or uses to you as the property it replaces. You decide this by determining:

• Whether the properties are of similar service to you,
• The nature of the business risks connected with the properties, and
• What the properties demand of you in the way of management, service, and relations to your tenants.

Example. You owned land and a building you rented to a manufacturing company. The building was condemned. During the replacement period, you had a new building constructed on other land you already owned. You rented out the new building for use as a wholesale grocery warehouse. Because the replacement property is also rental property, the two properties are considered similar or related in service or use if there is a similarity in:

1) Your management activities,
2) The amount and kind of services you provide to your tenants, and
3) The nature of your business risks connected with the properties.

Substituting replacement property. Once you designate certain property as replacement property on your tax return, you may not substitute other qualified property. But if your previously designated replacement property does not qualify, you can substitute other qualified property if you acquire it within the replacement period.

Controlling interest in a corporation. You can replace property by acquiring a controlling interest in a corporation that owns property similar or related in service or use to your condemned property. You have controlling interest if you own stock having at least 80% of the combined voting power of all classes of voting stock and at least 80% of the total number of shares of all other classes of stock.

Basis adjustment to corporation’s property. For condemnations occurring after August 20, 1996, the basis of property held by the corporation at the time you acquired control must be reduced by the amount of your post-poned gain, if any. You are not required to reduce the adjusted bases of the corporation’s properties below your adjusted basis in the corporation’s stock (determined after reduction by the amount of your post-poned gain).

Allocate this reduction to the following classes of property in the order shown below:

1) Property that is similar or related in service or use to the condemned property.
2) Depreciable property not reduced in (1) above.
3) All other property.

If two or more properties fall in class (1), (2), or (3), you allocate the reduction to each property in proportion to the adjusted bases of all the properties in that class. The reduced basis of any single property cannot be less than zero.

Replacement period. To postpone reporting your gain from a condemnation, you must buy replacement property within a specified period of time. This is the “replacement period.” The replacement period for a condemnation begins on the earlier of:

1) The date on which you disposed of the condemned property, or
2) The date on which the threat of condemnation began.

The replacement period ends 2 years after the close of the first tax year in which any part of the gain on the condemnation is realized.

It real property held for use in a trade or business or for investment (not including property held primarily for sale) is condemned, the replacement period ends 3 years after the close of the first tax year in which any part of the gain on the condemnation is realized. However, this 3-year replacement period cannot be used if you re-place the condemned property by acquiring control of a corporation owning property that is similar or related in service or use.

Determining when gain is realized. The replacement period ends 2 (or 3) years after the close of the first year in which you realize any part of the gain. If you are a cash basis taxpayer, you realize gain when you receive payments that exceed your basis in the property. If the condemning authority makes deposits into the court, you realize gain when you withdraw (or have the right to withdraw) amounts that exceed your basis.

This applies even though the amounts received are only partial or advance payments and the full amount of the award has not yet been determined. A replacement will be too late if you wait for a final determination that does not take place in the applicable replacement period after you first realize gain.

For accrual basis taxpayers, gain (if any) accrues in the earliest year when:

1) All events have occurred that fix the right to the condemnation award and the amount can be determined with reasonable accuracy, or
2) All or part of the award is actually or constructively received.

For example, if you have an absolute right to a part of a condemnation award when it is deposited into court, the amount deposited accrues in the year the deposit is made even though the full amount of the award is still contested.

Replacement property purchased before the condemnation. If you purchase your replacement property after there is a threat of condemnation but before the actual condemnation, and you still hold the replacement property at the time of the condemnation, you have purchased your replacement property within the replacement period. Property you acquire before there is a threat of condemnation does not qualify as replacement property acquired within the replacement period.

Example. On April 3, 1996, city authorities notified you that your property would be condemned. On June 5, 1996, you acquired property to replace your condemned property. You still had the new property when the city took possession of your old property on September 4, 1997. You have made a replacement within the replacement period.

Extension. You may get an extension of the replacement period if you apply to the District Director of the Internal Revenue Service for your area. You should apply before the end of the replacement period. Your application should contain all details of your need for an extension. You may file an application within a reasonable time after the replacement period ends if you can show reasonable cause for the delay. An extension of the replacement period will be granted if you can show reasonable cause for not making the replacement within the regular period.

Ordinarily, requests for extensions are granted near the end of the replacement period or the extended replacement period. Extensions are usually limited to a period of 1 year or less. The high market value or scarcity of replacement property is not a sufficient reason for granting an extension. If your replacement property is being constructed and you clearly show that the replacement or restoration cannot be made within the re-
placement period, you will be granted an extension of the period.

**Time for assessing a deficiency.** Any deficiency for any tax year in which part of the gain is realized may be assessed at any time before the expiration of 3 years from the date you notify the IRS District Director for your area that you have replaced, or intend not to replace, the condemned property within the replacement period.

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**Nontaxable Exchanges**

Certain exchanges are not taxable. This means that any gain from the exchange is not taxed, and any loss cannot be deducted. In other words, even if you realize a gain or loss on the exchange, it will not be recognized until you sell or otherwise dispose of the property you receive.

**Like-Kind Exchanges**

The exchange of property for the same kind of property is the most common type of nontaxable exchange. To be a like-kind exchange, the property traded and the property received must be both:

1. **Qualifying property, and**
2. **Like property.**

These two requirements are discussed later. If the like-kind exchange includes the receipt of money or unlike property or the assumption of your liabilities, you may have a taxable gain. See **Partially Nontaxable Exchanges**, later.

Additional requirements apply to exchanges in which the property received is not received immediately upon the transfer of the property given up. See **Deferred Exchanges**, later.

**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 of 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, you may still treat this transaction as a like-kind exchange, if it meets all the requirements.

**Basis of property received.** If you acquire property in a like-kind exchange, the basis of that property is the same as the basis of the property you transferred.

For the basis of property received in an exchange that is only partially nontaxable, see **Partially Nontaxable Exchanges**, later.

**Example.** You exchanged real estate held for investment having an adjusted basis of $25,000 for other real estate held for investment. The FMV of both properties is $50,000. The basis of your new property is the same as the basis of the old ($25,000).

**Money paid.** If, in addition to giving up like property, you pay money in a like-kind exchange, you still have no taxable gain or deductible loss. The basis of the property received is the basis of the property given up increased by the money paid.

**Example.** Bill Smith trades an old car for a new one. The new car costs $10,800. He is allowed $2,000 for the old car, and pays $8,800 cash. He has no taxable gain or deductible loss on the transaction, regardless of the adjusted basis of his old car. If Bill sold the old car to a third party for $2,000 and bought a new one, he would have a recognized gain or loss on the sale of his old car equal to the difference between the amount realized and the adjusted basis of the old car.

**Sale and purchase.** If you sell property and buy similar property in two mutually dependent transactions, you may have to treat the sale and purchase as a single nontaxable exchange.

**Example.** You used your car in your business for 2 years. Its adjusted basis is $3,500 and its trade-in value is $4,500. You are interested in a new car that costs $10,500. Ordinarily, you would trade your old car for the new one and pay the dealer $6,000. Your basis for depreciation of the new car would then be $9,500 ($6,000 plus $3,500 adjusted basis of the old car).

Because you want your new car to have a larger basis for depreciation, you arrange to sell your old car to the dealer for $4,500. You then buy the new one for $10,500 from the same dealer. However, you are treated as having exchanged your old car for the new one because the sale and purchase are reciprocally and mutually dependent. Your basis for depreciation for the new car is $9,500, the same as if you traded the old car.

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

If you have any taxable gain because you received money or unlike property, report it on Schedule D (Form 1040) or Form 4797, whichever applies. See chapter 5. You may have to report the taxable gain as ordinary income because of depreciation. See **Like-Kind Exchanges and Involuntary Conversions** in chapter 4.

**Exchange expenses.** Exchange expenses are generally the closing costs that you pay. They include such items as brokerage commissions, attorney fees, and deed preparation fees. Subtract these expenses from the consideration received to figure the amount realized on the exchange. Also add them to the basis of the like-kind property received. If you receive cash or unlike property in addition to the like-kind property and realize a gain on the exchange, subtract the expenses from the cash or fair market value of the unlike property. Then use the net amount to figure the recognized gain. See **Partially Nontaxable Exchanges**, later.

**Qualifying Property**

In a like-kind exchange, both the property you give up and the property you receive must be held by you for investment or for productive use in your trade or business. Machinery, buildings, land, trucks, and rental houses are examples of property that may qualify.

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

- Property you use for personal purposes, such as your home and your family car.
- Stock in trade or other property held primarily for sale, such as inventories, raw materials, and real estate held by dealers.
- Stocks, bonds, notes, or other securities or evidences of indebtedness, such as accounts receivable.
- Partnership interests.
- Certificates of trust or beneficial interest.
- Choses in action.

However, you might have a nontaxable exchange under other rules. See **Other Nontaxable Exchanges**, later.

An exchange of assets of a business for the assets of a similar business cannot be treated as an exchange of one property for another property. Whether you engaged in a like-kind exchange depends on an analysis of each asset involved in the exchange. However, see **Multiple Property Exchanges**, later.

**Like Property**

There must be an exchange of like property. The exchange of real estate for real estate and the exchange of personal property for similar personal property are exchanges of like property. For example, the trade of land improved with an apartment house for land improved with a store building, or a panel truck for a pickup truck, is a like-kind exchange.

An exchange of personal property for real property does not qualify as a like-kind exchange. For example, an exchange of a piece of machinery for a store building does not qualify. Nor does the exchange of livestock of different sexes qualify.

**Real property.** An exchange of city property for farm property, or improved property for unimproved property is a like-kind exchange.

The exchange of real estate you own for a real estate lease that runs 30 years or more is a like-kind exchange. However, not all exchanges of interests in real property qualify. The exchange of a life estate expected to last less than 30 years for a remainder interest is not a like-kind exchange.

An exchange of a remainder interest in real estate for a remainder interest in other real estate is a like-kind exchange if the nature and character of the two property interests are the same.

**Special rule for foreign real property exchanges.** Real property located in the United States and real property located outside of the United States are not considered like-kind property under the like-kind exchange rules. If you exchange foreign real property for property located in the United States, your gain or loss on the exchange is recognized. Foreign real property is real property not located in a state or the District of Columbia.

This foreign real property exchange rule does not apply to the replacement of condemned real property. Foreign and U.S. real property can still be considered like-kind property under the rules for replacing condemned property to postpone gain on the
Personal property. Depreciable tangible personal property can be either “like kind” or “like class” to qualify for nonrecognition treatment. Like-class properties are depreciable tangible personal properties within the same General Asset Class or Product Class. Property classified in any General Asset Class may not be classified within a Product Class. General Asset Classes. General Asset Classes describe the types of property frequently used in many businesses. They include:

1) Office furniture, fixtures, and equipment (asset class 00.11),
2) Information systems, such as computers and peripheral equipment (asset class 00.12),
3) Data handling equipment except computers (asset class 00.13),
4) Airplanes (airframes and engines), except planes used in commercial or contract carrying of passengers or freight, and all helicopters (airframes and engines) (asset class 00.21),
5) Automobiles and taxis (asset class 00.22),
6) Buses (asset class 00.23),
7) Light general purpose trucks (asset class 00.241),
8) Heavy general purpose trucks (asset class 00.242),
9) Railroad cars and locomotives except those owned by railroad transportation companies (asset class 00.25),
10) Tractor units for use over the road (asset class 00.26),
11) Trailers and trailer-mounted containers (asset class 00.27),
12) Vessels, barges, tugs, and similar water-transportation equipment, except those used in marine construction (asset class 00.28), and
13) Industrial steam and electric generation or distribution systems (asset class 00.4).

Product Classes. Product Classes include property listed in a 4-digit product class (except any ending in “9,” a miscellaneous category) in Division D of the Standard Industrial Classification codes of the Executive Office of the President, Office of Management and Budget, Standard Industrial Classification Manual (SIC Manual). Copies of the SIC Manual may be obtained from the National Technical Information Service, an agency of the U.S. Department of Commerce.

Example 1. You transfer a personal computer used in your business for a printer to be used in your business. The properties exchanged are within the same General Asset Class and are therefore of a like class.

Example 2. Trena transfers a grader to Ron in exchange for a scraper. Both are used in a business. Neither property is within any of the General Asset Classes. Both properties, however, are within the same Product Class and are therefore of a like class.

Intangible personal property and non-depreciable personal property. If you exchange intangible personal property or non-depreciable personal property for like-kind property, no gain or loss is recognized on the exchange. (There are no like classes for these properties.) Whether intangible personal property, such as a patent or copyright, is of a like kind to other intangible personal property generally depends on the nature or character of the rights involved. It also depends on the nature or character of the underlying property to which those rights relate.

Example. The exchange of a copyright on a novel for a copyright on a different novel can qualify as a like-kind exchange. However, the exchange of a copyright on a novel for a copyright on a song is not a like-kind exchange.

Goodwill. The exchange of the goodwill or going concern value of a business for the goodwill or going concern value of another business is not a like-kind exchange.

Special rule for foreign personal property exchanges. For exchanges of property after June 8, 1986, if property you (or a related person) held it. This does not apply if the exchange is not a like-kind exchange. Any property received after the date you transfer the property given up in the exchange is recognized.

This rule does not apply to any transfer under a written binding contract in effect on June 8, 1997, and at all times thereafter to the disposition of property. A contract will not fail to be binding solely because it provides for a sale in lieu of an exchange or the property to be acquired where the property was not identified under that contract before June 9, 1997.

Deferred exchanges. A deferred exchange is one in which you transfer property you use in business or hold for investment and, at a later time, you 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 (that is, property for property), rather than a transfer of property for money that is used to purchase replacement property.

If, before you receive the replacement property, you actually or constructively receive money or unlike property in full payment for the property you transferred, the transaction will be treated as a sale rather than a deferred exchange. In that case, you must recognize gain or loss on the transaction, even if you later receive the replacement property. (It would be treated as if you purchased it.)

You are in actual or constructive receipt of money or unlike property at the time the money or property is credited to your account or made available to you. You are also in actual or constructive receipt of money or unlike property at the time any limits or restrictions on it expire or are waived.

The determination of whether you are in actual or constructive receipt of money or unlike property, however, is made without regard to certain arrangements you make to ensure that the other party carries out its obligations to transfer the replacement property to you. For example, if you have that obligation secured by a mortgage or by cash or its equivalent held in a qualified escrow account or qualified trust, that arrangement will be disregarded in determining whether you are in actual or constructive receipt of money or unlike property. For more information, see section 1.1031(k)-1(g) of the Income Tax Regulations. Also, see Like-Kind Exchanges Using Qualified Intermediaries, later.

Identification requirement. You must identify the property to be received within 45 days after the date you transfer the property given up in the exchange. Any property received during that time is considered to have been identified.

If you transfer more than one property (as part of the same transaction) and the properties are transferred on different dates, the identification period and the receipt period (discussed later) begin on the earliest date of the transfers.

Identifying replacement property. You must identify the replacement property in a signed written document and deliver it to the other person involved in the exchange. You must clearly describe the replacement property in the written document. For example, use the legal description or street address for real property and the make, model, and year for a car. In the same manner, you can revoke an identification of replacement property at any time before the end of the identification period.

Identifying alternative and multiple properties. You can identify more than one replacement property. Regardless of the number of properties you give up, the maximum number of replacement properties you can identify is:

1) Three, or
2) Any number of properties whose total fair market value (FMV) at the end of the identification period is not more than double the total FMV, on the date of transfer, of all properties you give up.

If, as of the end of the identification period, you have identified more properties than permitted under this maximum rule, the only property that will be considered identified is:

• Any replacement property you received before the end of the identification period, and
Any replacement property identified before the end of the identification period and received before the end of the receipt period, but only if the FMV of the property is at least 95% of the total FMV of all identified replacement properties. (Do not include any you revoked.) FMV is determined on the earlier of the date you received the property or the last day of the receipt period.

Disregard incidental property. Do not treat property that is incidental to a larger item of property as separate from the larger item when you identify replacement property. Property is incidental to a larger item of property if:

1) It is typically transferred with the larger item, and
2) The total FMV of all the incidental property is not more than 15% of the total FMV of the larger item of property.

Replacement property to be produced. Gain or loss from a deferred exchange can qualify for nonrecognition even if the replacement property is not in existence or is being produced at the time you identify it as replacement property. If you need to know the FMV of the replacement property to identify it, estimate its FMV as of the date you expect to receive it.

To determine whether the replacement property you received qualifies as like-kind by being substantially the same as the property you identified, do not take into account any variations due to usual production changes. Substantial changes in the property to be produced, however, will disqualify it as like-kind property.

If your identified replacement property is personal property to be produced, it must be completed by the date you receive it to qualify as like-kind property.

If your identified replacement property is real property to be produced and it is not completed by the date you receive the property, it may still qualify as like-kind property. It will qualify as like-kind property only if, had it been completed on time, the property you received would have been considered to be substantially the same as the property you identified. It is considered to be substantially the same only to the extent the property received is considered real property under local law. However, any additional production on the replacement property after you receive it does not qualify as like-kind property. (To this extent, the transaction is treated as a taxable exchange of property for services.)

Receipt requirement. The property must be received by the earlier of:

- The 180th day after the date on which you transfer the property given up in the exchange, or
- The due date, including extensions, for your tax return for the tax year in which the transfer of the property given up occurred.

You must receive substantially the same property that met the identification requirement, discussed earlier.

Like-Kind Exchanges Using Qualified Intermediaries
If you transfer property through a qualified intermediary, the transfer of the property given up and receipt of like-kind replacement property is treated as an exchange. This rule applies even if you receive money or other property directly from a party to the transaction other than the qualified intermediary.

A qualified intermediary is a person who:

1) Enters into a written exchange agreement with you to acquire and transfer the property you give up and to acquire the replacement property and transfer it to you. This agreement must expressly limit your rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property held by the qualified intermediary.

2) Is neither of the following:
   a) Your agent at the time of the transaction. This includes a person who has been your employee, attorney, accountant, investment banker or broker, or real estate agent or broker who you enter into an agreement with before the transfer of the property you give up. This agreement must expressly limit your agent’s rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property held by the qualified intermediary.
   b) A person who is related to you or your agent under the rules discussed in chapter 2 under Non-Deductible Loss, substituting “10%” for “50%”.

An intermediary is treated as acquiring and transferring property if:

1) The intermediary acquires and transfers legal title to the property.
2) The intermediary enters into an agreement with a person other than you for the transfer to that person of the property you give up and that property is transferred to that person, and
3) The intermediary enters into an agreement with the owner of the replacement property for the transfer of that property and the replacement property is transferred to you.

An intermediary is treated as entering into an agreement if the rights of a party to the agreement are assigned to the intermediary and all parties to that agreement are notified in writing of the assignment by the date of the relevant transfer of property.

Partially Nontaxable Exchanges
If, in addition to like property, you receive money or unlike property in a like-kind exchange in which you realize a 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 fair market value of the unlike property you receive.

TIP: A loss is never deductible in a nontaxable exchange even if you receive unlike property or cash.

To figure the amount of taxable gain, first determine the fair market 2-value of any unlike property you receive and add it to the amount of any money you receive. The total is the maximum amount of gain that can be taxed. Next, figure the amount of gain on the whole exchange as discussed earlier under Gain or Loss From Sales and Exchanges: Your recognized (taxable) gain is the lesser of these two amounts.

Example. You exchange real estate held for investment that has an adjusted basis of $8,000 for other real estate that you want to hold for investment. The real estate you receive has a fair market value of $10,000. You also receive $1,000 in cash. You paid $500 in exchange expenses. Although the total gain realized on the transaction is $2,500, only $500 ($1,000 cash received minus the $500 exchange expenses) is recognized (included in your income).

Assumption of liabilities. If the other party to a nontaxable exchange assumes any of your liabilities, or if you transfer property subject to a liability, you will be treated as if you received cash in the amount of the liability.

Example. The facts are the same as in the previous example, except the property you give up is subject to a $3,000 mortgage. Figure the gain realized as follows:

<table>
<thead>
<tr>
<th></th>
<th>$10,000</th>
<th>$3,000</th>
<th>$14,000</th>
<th>($500)</th>
</tr>
</thead>
<tbody>
<tr>
<td>FMV of like property received</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash received</td>
<td></td>
<td>1,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total received</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mortgage assumed on property given up</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total received</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Minus: Exchange expenses</td>
<td></td>
<td></td>
<td>(500)</td>
<td></td>
</tr>
<tr>
<td>Amount Realized</td>
<td></td>
<td></td>
<td>$14,500</td>
<td></td>
</tr>
<tr>
<td>Minus: Adjusted basis of property you transferred</td>
<td></td>
<td></td>
<td>($8,000)</td>
<td></td>
</tr>
<tr>
<td>Realized gain</td>
<td></td>
<td></td>
<td>$5,500</td>
<td></td>
</tr>
</tbody>
</table>

The realized gain is taxed only up to $3,500, the sum of the cash received ($1,000 + $500 exchange expenses) and the mortgage ($3,000).

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

Example. You exchange stock and real estate that you held for investment for real estate that you also intend to hold for investment. The stock you transfer has a fair market value of $1,000 and an adjusted basis of $4,000. The real estate you exchange has a fair market value of $19,000 and an adjusted basis of $15,000. The real estate you receive has a fair market value of $20,000. You do not have a taxable gain on the exchange of the real estate because it qualifies as a nontaxable exchange. However, you must recognize (report on the return) a $3,000 loss on the stock because it is unlike property.

Basis of property received. The total basis for all properties (other than money) you receive in a partially nontaxable exchange is the total adjusted basis of the properties you give up, with the following adjustments:

1) Add—
   a) Any additional costs you incur, and
   b) Any gain you recognize on the exchange, and
2) Subtract—
   a) Any money you receive, and
   b) Any loss you recognize on the exchange.

Allocate this basis first to the unlike property, other than money, up to its fair market value.
on the date of the exchange. The rest is the basis of the like property.

For more information, see Publication 551.

**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:

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

In this situation, you figure your recognized gain and the basis of the property you receive by comparing the properties within each exchange group.

**Exchange groups.** Each exchange group consists of properties transferred and received in the exchange that are of like kind or like classes. (See Like Property, earlier.) If property could be included in more than one exchange group, you can include it in any one of those groups. However, the following may not be included in an exchange group:

- Money,
- Stock in trade or other property held primarily for sale,
- Stocks, bonds, notes, or other securities or evidences of debt or interest,
- Interests in a partnership,
- Certificates of trust or beneficial interests, or
- Choses in action.

**Example.** Ben exchanges computer A (asset class 00.12), automobile A (asset class 00.22), and truck A (asset class 00.241), for computer R (asset class 00.12), automobile R (asset class 00.22), truck R (asset class 00.241), and $400. All properties transferred were used in Ben's business. Similarly, all properties received will be used in his business.

The first exchange group consists of computers A and R; the second exchange group consists of automobiles A and R; and the third exchange group consists of trucks A and R.

**Treatment of liabilities.** Offset all liabilities you assume as part of the exchange. However, for exchanges of multiple properties, you do not make a property-by-property comparison if you:

- If you are relieved of more liabilities than you assume (excess liabilities), treat the excess as cash, demand deposits and like accounts, and similar items for purposes of making allocations to the residual group, discussed later.

The treatment of liabilities and any excesses will be the same even if the like-kind exchange treatment applies to only a portion of a larger transaction. If so, determine the excess liabilities you assume or the excess liabilities of which you are relieved based on all liabilities you assume or are relieved of as part of the larger transaction.

**Example.** The facts are the same as in the preceding example. In addition, the fair market value, and liabilities secured by each property, if any, are as follows:

<table>
<thead>
<tr>
<th>Property</th>
<th>Fair Market Value</th>
<th>Liability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Computer A</td>
<td>$1,500</td>
<td>$0</td>
</tr>
<tr>
<td>Automobile A</td>
<td>2,500</td>
<td>500</td>
</tr>
<tr>
<td>Truck A</td>
<td>2,000</td>
<td>0</td>
</tr>
</tbody>
</table>

Ben Transfers:

- Computer A
- Automobile A
- Truck A

Ben Receives:

- Computer R
- Automobile R
- Truck R
- Cash

All liabilities assumed by Ben ($1,000) are offset by all liabilities of which he is relieved ($500), resulting in excess liabilities assumed of $500. The excess is allocated among Ben's exchange groups in proportion to the fair market value of the properties received in the exchange groups as follows:

- $131 ($500 × $1,600 ÷ $6,100) is allocated to the first exchange group (Computers A and R). The fair market value of Computer R is reduced to $1,469 ($1,600 − $131).
- $254 ($500 × $3,100 ÷ $6,100) is allocated to the second exchange group (Automobiles A and R). The fair market value of Automobile R is reduced to $2,846 ($3,100 − $254).
- $115 ($500 × $1,400 ÷ $6,100) is allocated to the third exchange group (Trucks A and R). The fair market value of Truck R is reduced to $1,285 ($1,400 − $115).

In each exchange group, Ben uses the reduced fair market value of the properties received to figure the exchange group's surplus or deficiency and to determine whether a residual group has been created.

**Residual group.** A residual group is created if the total fair market value of the properties transferred in a group is greater than the total fair market value of the properties received in that exchange group. If so, the excess equals the total fair market value of the properties received in that exchange group. This excess is allocated to the residual group.

**Example.** Fran exchanges computer A (asset class 00.12) and automobile B (asset class 00.22) for printer B (asset class 00.12), automobile B (asset class 00.22), corporate stock, and $500. Fran used computer A and automobile B in her business and will use printer B and automobile B in her business.

This transaction results in two exchange groups: (1) computer A and printer B; and (2) automobile A and automobile B.

The fair market values of the properties are as follows:

<table>
<thead>
<tr>
<th>Property</th>
<th>Fair Market Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Computer A</td>
<td>$1,000</td>
</tr>
<tr>
<td>Automobile A</td>
<td>4,000</td>
</tr>
<tr>
<td>Corporate Stock</td>
<td>750</td>
</tr>
<tr>
<td>Cash</td>
<td>500</td>
</tr>
</tbody>
</table>

Because the total fair market value of the properties transferred in the exchange groups ($5,000) exceeds the total fair market value of the properties received in the exchange groups ($3,750) by $1,250, there is a residual group in that amount. It consists of the $500 of cash and the $750 worth of corporate stock.

**Exchange group surplus and deficiency.** For each exchange group, you must determine whether there is an "exchange group surplus" or "exchange group deficiency." An exchange group surplus is the excess of the total fair market value of the properties received in an exchange group (less any excess liabilities you assume that are allocated to that exchange group) over the total fair market value of the properties transferred in that exchange group. An exchange group deficiency is the excess of the total fair market value of the properties transferred in an exchange group over the total fair market value of the properties received in that ex-
change group (less any excess liabilities you assume that are allocated to that exchange group).

**Example.** Karen exchanges computer A (asset class 00.12) and automobile A (asset class 00.22), both of which she used in her business, for printer B (asset class 00.12) and automobile B (asset class 00.22), both of which she will use in her business. Karen’s adjusted basis and the fair market value of the exchanged properties are as follows:

<table>
<thead>
<tr>
<th></th>
<th>Adjusted Basis</th>
<th>Fair Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Karen Transfers:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Computer A</td>
<td>$375</td>
<td>$1,000</td>
</tr>
<tr>
<td>Automobile A</td>
<td>$1,500</td>
<td>$4,000</td>
</tr>
<tr>
<td>Karen Receives:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Printer B</td>
<td>$2,050</td>
<td></td>
</tr>
<tr>
<td>Automobile B</td>
<td>$2,950</td>
<td></td>
</tr>
</tbody>
</table>

The first exchange group consists of computer A and printer B. It has an exchange group surplus of $1,050 because the fair market value of printer B ($2,050) exceeds the fair market value of computer A ($1,000) by that amount.

The second exchange group consists of automobile A and automobile B. It has an exchange group deficiency of $1,050 because the fair market value of automobile A ($4,000) exceeds the fair market value of automobile B ($2,950) by that amount.

**Recognized gain.** Gain or loss realized for each exchange group and the residual group is the difference between the total fair market value of the transferred properties in that exchange group or residual group and the total adjusted basis of the properties. For each exchange group, recognized gain is the lesser of the gain realized or the exchange group deficiency (if any). Losses are not recognized for an exchange group. The total gain recognized on the exchange of like-kind or like-class properties is the sum of all the gain recognized for each exchange group.

For a residual group, you must recognize the entire gain or loss realized.

For properties you transfer that are not within any exchange group or the residual group, figure realized and recognized gain or loss as explained under Gain or Loss From Sales and Exchanges, earlier.

**Example.** Based on the facts in the previous example, Karen recognizes gain on the exchange as follows:

For the first exchange group, the amount of gain realized is the excess of the fair market value of computer A ($1,000) over its adjusted basis ($375), or $625. The amount of gain recognized is the lesser of the gain realized ($625) or the exchange group deficiency ($0), or $0.

For the second exchange group, the amount of gain realized is the excess of the fair market value of automobile A ($4,000) over its adjusted basis ($1,500), or $2,500. The amount of gain recognized is the lesser of the gain realized ($2,500) or the exchange group deficiency ($1,050), or $1,050.

The total amount of gain recognized by Karen in the exchange is the sum of the gains recognized with respect to both exchange groups ($0 + $1,050), or $1,050.

**Basis of properties received.** The total basis of properties received in each exchange group is the sum of:

1. The total adjusted basis of the transferred properties within that exchange group.
2. Your recognized gain on the exchange group.
3. The exchange group surplus (or minus the exchange group deficiency), and
4. The excess liabilities you assume that are allocated to the group.

You allocate the total basis of each exchange group proportionately to each property received in the exchange group according to the property’s fair market value. The basis of each property received within the residual group (other than money) is equal to its fair market value.

**Example.** Based on the facts in the two previous examples, the bases of the properties received by Karen in the exchange, printer B and automobile B, are determined in the following manner.

The basis of the property received in the first exchange group is $1,425. This is the sum of:

1. The adjusted basis of the property transferred within that exchange group ($375),
2. The amount of gain recognized for that exchange group ($0),
3. The amount of the exchange group surplus ($1,050), and
4. The amount of excess liabilities assumed allocated to that exchange group ($0).

Because printer B is the only property received within the first exchange group, the entire basis of $1,425 is allocated to printer B.

The basis of the property received in the second exchange group is $1,500. This is—

1. The sum of:
   a) The adjusted basis of the property transferred within that exchange group ($1,500),
   b) The amount of gain recognized for that exchange group ($1,050), and
   c) The amount of excess liabilities assumed allocated to that exchange group ($0).

   Minus the amount of the exchange group deficiency ($1,050).

Because automobile B is the only property received within the second exchange group, the entire basis of $1,500 is allocated to automobile B.

**Like-Kind Exchanges Between Related Parties**

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

**Related parties.** Under these rules, related parties include, for example, you and a member of your family (spouse, brother, sister, 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 more information on related parties, see Nondeductible Loss under Sales and Exchanges Between Related Parties in chapter 2.

**Example.** You use a panel truck in your house painting business. Your sister is a landscaper who uses a station wagon in her business. The fair market value (FMV) of your truck is $7,000 and its adjusted basis is $6,000. The FMV of your sister’s station wagon is $7,200 and its adjusted basis is $1,000. In December 1996, you exchange vehicles with your sister. This was a like-kind exchange in which no gain or loss was recognized.

In January 1997, you sold the station wagon to a third party for $7,200. Because you sold the station wagon within 2 years after the exchange, you must recognize the gain from the like-kind exchange you made with your sister. That gain is $1,200 ($7,200, the FMV of your sister’s station wagon, minus $6,000, the adjusted basis of your truck) and must be included in your income for 1997, the year of the sale. You must also report any gain you realized on the sale of the station wagon. In this case, however, the gain is zero because the $7,200 sales price equals the increased basis of $7,200 ($6,000 plus $1,200 recognized gain) for the station wagon.

In addition, your sister must recognize her gain on the like-kind exchange. That gain is $6,000 ($7,000, the FMV of your truck, minus $1,000, the adjusted basis of her station wagon) and must be included in her income for 1997, the year you sold the station wagon. Her basis in the truck is increased to $7,000 (the adjusted basis of $1,000 plus $6,000 recognized gain).

**Special rule for 2-year holding period.** The 2-year holding period begins on the date of the last transfer of property that was part of the like-kind exchange. If the holder’s risk of loss on the property is substantially diminished during any period, however, that period is not counted toward the 2-year holding period.

The holder’s risk of loss on the property is substantially diminished by:

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

A put is an option that entitles the holder to sell property at a specified price at any time before a specified future date.

A short sale involves property you generally do not own. You borrow the property to deliver to a buyer and, at a later date, buy substantially identical property and deliver it to the lender.

**Exceptions to the related party rules.** The following kinds of property dispositions are excluded from these rules:

1. Dispositions due to the death of either related person,
2. Involuntary conversions, or
3) Dispositions if it is established to the satisfaction of the IRS that neither the exchange nor the disposition had as a main purpose the avoidance of federal income tax.

Other Nontaxable Exchanges

The following discussions describe other exchanges that may not be taxable.

Partnership Interests

Exchanges of partnership interests do not qualify as nontaxable exchanges of like-kind property. This applies regardless of whether they are general or limited partnership interests or are interests in the same partnership or different partnerships. However, under some circumstances such an exchange may be treated as a tax-free contribution of property to a partnership.

An interest in a partnership that has a valid election in effect under section 761(a) of the Internal Revenue Code to be treated as an interest in each of the partnership assets and not as a partnership interest. See Contribution of Property and Sale, Exchange, or Other Transfer in Publication 541, Partnerships.

U.S. Treasury Notes or Bonds

Certain issues of U.S. Treasury obligations may be exchanged for certain other issues, designated by the Secretary of the Treasury, with no gain or loss recognized on the exchange. See U.S. Treasury Bills, Notes, and Bonds under Interest Income in Publication 550 for more information on income from these investments. For other information on the notes or bonds involved, call the Bureau of the Public Debt at (202) 874-4000, or write to the:

Bureau of the Public Debt
Capital Area Servicing Center
1300 C Street, S.W.
Washington, DC 20239-0001

Insurance Policies and Annuities

No gain or loss is recognized if you exchange:

1) A life insurance contract for another or for an endowment or annuity contract,

2) An annuity contract for an annuity contract or for another endowment contract providing for regular payments beginning at a date not later than the beginning date under the old contract, or

3) An annuity contract for another if the insured or annuitant remains the same.

If you realize a gain on the exchange of an endowment contract or annuity contract for a life insurance contract or an exchange of an annuity contract for an endowment contract, you must recognize the gain.

For information on transfers and rollovers of employer-provided annuities, see Publication 575, Pension and Annuity Income, or Publication 571, Tax-Sheltered Annuity Programs for Employees of Public Schools and Certain Tax-Exempt Organizations.

Cash received. The nonrecognition and nontaxable transfer rules do not apply to a rollover in which you receive cash proceeds from the surrender of one policy and invest the cash in another policy. However, if the following requirements are met, you can treat a cash distribution and reinvestment as meeting the nonrecognition or nontaxable transfer rules.

1) At the time you receive the distribution, the insurance company that issued the policy or contract is subject to a rehabilitation, conservatorship, insolvency, or similar state proceeding,

2) You withdraw all amounts to which you are entitled or the maximum amount permitted under the state proceeding,

3) You reinvest the distribution, not later than 60 days after receipt, in a single policy or contract issued by another insurance company, or in a single custodial account,

4) You assign all rights to future distributions to the new issuer for investment in the new policy or contract if the distribution was restricted by the state proceeding, and

5) You would have qualified under the nonrecognition or nontaxable transfer rules if you had exchanged the affected policy or contract for the new one.

If you do not reinvest all of the cash distribution, the rules for partially nontaxable exchanges, discussed earlier, apply.

In addition to meeting these five requirements, you must:

1) Give to the issuer of the new policy or contract a statement that includes —

   a) The gross amount of cash distributed,

   b) The amount reinvested, and

   c) The amount of your investment in the affected policy or contract on the date of the initial cash distribution, and

2) Attach to your timely filed tax return for the year of the initial distribution —

   a) A statement entitled “ELECTION UNDER REV. PROC. 92-44” that includes the name of the issuer and the policy number (or similar identifying number) of the new policy or contract, and

   b) A copy of the statement given to the issuer of the new policy or contract.

Corporate Stock

In certain cases, exchanges of corporate stock are not taxable. The rules for these exchanges are given next.

Stock for stock of the same corporation.

You may exchange common stock for common stock in the same corporation, or preferred stock for preferred stock in the same corporation, without having a taxable gain or loss.

Money or other property received. If in an otherwise nontaxable exchange you receive money or other property in addition to stock, then your gain on the exchange, if any, may be taxed. The rules for figuring the taxable gain generally follow those for a partially nontaxable exchange discussed earlier under Like-Kind Exchanges. Any loss is not recognized.

Nonqualified preferred stock. For exchanges after June 8, 1997, nonqualified preferred stock is treated as property other than stock. Generally, this applies to preferred stock with one or more of the following features:

- The holder has the right to require the issuer or a related person to redeem or purchase the stock.
- The issuer or a related person is required to redeem or purchase the stock.
- The issuer or a related person has the right to redeem the stock and, on the issue date it is more likely than not that the right will be exercised.
- The dividend rate on the stock varies with reference to interest rates, commodity prices, or similar indices.

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

Convertible stocks and bonds. If you convert corporate bonds into stock of the same corporation, or preferred stock into common stock of the same corporation, you will not have a taxable gain or loss. The conversion must be made according to the terms of the bond or preferred stock certificate.

Corporate reorganizations. When a corporation reorganizes, the exchange of securities in the old organization for securities in the new organization may not be taxable.

Property for stock. If you transfer property to a corporation in exchange for stock or securities in that corporation, and immediately afterwards you are in control of the corporation, the exchange is usually not taxable.

This rule applies both to individual transferees and to groups of transferees who transfer property to a corporation. It does not apply if the corporation is an investment company. It also may not apply to your transfer of the corporation’s installment obligation. See Installment obligation exchanged for debtor’s stock, later.

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

Example 1. You and Bill Jones purchase property for $100,000. You both organize a corporation when the property has a fair market value of $300,000. You transfer the property to the corporation for all its authorized capital stock, which has a par value of $300,000. No gain is included in income by you, Bill, or the corporation.

Example 2. You and Bill transfer the property having a basis of $100,000 to a corporation in exchange for stock having a fair market value of $300,000. This represents only 75% of each class of stock of the corporation. The other 25% already was issued to someone else. You and Bill recognize a taxable gain of $200,000 on the transaction.
nontaxable exchange discussed earlier under Stock changes after June 8, 1997, nonqualified preferred stock (described earlier under Stock for stock of the same corporation) received is treated as property other than stock. 

Liabilities. If the corporation assumes your liabilities, or the property is taken subject to a liability, the transfer is not generally treated as if you received money or other property. There are two exceptions to this treatment:

1) If the liabilities the corporation assumes are more than your adjusted basis in the property you exchange, gain is recognized up to the amount of the excess. However, if the liabilities assumed give rise to a deduction when paid, such as a trade account payable or interest, no gain is recognized.

2) If there is no good business reason for the corporation to assume your liabilities, or if your main purpose in the exchange is to avoid federal income tax, the assumption is treated as if you received money in the amount of the liabilities.

Example. You transfer property worth $35,000 and render services valued at $3,000 to a corporation in exchange for stock valued at $38,000. Right after the exchange you own 85% of the outstanding stock. No gain is included in income on the exchange of property. However, you recognize ordinary income of $3,000 as payment for services you rendered to the corporation.

Property of relatively small value. The term property does not include property of a relatively small value when it is compared to the value of stock and securities already owned or to be received for services by the transferor, if the main purpose of the transfer is to qualify for the nonrecognition of gain or loss by other transferors. Property transferred will not be considered to be of relatively small value if its fair market value is at least 10% of the fair market value of the stock and securities already owned or to be received for services by the transferor.

Stock received in disproportion to property transferred. If a group of transferors exchanges property for corporate stock, each transferor does not have to receive stock in proportion to his or her interest in the property transferred. If a disproportionate transfer takes place, it will be treated for tax purposes in accordance with its true nature. It may be treated as if the stock were first received in proportion and then some of it used to make gifts, pay compensation for services, or satisfy the transferor's obligations.

Money or other property received. If, in an otherwise nontaxable exchange of property for corporate stock, you also receive money, or property other than stock, you may have a taxable gain. You are taxed only up to the amount of money plus the fair market value of the other property you receive. The rules for figuring the taxable gain in this situation generally follow those for a partially nontaxable exchange discussed earlier under Like-Kind Exchanges. If the property you give up includes depreciable property, the taxable gain may have to be reported as ordinary income because of depreciation. See chapter 4. No loss is recognized.

Preferred stock received. For exchanges after June 8, 1997, nonqualified preferred stock (described earlier under Stock for stock of the same corporation) received is treated as property other than stock.

Liabilities. If the corporation assumes your liabilities, or the property is taken subject to a liability, the transfer is not generally treated as if you received money or other property. There are two exceptions to this treatment:

1) If the liabilities the corporation assumes are more than your adjusted basis in the property you exchange, gain is recognized up to the amount of the excess. However, if the liabilities assumed give rise to a deduction when paid, such as a trade account payable or interest, no gain is recognized.

2) If there is no good business reason for the corporation to assume your liabilities, or if your main purpose in the exchange is to avoid federal income tax, the assumption is treated as if you received money in the amount of the liabilities.

Example. You transfer property to a corporation for stock. You also receive $10,000 in the exchange. Your adjusted basis in the transferred property is $20,000. The stock you receive has a fair market value (FMV) of $16,000. The corporation also assumes a $5,000 mortgage on the property. Gain is realized as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FMV of stock received</td>
<td>$16,000</td>
</tr>
<tr>
<td>Cash received</td>
<td>10,000</td>
</tr>
<tr>
<td>Liability assumed by corporation</td>
<td>$5,000</td>
</tr>
<tr>
<td>Total received</td>
<td>$31,000</td>
</tr>
<tr>
<td>Minus: Adjusted basis of property transferred</td>
<td>20,000</td>
</tr>
<tr>
<td>Realized gain</td>
<td>$11,000</td>
</tr>
</tbody>
</table>

The recognized gain is limited to $10,000, the amount of cash received.

Installment obligation exchanged for debtor's stock. If you exchange an installment obligation for the debtor's stock having a greater value than your basis in the installment obligation, the exchange satisfies the installment obligation at other than its face value. You must recognize the gain on the exchange even if right after the exchange you are in control of the corporation. The recognized gain is the difference between the fair market value of the stock and your basis in the installment obligation. Your basis in the installment obligation is the excess of the obligation's face value over the income recouped if the obligation were satisfied in full. The corporation does not recognize any gain or loss from the exchange.

Transfers Between Spouses

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 if the recipient-spouse is a nonresident alien. Nor does it apply to a transfer in trust to the extent the adjusted basis of the property is less than the amount of the liabilities assumed and the liabilities on the property.

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

For more information on transfers between spouses, see Property Settlements in Publication 504, Divorced or Separated Individuals.

Rollover of Capital Gain

You can choose to roll over a capital gain from the sale of publicly traded securities or qualified small business stock if you make certain other investments.

Sale of publicly traded securities. You can choose to roll over a capital gain from the sale of publicly traded securities (securities traded on an established securities market) into a specialized small business investment company (SSBIC). If you make this choice, the gain from the sale is recognized only to the extent the amount realized is more than the cost of SSBIC common stock or partnership interest bought during the 60-day period beginning on the date of the sale. You must reduce your basis in the SSBIC stock or partnership interest by the gain not recognized.

The gain that can be rolled over during any tax year is limited. For individuals, the limit is the smaller of:

1) $50,000 ($25,000 for married individuals filing separately), or
2) $500,000 ($250,000 for married individuals filing separately) minus the gain rolled over in all earlier tax years.

For C corporations, the limit is the smaller of:

1) $250,000, or
2) $1 million minus the amount of gain rolled over in all earlier tax years.

For more information, see chapter 4 of Publication 550, Investment Income and Expenses.

Sale of qualified small business stock. For sales after August 5, 1997, you can choose to roll over a capital gain from the sale of qualified small business stock held for more than 6 months into other qualified small business stock. If you make this choice, the gain from the sale is recognized only to the extent the amount realized is more than the cost of the other qualified small business stock bought during the 60-day period beginning on the date of sale. You must reduce your basis in the other qualified small business stock by the gain not recognized.

For more information, see chapter 4 in Publication 550.

Ordinary or Capital Gain or Loss

Introduction

You must classify your gains and losses as either ordinary or capital gains or losses (and
your capital gains or losses as either short-term or long-term gains or losses). You must do this to figure your net capital gain or loss. For individuals, a net capital gain may be taxed at a lower tax rate than ordinary income. See Maximum Tax Rates on Net Capital Gain in chapter 3. Your deduction for a net capital loss may be limited. For information on how to treat your gains or losses, see chapter 3.

Capital gain or loss. Generally, you will have a capital gain or loss if you sell or exchange a capital asset. You may also have a capital gain if your section 1231 transactions result in a net gain.

Section 1231 transactions. These are sales and exchanges of property held more than 1 year and either used in a trade or business or held for the production of rents or royalties. They also include certain involuntary conversions of business or investment property, including capital assets. See Section 1231 Gains and Losses in chapter 4 for more information.

Topics
This chapter discusses:
- Capital assets
- Noncapital assets
- Sales and exchanges between related parties
- Other dispositions

Useful Items
You may want to see:
Publication
- 550 Investment Income and Expenses

Form (and Instructions)
- Schedule D (Form 1040) Capital Gains and Losses
- 4797 Sales of Business Property
- 8594 Asset Acquisition Statement Under Section 1060

See chapter 6 for information about getting these publications and forms.

Noncapital Assets
This discussion lists and illustrates the six exceptions to capital assets. They are:
1) Property held mainly for sale to customers or property that will physically become part of merchandise for sale to customers,
2) Accounts or notes receivable acquired in the ordinary course of a trade or business, or for services rendered as an employee, or from the sale of any properties described in (1).
3) Depreciable property used in your trade or business (even if fully depreciated),
4) Real property used in your trade or business,
5) A copyright, a literary, musical, or artistic composition, a letter or memorandum, or similar property —
   a) Created by your personal efforts,
   b) Prepared or produced for you (in the case of a letter, memorandum, or similar property), or
   c) Acquired from a person who created the property or for whom the property was prepared, under circumstances (for example, by gift) entitling you to the basis of the person who created the property, or for whom it was prepared or produced
6) U.S. Government publications that you got from the government for free or for less than the normal sales price, or that you acquired under circumstances entitling you to the basis of someone who got the publications for free or for less than normal sales price.

Property held mainly for sale to customers. Stock in trade, inventory, and other property you hold mainly for sale to customers in your trade or business are not capital assets. Their treatment is discussed in chapter 4.

Personal use property. Property held for personal use is a capital asset. Gain from a sale or exchange of that property is a capital gain. Loss from the sale or exchange of that property is not deductible. You can deduct a loss relating to personal use property only if it results from a casualty or theft.

Investment property. Investment property (such as stocks and bonds) is a capital asset and a gain or loss from its sale or exchange is a capital gain or loss. This treatment does not apply to property used to produce rental income. See Business assets, later, under Noncapital Assets.

Release of restriction on land. Amounts you get for the release of a restrictive covenant in a deed to land are treated as proceeds from the sale of a capital asset.

Sales and Exchanges Between Related Parties
This section discusses the special rules that may apply to the sale or exchange of property between related parties. If these rules apply, gains may be treated as ordinary income and losses may not be deductible. See Transfers Between Spouses in chapter 1 for special rules that apply to spouses.

Gain Is Ordinary Income
If a gain is recognized on the sale or exchange of property to a related party, the gain may be ordinary income even if the property is a capital asset. It is ordinary income if the sale or exchange is one of the following transactions.

Depreciable property transactions. Gain on the sale or exchange of property, including a leasehold or a patent application, that is depreciable property in the hands of the party who receives it, is ordinary income if the transaction is either directly or indirectly between:
1) A person and the person's controlled entity or entities,
2) A taxpayer and any trust in which the taxpayer (or any person related to the taxpayer) is a beneficiary, unless the beneficiary's interest in the trust is a remote contingent interest, that is, the value of the interest computed actuarially is 5% or less of the value of the trust property.
3) For tax years beginning after August 5, 1997, an executor and a beneficiary of an estate, unless the sale or exchange is in satisfaction of a pecuniary bequest.
4) An employer (or any person related to the employer under rules (1), (2), or (3)) and a welfare benefit fund (within the meaning of section 419(e) of the Internal Revenue Code) that is controlled directly or indirectly by the employer (or any person related to the employer).

A person's controlled entity is:
1) A corporation in which more than 50% of the value of all outstanding stock, or a partnership in which more than 50% of the capital interest or profits interest,
is owned, directly or indirectly, by or for that person, or
2) An entity whose relationship with that person is one of the following:
   a) A corporation and a partnership, if the same persons own more than 50% in value of the outstanding stock of the corporation and more than 50% of the capital interest or profits interest in the partnership.
   b) Two corporations that are members of the same controlled group as defined in section 1563(a) of the Internal Revenue Code, except that “more than 50%” is substituted for “at least 80%” in that definition.
   c) Two S corporations, if the same persons own more than 50% in value of the outstanding stock of each corporation.
   d) Two corporations, one of which is an S corporation, if the same persons own more than 50% in value of the outstanding stock of each corporation.

Controlled partnership transactions. A gain recognized in a controlled partnership transaction may be ordinary income. The gain is ordinary income if it results from the sale or exchange of property that, in the hands of the party who receives it, is a noncapital asset such as trade accounts receivable, inventory, stock in trade, or depreciable or real property used in a trade or business.

A controlled partnership transaction is a transaction directly or indirectly between:
1) A partnership and a partner who owns, directly or indirectly, more than 50% of the capital interest or profits interest in the partnership, or
2) Two partnerships, if the same persons own, directly or indirectly, more than 50% of the capital interests or profits interests in both partnerships.

Determining ownership. In the above transactions, use the following rules to determine the ownership of stock or partnership interest.

1) Stock or a partnership interest owned, directly or indirectly, by or for a corporation, partnership, estate, or trust is treated as being owned proportionately by or for its shareholders, partners, or beneficiaries. (However, for a partnership interest owned by or for an S corporation, this applies only to shareholders who own, directly or indirectly, 5% or more in value of the stock of the corporation.)

2) An individual is considered as owning the stock or partnership interest owned, directly or indirectly, by or for a corporation, partnership, estate, or trust.

3) Stock or a partnership interest constructively owned by a person under rule (1), for applying rules (1) and (2), is treated as actually owned by that person. But stock or partnership interest constructively owned by an individual under rule (2) will not be treated as owned by the individual for applying rule (2) to make another person the constructive owner of that stock or partnership interest.

Nondeductible Loss
A loss on the sale or exchange of property between related parties is not deductible. This applies to both direct and indirect transactions, but not to distributions of property from a corporation in a complete liquidation. The following are related parties:

1) Members of a family, including only brothers, sisters, half-brothers, half-sisters, spouse, ancestors (grandparents, etc.), and lineal descend-ants (children, grandchildren, etc.).
2) An individual and a corporation when the individual owns, directly or indirectly, more than 50% in value of the outstanding stock of the corporation.
3) Two corporations that are members of the same controlled group as defined in section 267(f) of the Internal Revenue Code.
4) A trust fiduciary and a corporation when the trust or the grantor of the trust owns, directly or indirectly, more than 50% in value of the outstanding stock of the corporation.
5) A grantor and fiduciary, and the fiduciary and beneficiary, of any trust.
6) Fiduciaries of two different trusts, and the fiduciary and beneficiary of two different trusts, if the same person is the grantor of both trusts.
7) A tax-exempt educational or charitable organization and a person who, directly or indirectly, controls such an organization, or a member of that person’s family.
8) A corporation and a partnership if the same persons own more than 50% in value of the outstanding stock of the corporation and more than 50% of the capital interest or profits interest in the partnership.
9) Two S corporations if the same persons own more than 50% in value of the outstanding stock of each corporation.
10) Two corporations, one of which is an S corporation, if the same persons own more than 50% in value of the outstanding stock of each corporation.
11) For tax years beginning after August 5, 1997, an executor and a beneficiary of an estate unless the sale or exchange is in satisfaction of a pecuniary bequest.
12) Two partnerships if the same persons own, directly or indirectly, more than 50% of the capital interests or profits interests in both partnerships.
13) A person and a partnership when the person owns, directly or indirectly, more than 50% of the capital interest or profits interest in the partnership.

If a sale or exchange is between any of these related parties and involves the lump-sum sale of a number of blocks of stock or pieces of property, the gain or loss must be computed separately for each block of stock or piece of property. The gain on each item is taxable. The loss on any item is non-deductible. Gains from the sales of any of these items may not be reduced by losses on the sales of any of the other items.

Partnership interests. The nondeductible loss rule does not apply to a sale or exchange between the related parties described in (12) or (13) above of an interest in the partnership.

Special rules for controlled groups. Losses on transactions between members of the same controlled group described in (3) above are deferred rather than denied. For more information, see section 267(f) of the Internal Revenue Code.

Ownership of stock or partnership interests. In determining whether an individual owns directly or indirectly any of the outstanding stock of a corporation or an interest in a partnership for purposes of a loss on a sale or exchange, the following rules apply.

Rule 1. Stock or a partnership interest owned, directly or indirectly, by or for a corporation, partnership, estate, or trust is considered owned proportionately by or for its shareholders, partners, or beneficiaries. (However, for a partnership interest owned by or for an S corporation, this applies only to shareholders who own, directly or indirectly, 5% or more in value of the stock of the corporation.)

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

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

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

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

Property received from a related party. If, in a purchase or exchange, you received property from a related party who had a loss that was not allowable and you later sell or exchange the property at a gain, you recognize the gain only to the extent that it is more than the loss previously disallowed to the related party. This rule applies only to the original transferee.

Example 1. Your brother sold stock to you for $7,600. His cost basis was $10,000. His loss of $2,400 was not deductible. You later sell the same stock to an unrelated party for $10,500, realizing a gain of $2,900 ($10,500 - $7,600). Your recognized gain is only $500, the excess gain over the $2,400 loss not allowed to your brother.
**Other Dispositions**

This section discusses some special rules for determining the treatment of gain or loss from various dispositions of property.

**Sale of a Business**

The sale of a business is not usually a sale of one asset. Instead, all of the assets of the business are sold. Generally, when this occurs, each asset is treated as being sold separately for determining the treatment of gain or loss.

A business usually has many assets. When sold, these assets must be classified as capital assets, depreciable property used in the business, real property held for sale to customers, such as inventory or stock in trade. The gain or loss on each asset is figured separately. The sale of capital assets results in capital gain or loss (discussed in chapter 3). The sale of real property or depreciable property used in the business and held more than 1 year results in gain or loss from a section 1231 transaction (discussed in chapter 4). The sale of inventory results in ordinary income or loss.

**Partnership interests.** An interest in a partnership or joint venture is treated as a capital asset when sold. The part of any gain or loss from unrealized receivables or inventory items that have appreciated substantially in value will be treated as ordinary gain or loss. For more information, see *Disposition of Partner’s Interest in Publication 541.*

**Corporation interests.** Your interest in a corporation is represented by stock certificates. When you sell these certificates, you usually realize capital gain or loss. For information on the sale of stock, see chapter 4 in *Publication 550.*

**Corporate liquidations.** Corporate liquidations of property are generally treated as a sale or exchange. Gain or loss is generally recognized by the corporation on a liquidating sale of its assets. Gain or loss is also generally recognized on a liquidating distribution of assets as if the corporation sold the assets to the distributee at fair market value.

**Dispositions of Intangible Property**

Intangible property is any personal property that has value but cannot be seen or touched. It includes such items as patents, copyrights, and the goodwill value of a business.

Gain or loss on the sale or exchange of amortizable or depreciable intangible property held more than 1 year (other than an amount recaptured as ordinary income) is a section 1231 gain or loss. The treatment of section 1231 gain or loss and the recapture of amortization and depreciation as ordinary income are explained in chapter 4. See chapter 12 of *Publication 535, Business Expenses,* for information on amortizable intangible property, and chapter 1 of *Publication 946, How To Depreciate Property,* for information on depreciable intangible property. Gain or loss on dispositions of other intangible property is ordinary or capital gain or loss depending on whether the property is a capital asset or a noncapital asset.

The following discussions explain special rules that apply to certain dispositions of intangible property.

**Section 197 Intangibles**

Section 197 intangibles are certain intangibles acquired after August 10, 1993 (after July 25, 1991, if elected), and held in connection with the conduct of a trade or business or an activity entered into for profit, whose costs are amortized over 15 years. They include:

1. **Goodwill,**
2. **Going concern value,**
3. **Workforce in place,**
4. **Business books and records, operating systems, and other information bases,**
5. **Patents, copyrights, formulas, processes, designs, patterns, knowhow, formats, and similar items,**
6. **Customer-based intangibles,**
7. **Supplier-based intangibles,**
8. **Licenses, permits, and other rights granted by a governmental unit,**
9. **Covenants not to compete entered into in connection with the acquisition of a business,** and
10. **Franchises, trademarks, and trade names.**

For more information, see chapter 12 of *Publication 535.*

The following special rules apply to dispositions of section 197 intangibles.

**Covenant not to compete.** A covenant not to compete (or similar arrangement) that is a section 197 intangible cannot be treated as disposed of or worthless before you have disposed of your entire interest in the trade or business for which the covenant was entered into. Members of the same controlled group of corporations and commonly controlled businesses are treated as a single entity in determining whether a member has disposed of its entire interest in a trade or business.

**Nondeductible loss.** You cannot deduct a loss from the disposition or worthlessness of a section 197 intangible that you acquired in the same transaction (or series of related transactions) as another section 197 intangible you still hold. Instead, you must increase the adjusted basis of your retained section 197 intangible by the amount of nondeductible loss. If you retain more than one section 197 intangible, increase each intangible’s adjusted basis. Figure the increase by multiplying the nondeductible loss amount by a fraction, the numerator of which is the retained intangible’s adjusted basis on the date of the transfer.
of the loss and the denominator of which is the total adjusted basis of all retained intangibles on the date of the loss.

In applying this rule, members of the same controlled group of corporations and commonly controlled businesses are treated as a single entity. For example, a corporation cannot deduct a loss on the sale of a section 197 intangible if, after the sale, a member of the same controlled group retains other section 197 intangibles that were acquired in the same transaction as the intangible sold.

**Patents**

Under a special rule, the transfer of a patent by an individual is treated as a sale or exchange of a capital asset held more than 18 months. This applies even if the payments for the patent are made periodically during the transferee's use or are contingent on the productivity, use, or disposition of the patent. For information on the treatment of gain or loss on the transfer of capital assets, see chapter 3.

This treatment applies to your transfer of a patent if you meet all the following conditions:

1. You are the holder of the patent.
2. You transfer the patent other than by gift, inheritance, or devise.
3. You transfer all substantial rights to the patent or an undivided interest in all such rights.
4. You do not transfer the patent to a related person.

**Holder.** You are the holder of a patent if you are either:

1. The individual whose effort created the patent property and who qualifies as the original and first inventor, or
2. The individual who purchased an interest in the patent from the inventor before the invention was tested and operated successfully under operating conditions, and who is neither related to, nor the employer of, the inventor.

**All substantial rights.** All substantial rights to patent property are all rights that have value when they are transferred. A security interest (such as a lien), or a reservation calling for forfeiture for nonperformance, is not treated as a substantial right for these rules and may be kept by you as the holder of the patent.

In the following transfers of patent rights, all substantial rights are not transferred, and the holder is not entitled to the special tax treatment:

1. The rights are limited geographically within a country.
2. The rights are limited to a period less than the remaining life of the patent.
3. The rights are limited to fields of use within trades or industries and are less than all the rights that exist and have value at the time of the transfer.
4. The rights are less than all the claims or inventions covered by the patent that exist and have value at the time of the transfer.

**Related persons.** The special tax treatment does not apply if the transfer is either directly or indirectly between you and a related person, as defined earlier under Sales and Exchanges Between Related Parties, and its discussion Non-deductible Loss, with the following changes:

1. Members of your family include your spouse, ancestors, and lineal descendents, but not your brothers, sisters, half-brothers, or half-sisters.
2. Substitute “25% or more” ownership for “more than 50%” in that listing.

If you fit within the definition of a related person independent of family status, the brother-sister exception in (1), above, does not apply. Thus, a transfer between a brother and a sister as beneficiary and fiduciary of the same trust is a transfer between related parties. The brother-sister exception does not apply because the trust relationship is independent of family status.

**Franchise, Trademark, or Trade Name**

If you transfer or renew a franchise, trademark, or trade name for a price that is contingent on its productivity, use, or disposition, the amount you receive is generally treated as an amount realized from the sale of a noncapital asset. A franchise includes an agreement that gives one of the parties the right to distribute, sell, or provide goods, services, or facilities within a specified area.

If you keep any significant power, right, or continuing interest in a franchise, trademark, or trade name includes, but is not limited to, the following rights in the transferred interest:

1. A right to disapprove any assignment of the interest, or any part of it.
2. A right to end the agreement at will.
3. A right to set standards of quality for products used or sold, or for services provided, and for the equipment and facilities used to promote such products or services.
4. A right to make the recipient sell or advertise only your products or services.
5. A right to make the recipient buy most supplies and equipment from you.
6. A right to get payments based on the productivity, use, or disposition of the transferred item of interest if those payments are a substantial part of the transfer agreement.

**Subdivision of Land**

If you own a tract of land, and to sell or exchange it, you subdivide it into individual lots or parcels, you may receive capital gain treatment on at least part of the proceeds provided you meet certain requirements. See section 1227 of the Internal Revenue Code.

**Timber**

Standing timber you held as investment property is a capital asset. Gain or loss from its sale or exchange is reported as a capital gain or loss on Schedule D (Form 1040). If you held the timber primarily for sale to customers, it is not a capital asset. Gain or loss on its sale is ordinary business income or loss. It is reported in the gross receipts or sales and cost of goods sold items of your return.

Farmers who cut timber on their land and sell it as logs, firewood, or pulpwood usually have no cost or other basis for that timber. These sales constitute a very minor part of their farm businesses. In these cases, amounts realized from such sales, and the expenses of cutting, hauling, etc., are ordinary farm income and expenses on Schedule F (Form 1040).

Special rules apply if you owned the timber more than 1 year and choose to either:

1. Treat timber cutting as a sale or exchange, or
2. Enter into a cutting contract.

Under these rules, discussed below, disposition of the timber is treated as a section 1231 transaction. Gain or loss is reported on Form 4797.

**Christmas trees.** Evergreen trees, such as Christmas trees, that are more than 6 years old when severed from their roots and sold for ornamental purposes, are included in the term “timber.” They qualify for both special rules, discussed next.

**Election to treat cutting as a sale or exchange.** Under the general rule, the cutting of timber results in no gain or loss. It is not until a sale or exchange occurs that gain or loss is realized. But if you owned or had a contractual right to cut timber, you may choose to treat the cutting of timber as a section 1231 transaction in the year it is cut. Even though the cut timber is not actually sold or exchanged, you report your gain or loss on the cutting for the year the timber is cut. Any later sale results in ordinary business income or loss. See Example, later.

To choose this treatment, you must:

1. Own, or hold a contractual right to cut, the timber for a period of more than 1 year before it is cut, and
2. Cut the timber for sale or for use in your trade or business.

**Making the election.** You make your election on your return for the year the cutting takes place by including in income the gain or loss on the cutting items of your return, including a computation of your gain or loss. You do not have to make the election in the first year you cut timber. You may choose to make it in any year to which the election would apply. If the timber is partnership property, the election is made on the partnership return. This election cannot be made on an amended return.

Once you have made the election, it remains in effect for all later years, unless you revoke it.

**Revoking a post-1986 election.** You can revoke an election you made for a tax year beginning after 1986 only if you can show undue hardship and get the consent of the Internal Revenue Service (IRS). Thereafter, you may not make any new election unless you have the consent of IRS.
Revoking a pre-1987 election. You can revoke an election you made for a tax year beginning before 1987 without the consent of IRS. You can revoke the election by attaching a statement to your tax return for the year the revocation is to be effective. If you make this special revocation, which can be made only once, you can make a new election without the consent of IRS. Any further revocation will require the consent of IRS.

The statement must provide:
1) Your name, address, and identification number,
2) The year the revocation is effective and the timber to which it applies,
3) That the revocation being made is of the election to treat the cutting of timber as a sale or exchange under section 631(a) of the Internal Revenue Code,
4) That the revocation is being made under section 311(d) of Public Law 99-514, and
5) That you are entitled to make the revocation under section 311(d) of Public Law 99-514 and temporary regulations section 301.9100-7T.

Gain or loss. Your gain or loss on the cutting of standing timber is the difference between its adjusted basis for depletion and its fair market value on the first day of your tax year in which it is cut. Your adjusted basis for depletion of cut timber is based on the number of units (feet board measure, log scale, or other units) of timber cut during the tax year and considered to be sold or exchanged. Your adjusted basis for depletion is also based on the depletion unit of timber in the account used for the cut timber, and should be figured in the same manner as shown in section 611 of the Internal Revenue Code and Income Tax Regulation section 1.611-3. Depletion on timber is discussed in chapter 13 in Publication 535.

Example. In April 1997, you owned 4,000 MFB (1,000 board feet) of standing timber for more than 1 year. It had an adjusted basis for depletion of $40 per MFB. You are a calendar year taxpayer. On January 1, 1997, the timber had a fair market value (FMV) of $120 per MFB. It was cut in April for sale. On your 1997 tax return, you elect to treat the cutting of the timber as a sale or exchange. You report the difference between the FMV and your adjusted basis for depletion as a gain. This amount is reported on Form 4797 along with your other section 1231 gains and losses to figure whether it is treated as capital or ordinary gain or loss. Owners of timber are any persons who owns an interest in, including a sublessor and the holder of a contract to cut the timber. You own an interest in timber if you have the right to cut it for sale on your own account or for use in your business.

Economic interest. You have retained an economic interest in timber if, under the cutting contract, the expected return on your investment is conditioned on the cutting of the timber.

Tree stumps. Tree stumps are a capital asset if they are on land held by an investor who is not in the timber or stump business as a buyer, seller, or processor. Gain from the sale of stumps sold in one lot by such a holder is taxed as a capital gain. However, tree stumps held by timber operators after the saleable standing timber was cut and removed from the land are considered by-products. Gain from the sale of stumps in lots or tonnage by such operators is taxed as ordinary income.

Precious Metals and Stones, Stamps, and Coins

Gold, silver, gems, stamps, coins, etc., are capital assets except when they are held for sale by a dealer. Any gain or loss from the sale or exchange is generally a capital gain or loss. If you are a dealer, the amount received from the sale is ordinary business income.

Coal and Iron Ore

If you own, for more than 1 year, coal (including lignite) or iron ore mined in the United States, and dispose of it under a contract in which you keep an economic interest in the coal or iron ore, the disposition is treated as a sale of section 1231 property. For this rule, the date the coal or iron ore is mined is considered the date of its disposal.

Your gain or loss is the difference between the amount realized from the disposal of the coal or iron ore and the adjusted basis you use to figure cost depletion (increased by certain expenditures not allowed as deductions for the tax year). This amount is included on Form 4797 along with your other section 1231 gains and losses.

You are considered an owner if you own or sublet an economic interest in the coal or iron ore in place. If you own only an option to buy the coal in place, you do not qualify as an owner. In addition, this special gain or loss treatment does not apply to income realized by an owner who is a co-adventurer, partner, or principal in the mining of coal or iron ore.

The expenses of making and administering the contract under which the coal or iron ore was disposed of and the expenses of preserving the economic interest kept under the contract are not allowed as deductions in figuring taxable income. Rather, their total along with the adjusted basis is deducted from the amount received to determine gain. If the total of these expenses plus the adjusted depletion basis is more than the amount received, the result is a loss.

Special Rule. The above treatment does not apply if you dispose of the iron ore or coal directly or indirectly to:
1) A related person whose relationship to you would result in the disallowance of a loss (see Nondeductible Loss under Sales and Exchanges Between Related Parties, earlier), or
2) An individual, trust, estate, partnership, association, company, or corporation, or controlled directly or indirectly by the same interests that own or control your business.

Conversion Transactions

Recognized gain on the disposition or termination of any position held as part of certain conversion transactions entered into after April 30, 1993, is treated as ordinary income. This applies if substantially all your expected return is attributable to the time value of your net investment (like interest on a loan) and the transaction is:
1) An applicable straddle (generally, any set of offsetting positions with respect to personal property, including stock),
2) A transaction in which you acquire property and, at or about the same time, contract to sell the same or substantially identical property at a specified price, or
3) Any other transaction that is marketed and sold as producing capital gain from a transaction in which substantially all of your expected return is due to the time value of your net investment.

For more information, see chapter 4 of Publication 550, Investment Income and Expenses.
The treatment of 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 from its disposition is short term. If you hold a capital asset for more than 1 year, the gain or loss from its disposition is long term.

### Table 3-2. Holding Period for Different Types of Acquisitions

<table>
<thead>
<tr>
<th>Type of acquisition</th>
<th>When your holding period starts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stocks and bonds bought on a securities market</td>
<td>Day after trading date you bought security. Ends on trading date you sold security.</td>
</tr>
<tr>
<td>U.S. Treasury notes and bonds</td>
<td>If bought at auction, day after notification of bid acceptance. If bought through subscription, day after subscription was submitted.</td>
</tr>
<tr>
<td>Nontaxable exchanges</td>
<td>Day after you acquired old property.</td>
</tr>
<tr>
<td>Gift</td>
<td>If your basis is giver’s adjusted basis, same day as giver’s holding period began. If your basis is FMV, day after date of gift.</td>
</tr>
<tr>
<td>Real property bought</td>
<td>Generally, day after date you received title to the property.</td>
</tr>
<tr>
<td>Real property repossessed</td>
<td>Day after date you originally received title to the property but does not include time between the original sale and date of repossession.</td>
</tr>
</tbody>
</table>

### Example.
If you bought an asset on June 18, 1997, you should start counting on June 19, 1997. If you sell the asset on June 18, 1998, your holding period is not more than 1 year, but if you sell it on June 19, 1998, your holding period is more than 1 year.

**Patent property.** If you dispose of patent property, you are generally considered to have held the property for more than 18 months, regardless of how long you actually held it. For more information, see *Patents* in chapter 2.

**Inherited property.** If you inherit property, you are considered to have held the property for more than 18 months, regardless of how long you actually held it.

**Installment sale.** The gain from an installment sale of an asset qualifying for long-term capital gain treatment in the year of sale continues to be long term in later tax years. If it is short term in the year of sale, it continues to be short term when payments are received in later tax years.

**Nontaxable exchanges.** 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 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.

**Example.** You bought machinery on December 4, 1996. On June 3, 1997, you traded this machinery for other machinery in a non-taxable exchange. On December 5, 1997, you sold the machinery you got in the exchange. Your holding period for this machinery begins on December 5, 1997. Therefore, you will have a long term gain or loss.

**Corporate liquidation.** The holding period for property you receive in a liquidation generally starts on the day after you receive it if gain or loss is recognized.

**Profit-sharing plan.** The holding period of common stock withdrawn from a qualified contribution profit-sharing plan begins on the day following the day the plan trustee delivered the stock to the transfer agent with instructions to reissue the stock in your name.

**Gifts.** 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. For more information on basis, get Publication 551.

**Real property.** To figure how long you held real property, start counting on the day after you received title to it or, if earlier, 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.

**Repossession.** If you sell real property but keep a security interest in it and then later repossess it, your holding period for a later sale includes the period you held the property before the original sale, as well as the period after the repossession. Your holding period does not include the time between the original sale and the repossession. That is, it does not include the period during which the first buyer held the property.

**Nonbusiness bad debts.** Nonbusiness bad debts are short-term capital losses. For information on nonbusiness bad debts, see chapter 4 of Publication 550.

### 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.** Merge your short-term capital gains and losses. Do this by adding all your short-term capital gains. Then add all your short-term capital losses. Subtract one total from the other. The result is your net short-term capital gain or loss.

**Net long-term capital gain or loss.** Follow the same steps to merge 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 excess is taxable. However, the part that is not more than your net capital gain may be taxed at a rate that is lower than the rate of...
Net loss. If the total of your capital losses is more than the total of your capital gains, the excess 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

This discussion relates only to individuals who have allowable capital losses. See chapter 2 for information on allowable losses.

If your capital losses are more than your capital gains, you must deduct the excess even if you do not have ordinary income to offset it. The yearly limit on the amount of the capital loss you can deduct is $3,000 ($1,500 if you are married and file a separate return).

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

1) Your excess capital loss is more than the yearly limit, or
2) The amount shown on line 36, Form 1040 (your taxable income without your deduction for exemptions), is less than zero.

If either of these situations applies to you in 1997, complete the Capital Loss Carryover Worksheet, provided in the instructions to Schedule D (Form 1040), to figure the amount of your loss that you can carry over to 1998.

In 1998, you will treat the carryover loss as if it occurred in that year. It will be combined with any capital gains and losses you have in 1998, and any excess capital loss will be subject to the limit for that year. Any loss not used in 1998 will be carried over to 1999.

Example. Bob and Gloria Sampson sold property in 1997. The sale resulted in a capital loss of $7,000. The Sampsons had no other capital transactions. On their joint 1997 return, the Sampsons deducted $3,000, the yearly limit. They had taxable income of $2,000. The unused part of the loss, $4,000 ($7,000 − $3,000), is carried over to 1998. The allowable $3,000 deduction is considered used in 1997.

If the Sampsons’ capital loss had been $2,000, it would not have been more than the yearly limit. Their capital loss deduction would have been $2,000. They would have no carryover to 1998.

Short-term and long-term losses. When you carry over a loss, it retains its original character as either long term or short term. A short-term loss that you carry over to the next tax year is added to short-term losses occurring in that year. A long-term loss that you carry over to the next tax year is added to long-term losses occurring in that year. Thus, a long-term capital loss you carry over to the next year reduces that year’s long-term gains before its short-term gains.

If you have both short-term and long-term losses, your short-term losses are used first against your allowable capital loss deduction.

If, after using your short-term losses, you have not reached the limit on the capital loss deduction, use your long-term losses until you reach the limit. This computation of your short-term capital loss carryover or your long-term capital loss carryover is made on the Capital Loss Carryover Worksheet provided in the instructions for Schedule D (Form 1040).

Joint and separate returns. On a joint return, the capital gains and losses of a husband and wife are figured as the gains and losses of an individual. If you are married and filing a separate return, your yearly capital loss deduction is limited to $1,500. Neither you nor your spouse may deduct any part of the other’s loss.

If you and your spouse once filed separate returns and are now filing a joint return, combine your separate capital loss carryovers. However, if you and your spouse once filed jointly and are now filing separately, any capital loss carryover from the joint return can be deducted only on the return of the spouse who actually had the loss.

Death of taxpayer. Capital losses cannot be carried over after a taxpayer’s death. They are deductible only on the final income tax return filed on the decedent’s behalf. The capital loss limit discussed earlier still applies in this situation. Even if the loss is greater than the limit, the decedent’s estate cannot deduct the excess or carry it over to following years.

Corporations. A corporation may deduct capital losses only up to the amount of its capital gains. In other words, if a corporation has an excess capital loss, it cannot be deducted in the current tax year. It must be carried to other tax years and deducted from capital gains occurring in those years. For more information, see Publication 542.

Maximum Tax Rates on Net Capital Gain

The 31%, 36%, and 39.6% income tax rates for individuals do not apply to a capital gain. In some cases, the 15% and 28% rates do not apply either. Instead, your net capital gain is taxed at a lower maximum rate.

Net capital gain is the excess of net long-term capital gain for the year over the net short-term capital loss for the year.

You will need to use Part IV of Schedule D (Form 1040) to figure your tax using the maximum capital gains rates if both of the following are true.

1) Both lines 16 and 17 of Schedule D are gains.
2) Your taxable income on Form 1040, line 38, is more than zero.

The maximum rate may be 10%, 20%, 25%, or 28%, or a combination of those rates, as shown in Table 3–3. For information about changes for 1998 and later years, see Publication 553, Highlights of 1997 Tax Changes.

Using the maximum rates. The part of a net capital gain that is subject to each maximum rate is determined by first netting long-term capital gains with long-term capital losses in the following tax rate groups.

1) A 28% group, consisting of gains and losses from:
   a) Sales before May 7, 1997,
   b) Sales after July 28, 1997, of property held 18 months or less,
   c) Collectibles (including gain from the sale of an interest in a partnership, S corporation, or trust attributable to unrealized appreciation of collectibles), and
   d) Any long-term capital loss carryover.

   The term “sale” for this purpose includes an exchange, involuntary conversion, and installment payment received.

2) A 25% group, consisting of unrecaptured section 1250 gain.

3) A 20% group, consisting of gains and losses not in the 28% or 25% group.

If any group has a net loss, the following rules apply.

• A net loss from the 28% group reduces any gain from the 25% group, and then any net gain from the 25% group.
• A net loss from the 20% group reduces any net gain from the 25% group, and then any gain from the 25% group.

If you have a net short-term capital loss, it reduces any net gain from the 25% group, then any gain from the 20% group, and finally any net gain from the 20% group.

The resulting net gain (if any) from each group is subject to the maximum tax rate for that group. (The 10% maximum rate applies to a net gain from the 20% group to the extent that, if there were no maximum capital gains rates, the net capital gain would be taxed at the 15% regular tax rate.)

Collectibles. This is a work of art, rug, antique, metal, gem, stamp, coin, or alcoholic beverage held more than 1 year.

Unrecaptured section 1250 gain. This is the part of any long-term capital gain on section 1250 property (real property) sold after May 6, 1997, that is attributable to depreciation. For sales after July 28, 1997, use only the gain from section 1250 property held more than 18 months in figuring the unrecaptured section 1250 gain. The unrecaptured section 1250 gain cannot be more than the excess of the net section 1231 gain over the net section 1231 gain that is treated as ordinary income. For more information about section 1250 property and net section 1231 gain, see chapter 4.

Net capital gain from disposition of investment property. If you elect to include any part of a net capital gain from a disposition of investment property in investment income for figuring your investment interest deduction, you must reduce the net capital gain eligible for the maximum tax rates by the same amount. You make this election on Form 4952, Investment Interest Expense Deduction, line 4e. For information on making this election, see the instructions to Form 4952. For information on the investment interest deduction, see chapter 3 in Publication 550.
Table 3-3. What Is Your Maximum Capital Gains Rate for 1997?

<table>
<thead>
<tr>
<th>IF the sale* took place . . .</th>
<th>AND the capital asset was held . . .</th>
<th>AND your gain . . .</th>
<th>THEN your maximum capital gains rate is . . .</th>
</tr>
</thead>
<tbody>
<tr>
<td>Before May 7, 1997</td>
<td>More than 1 year</td>
<td>Is from selling any type of capital asset</td>
<td>28%</td>
</tr>
<tr>
<td>After May 6, 1997, but before July 29, 1997</td>
<td>More than 1 year</td>
<td>1) Is a collectibles gain</td>
<td>28%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>2) Is an unrecaptured section 1250 gain</td>
<td>25%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>3) Is not a gain that (1), (2), or (4) applies to</td>
<td>20%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>4) Would be taxed, if there were no maximum capital gains rates, at the 15% regular tax rate — and (1) and (2) don’t apply</td>
<td>10%</td>
</tr>
<tr>
<td>After July 28, 1997</td>
<td>More than 1 year but not more than 18 months</td>
<td>Is from selling any type of capital asset</td>
<td>28%</td>
</tr>
<tr>
<td>After July 28, 1997</td>
<td>More than 18 months</td>
<td>1) Is a collectibles gain</td>
<td>28%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>2) Is an unrecaptured section 1250 gain</td>
<td>25%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>3) Is not a gain that (1), (2), or (4) applies to</td>
<td>20%</td>
</tr>
<tr>
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<td></td>
<td>4) Would be taxed, if there were no maximum capital gains rates, at the 15% regular tax rate — and (1) and (2) don’t apply</td>
<td>10%</td>
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</tbody>
</table>

*The term "sale" includes an exchange, involuntary conversion, and installment payment received.

4. Ordinary or Capital Gain or Loss for Business Property

Introduction

When you dispose of business property, your taxable gain or loss is usually a section 1231 gain or loss. Its treatment as ordinary or capital is determined under special rules for section 1231 transactions.

When you dispose of depreciable property (section 1245 property or section 1250 property) at a gain, you may have to recognize all or part of the gain as ordinary income under the depreciation recapture rules. Any remaining gain is a section 1231 gain.

Topics

This chapter discusses:

- Section 1231 gains and losses,
- Depreciation recapture on section 1245 property,
- Depreciation recapture on section 1250 property, and
- Depreciation recapture on installment sales, gifts, transfers at death, like-kind exchanges and involuntary conversions, and multiple property transactions.

Useful Items

You may want to see:

Publication

- 534 Depreciating Property Placed in Service Before 1987
- 537 Installment Sales
- 551 Basis of Assets
- 946 How To Depreciate Property

Form (and Instructions)

- 4797 Sales of Business Property
  See chapter 6 for information about getting these publications and forms.

Section 1231 Gains and Losses

Section 1231 gains and losses are the taxable gains and losses from section 1231 transactions. Their treatment as ordinary or capital depends on whether you have a net gain or a net loss from all your section 1231 transactions.

If you have a gain from a section 1231 transaction, first determine whether any of the gain is ordinary income under the depreciation recapture rules (explained later). Do not take that gain into account as section 1231 gain.

Section 1231 transactions. Transactions that result in gain or loss subject to section 1231 treatment are—

Sales or exchanges of real property or depreciable personal property. This property must be used in a trade or business or held for the production of rents or royalties and held for more than 1 year. Depreciable personal property includes amortizable section 197 intangibles (described in chapter 2 under Other Dispositions).

Sales or exchanges of leaseholds. The leasehold must be used in a trade or business and held for more than 1 year.
Sales or exchanges of cattle and horses. The cattle and horses must be held for draft, breeding, dairy, or sporting purposes and held for 2 years or more.

Sales or exchanges of other livestock. This livestock does not include poultry, it must be held for draft, breeding, dairy, or sporting purposes and held for 1 year or more.

Sales or exchanges of unharvested crops. The crop and land must be sold, exchanged, or involuntarily converted at the same time and to the same person and the land must be held for more than 1 year.

Growing crops sold with a lease on the land, though sold to the same person in the same transaction, are not included. The taxpayer cannot keep any right or option to re-acquire the land, directly or indirectly (other than a right customarily incident to a mortgage or other security transaction).

Cutting of timber or disposal of timber, coal, or iron ore. The cutting or disposal must be treated as a sale, as described in chapter 2 under Timber and Coal and Iron Ore.

Condemnations. The condemned property must have been held for more than 1 year. It must be business property or a capital asset. Any loss or gain due to a trade or business transaction is not considered a capital gain or loss.

Casualties and thefts. These must have been a casualty or theft of business property, property held for the production of rents and royalties, or investment property (such as notes and bonds). You must have held the property for more than 1 year. However, if your casualty or theft losses exceed your casualty or theft gains, neither the gains nor the losses are taken into account in the section 1231 computation.

For more information on casualties and thefts, see Publication 547.

Property for sale to customers. A sale, exchange, or involuntary conversion of property held mainly for sale to customers is not a section 1231 transaction. If you will get back all, or nearly all, of your investment in the property by selling it rather than by using it up in your business, it is property held mainly for sale to customers.

Example. You manufacture and sell steel cable, which you deliver on returnable reels that are depreciable property. Customers make deposits on the reels, which you refund if the reels are returned within a year. If they are not returned, you keep each deposit as the agreed-upon sales price. Most reels are returned within the one-year period. You keep adequate records showing depreciation and other charges to the capitalized cost of the reels. Under these conditions, the reels are not property held for sale to customers in the ordinary course of business because any gain or loss resulting from their not being returned may be capital or ordinary, depending on your section 1231 transactions.

Treatment as ordinary or capital. To determine if section 1231 gains and losses, combine all your section 1231 gains and losses for the year.

- If you have a net section 1231 loss, it is ordinary loss.
- If you have a net section 1231 gain, it is ordinary income up to the amount of your nonrecaptured section 1231 losses from previous years. The rest, if any, is long-term capital gain.

Nonrecaptured section 1231 losses. Your nonrecaptured section 1231 losses are your net section 1231 losses for the previous 5 years that have not been previously applied against a section 1231 gain by treating the gain as ordinary income. These losses are applied against your net section 1231 gain beginning with the earliest loss in the 5-year period.

Example. Ashley, Inc., a graphic arts company, is a calendar year corporation. In 1994, it had a net section 1231 loss of $8,000. For tax years 1996 and 1997, the company has net section 1231 gains of $5,250 and $4,600, respectively. In figuring taxable income for 1996, Ashley treated its net section 1231 gain of $5,250 as ordinary income by recapturing $5,250 of its $8,000 net section 1231 loss. In 1997, it applies its remaining net section 1231 loss, $2,750 ($8,000 minus $5,250) against its net section 1231 gain, $4,600. For 1997, the company reports $2,750 as ordinary income and $1,850 ($4,600 minus $2,750) as long-term capital gain.

Maximum tax rate on capital gain. The maximum tax rate on the net capital gain of an individual, estate, or trust is determined by treating any ordinary income from a net section 1231 gain as consisting of, first, any net section 1231 gain in the 28% group, then any net section 1231 gain in the 20% group, and finally any net section 1231 gain in the 0% group. Any long-term capital gain is treated as consisting of any remaining net section 1231 gain in each group. See Maximum Tax Rates on Net Capital Gain in chapter 3.

Example. The facts are the same as in the previous example, except that the company is operated by an individual as a sole proprietorship. The $4,600 net section 1231 gain for 1997 is the total of a $1,000 net section 1231 gain in the 28% group and a $3,600 net section 1231 gain in the 20% group. The $2,750 treated as ordinary income consists of $1,000 in the 28% group and $1,750 of the gain in the 20% group. Therefore, the maximum tax rate on the individual’s net capital gain for 1997 is determined by including the $1,850 long-term capital gain in the 20% group.

Depreciation Recapture

If you dispose of depreciable or amortizable property at a gain, you may have to treat all or part of the gain (even if otherwise nontaxable) as ordinary income.

To figure any gain that must be reported as ordinary income, you must keep permanent records of the facts necessary to figure the amount of depreciation or amortization allowed or allowable on your property. In determining the date and manner of acquisition, cost or other basis, depreciation or amortization, and all other adjustments that affect basis.

On property you got in a nontaxable exchange or as a gift, your records must also indicate the following:

1) Whether the adjusted basis was figured using depreciation or amortization you claimed on other property, and
2) Whether the adjusted basis was figured using depreciation or amortization another person claimed.

Corporate distributions. For information on depreciable property distributed by corporations, see Distributions of Appreciated Property in Publication 542.

General asset accounts. Special rules apply to dispossession of property you depreciated using a general asset account. For information on these rules, see Regulations section 1.168(i)-1(e).

Section 1245 Property

A gain on the disposition of section 1245 property is treated as ordinary income to the extent of depreciation allowed or allowable on the property. See Gain Treated as Ordinary Income, later.

Section 1245 property. This includes any property that is or has been subject to an allowance for depreciation or amortization and that is:

1) Personal property (either tangible or intangible),
2) Other tangible property (except buildings and their structural components) used as:
   a) An integral part of manufacturing, production, or extraction or of furnishing transportation, communications, electricity, gas, water, or sewage disposal services,
   b) A research facility in any of the activities in (a) above, or
   c) A facility in any of the activities in (a) for the bulk storage of fungible commodities,
3) That part of real property (not included in (2)) having an adjusted basis that was reduced by certain amortization deductions (including those for certified pollution control facilities, and child-care facilities, removal of architectural barriers to persons with disabilities and the elderly, or reforestation expenditures) or a section 179 deduction,
4) Single purpose agricultural (livestock) or horticultural structures, or
5) Storage facilities (except buildings and their structural components) used in distributing petroleum or any primary product of petroleum.

Buildings and structural components. Section 1245 property does not include buildings and structural components. Do not include structures that are essentially items of machinery or equipment as buildings and structural components. Also, do not include, as buildings, structures that house property used as an integral part of an activity, if the structures’ use is so closely related to the property’s use that the structures can be expected to be replaced when the property they initially house is replaced. The fact that the structures are specially designed to withstand the stress and other demands of the property
and the fact that the structures cannot be used economically for other purposes indicate that they are closely related to the use of the property they house. Thus, structures such as oil and gas storage tanks, grain storage bins, silos, fractionating towers, blast furnaces, basic oxygen furnaces, coke ovens, brick kilns, and coal tipples are not treated as buildings.

**Storage facility.** This is a facility used mainly for the bulk storage of fungible commodities. To be fungible, a commodity must be such that one part may be used in place of another. Bulk storage means the storage of a commodity in a large mass before it is used. Stored materials that vary in composition, size, and weight are not fungible. One part cannot be used in place of another part and the materials cannot be estimated and replaced by simple reference to weight, measure, and number. Thus, if a facility is used to store oranges that have been sorted and boxed, it is not used for bulk storage. The storage of different grades and forms of aluminum scrap is not bulk storage of fungible commodities.

**Gain Treated as Ordinary Income**

The amount of gain treated as ordinary income on the sale, exchange, or involuntary conversion of section 1245 property, including a sale and leaseback transaction, is limited to the **lower** of:

1. The depreciation and amortization allowed or allowable on the property (the recomputed basis of the property minus the adjusted basis of the property), or
2. The gain realized on the disposition (the amount realized from the disposition minus the adjusted basis of the property).

For any other disposition of section 1245 property, ordinary income is the lower of (1) above or the amount by which its fair market value exceeds its adjusted basis. See Gifts, and Transfers at Death, later.

Use Part III of Form 4797 to figure the ordinary income part of the gain.

**Recomputed basis.** The recomputed basis of your section 1245 property is the total of its adjusted basis plus depreciation and amortization adjustments (allowed or allowable) reflected in the adjusted basis. These include adjustments:

1. On property you exchanged for, or converted to, your section 1245 property in a like-kind exchange or involuntary conversion, and
2. Allowed or allowable to a previous owner, if your basis is determined with reference to that person’s adjusted basis.

**Example.** In January 1995, Don Smith bought and placed in service section 1245 property that cost $10,000 and had a 5-year recovery period. By the end of 1997, he deducted $7,120 of depreciation using the MACRS method, which reduced the asset’s adjusted basis to $2,880. Since this adjusted basis reflects deductions for depreciation of $7,120, the recomputed basis of the property is $10,000.

**Property received in an exchange or conversion.** If you received property in a like-kind exchange or involuntary conversion, the recomputed basis of that property includes a depreciation or amortization adjustment allowed or allowable on the old property you exchanged or converted. This adjustment is reduced by any gain you recognize on the exchange or conversion of the old property.

**Property received as a gift.** If you received property as a gift, the recomputed basis includes any depreciation or amortization adjustments allowed or allowable to the donor for that property.

**Depreciation and amortization.** Depreciation and amortization that must be recaptured as ordinary income include (but are not limited to) the following items:

1. Ordinary depreciation deductions;
2. Amortization deductions for—
   a) The cost of acquiring a lease;
   b) The cost of lessee improvements;
   c) Pollution control facilities;
   d) Reforestation expenses;
   e) Section 197 intangibles;
   f) Child care facility expenditures made before 1982, and
3. The section 179 expense deduction;
4. Deductions for—
   a) The cost of removing barriers to the disabled and the elderly;
   b) Tertiary injectant expenses, and
   c) Depreciable clean-fuel vehicles and refueling property (less the amount of any recaptured deduction);
5. The amount of any basis reduction for the investment credit (less the amount of any basis increase for credit recapture); and
6. The amount of any basis reduction for the qualified electric vehicle credit (less the amount of any basis increase for credit recapture).

**Example.** You file your returns on a calendar year basis. In February 1995, you purchased and placed in service for 100% use in your business a light-duty truck (5-year property) for a cost of $10,000. You used the half-year convention and figured your MACRS deductions for the truck were $2,000 in 1995 and $3,200 in 1996. You did not take the section 179 deduction on it. You sold the truck in May 1997 for $7,000. The MACRS deduction in 1997, the year of sale, is $960 (1/2 of $1,920). Figure the gain treated as ordinary income as follows.

1. Cost (Feb. 1995) ................................ $10,000
2. Minus: MACRS deductions ($2,000 + $3,200 + $960) .......... 6,160
3. Adjusted basis (May 1997) .................. $3,840
4. Depreciation allowed or allowable: 
   Recomputed basis ............... $10,000
   Minus: Adjusted basis .......... 3,840 $6,160
5. Gain realized: 
   Amount realized ............... $7,000
   Minus: Adjusted basis .......... 3,840 $3,160
6. Gain treated as ordinary income (lower of line 4 or line 5) ............. $3,160

**Depreciation on “other tangible property.”** You must take into account depreciation during periods when the property was not used as an integral part of an activity or did not constitute a research or storage facility, as described earlier under Section 1245 property.

For example, if depreciation deductions taken on certain storage facilities amounted to $10,000, of which $6,000 is from the periods before their use in a prescribed business activity, you must use the entire $10,000 in determining ordinary income because of depreciation.

**Depreciation allowed or allowable.** The greater of the depreciation allowed or allowable is generally the amount to use in figuring the part of gain to report as ordinary income. If, in prior years, you have consistently taken proper deductions under one method, the amount allowed for your prior years will not be increased even though a greater amount would have been allowed under another proper method. If you did not take any deduction at all for depreciation, your adjustments to basis for depreciation allowable are figured by using the straight line method.

This treatment applies only when figuring what part of gain is treated as ordinary income under the rules for section 1245 depreciation recapture.

**Multiple asset accounts.** In figuring ordinary income because of depreciation, you may treat any number of units of section 1245 property in a single depreciation account as one item if the total ordinary income because of depreciation figured by using this method is not less than it would be if depreciation on each unit were figured separately.

**Example.** In one transaction you sold 50 machines, 25 trucks, and certain other property that is not section 1245 property. All of the depreciation was recorded in a single depreciation account. After dividing the total received among the various assets sold, you figured that each unit of section 1245 property was sold at a gain. You may figure the ordinary income because of depreciation as if the 50 machines and 25 trucks were one item.

However, if 5 of the trucks had been sold at a loss, only the 50 machines and 20 of the trucks could be treated as one item in determining the ordinary income because of depreciation.

**Normal retirement.** The normal retirement of section 1245 property in multiple asset accounts does not require recognition of gain as ordinary income because of depreciation if your method of accounting for asset holdings does not require recognition of that gain.

**Section 1231 gain.** Any gain recognized that is more than the part that is ordinary income because of depreciation is a section 1231 gain. See Treatment as ordinary or capital under Section 1231 Gains and Losses, earlier.
Section 1250 Property
A gain on the disposition of section 1250 property is treated as ordinary income to the extent of additional depreciation allowed or allowable on the property. To determine the additional depreciation on section 1250 property, see Additional Depreciation, later.

You will not have additional depreciation if:

1) You figured depreciation for the property using the straight line method or any other method that does not result in depreciable basis that is more than the amount figured by the straight line method, and you have held the property more than a year,
2) You dispose of residential low-income rental property that you held for 16½ years or more (for low-income rental housing on which the special 60-month depreciation adjustments to the depreciation on it are not depreciated expenditures was allowed, the 16½ years starts when the rehabilitated property is placed in service),
3) You chose the alternate ACRS method for the types of 15-, 18-, or 19-year real property covered by the section 1250 rules, or
4) You dispose of residential rental property or nonresidential real property placed in service after 1986 (or after July 31, 1986, if the election to use MACRS was made). These properties are depreciated using the straight line method.

Section 1250 property. This includes all real property that is subject to an allowance for depreciation and that is not and never has been section 1245 property. It includes a leasehold of land or section 1250 property that is subject to an allowance for depreciation. A fee simple interest in land is not included because it is not depreciable expenditure.

If, because you change its use, your section 1250 property becomes section 1245 property, you may never again treat it as section 1250 property.

Gain Treated as Ordinary Income
To find what part of the gain from the disposition of section 1250 property is treated as ordinary income, follow these steps:

1) In a sale, exchange, or involuntary conversion of the property, figure the excess of the amount realized over the adjusted basis of the property. In any other disposition of the property, figure the excess of fair market value over the adjusted basis.
2) Figure the additional depreciation for the periods after 1975.
3) Multiply the smaller of (1) or (2) by the basis of the property whether allowed to you or another person (as for carryover basis property).

Example. Larry Johnson gives his son section 1250 property on which he took $2,000 in depreciation deductions, of which $500 is additional depreciation. Immediately after the gift, the son's adjusted basis in the property is the same as his father's and reflects the $500 additional depreciation. On January 1 of the next year, after taking depreciation deductions of $1,000 on the property, of which $200 is additional depreciation, the son sells the property. At the time of sale, the additional depreciation is $700 ($500 allowed the father plus $200 allowed the son).

Depreciation allowed or allowable. The greater of depreciation allowed or allowable to any person who held the property if the depreciation was used in figuring its adjusted basis in year (amount less depreciation allowed or allowable) to use in figuring the part of the gain to be reported as ordinary income. If you can show that the deduction allowed for any tax year was less than the amount allowable, the smaller figure will be the depreciation adjustment for figuring additional depreciation.

Retired or demolished property. The adjustments reflected in adjusted basis generally do not include deductions for depreciation on retired or demolished parts of section 1250 property, unless these deductions are reflected in the basis of replacement property that is section 1250 property.

Example. If a wing of a building is totally destroyed by fire, the depreciation adjustments figured in the adjusted basis of the building after the wing is destroyed do not include any deductions for depreciation on the destroyed wing, unless it is replaced and the adjustments for depreciation on it are reflected in the basis of the replacement property.

Useful life and salvage value. The useful life and salvage value you use to figure the amount that would have been the depreciation if you had used the straight line method are the same as those used under the depreciation method you actually used. Salvage value and useful life are not used for either the ACRS or MACRS methods of depreciation. If you did not use a useful life under the depreciation method actually used (such as with the units-of-production method), or if you did not take salvage value into account (such as with the declining balance method), the useful life or salvage value for figuring what would have been the straight line depreciation is the useful life and salvage value you would have used under the straight line method.

Property held by lessee. If a lessee makes a leasehold improvement, the lease period for figuring what would have been the straight line depreciation adjustments and for figuring the additional depreciation includes all renewal periods. This extension cannot extend the period taken into account to a period which exceeds the remaining useful life of the improvement. The same rule applies to the cost of acquiring a lease.

Renewal period. The term "renewal period" means any period for which the lease may be renewed, extended, or continued under an option exercisable by the lessee. However, the inclusion of renewal periods cannot extend the lease by more than two-thirds of the period that was the basis on which the actual depreciation adjustments were allowed.

Rehabilitation expenditures. A part of the special 60-month depreciation adjustment allowed for rehabilitation expenditures incurred before 1987 in connection with low-income rental housing is additional depreciation. The additional depreciation is the excess of the special depreciation adjustments over the adjustments that would have resulted if the straight line method were used, less the useful life, and salvage value had been used.

Example. On January 6, 1997, Fred Plums, a calendar year taxpayer, sold real property, in which the entire basis was from rehabilitation expenses of $50,000 incurred in 1983. The property was placed in service on January 3, 1984, and under the special depreciation provisions for rehabilitation expenditures was depreciated under the straight line method using a useful life of 60 months (5 years) and no salvage value. If Fred had used the regular straight line method, he would have used a salvage value of $5,000 and a useful life of 15 years, and had a depreciable basis of $45,000. Depreciation
Applicable Percentage

The applicable percentage used to figure the ordinary income because of additional depreciation depends on whether the real property you disposed of is nonresidential real property, residential rental property, or low-income housing. The applicable percentages for these types of real property are as follows.

Nonresidential real property. For real property that is not residential rental property, the applicable percentage for periods after 1969 is 100%. For periods before 1970, the applicable percentage is zero and no ordinary income will result on its disposition because of additional depreciation before 1970.

Residential rental property. For residential rental property (80% or more of the gross income is from dwelling units) other than low-income housing, the applicable percentage for periods after 1975 is 100%. For residential rental property, the applicable percentage for periods before 1976 is zero. Therefore, no ordinary income will result from a disposition of residential rental property because of additional depreciation before 1976.

Low-income housing. Low-income housing includes the following types of residential rental property:

1) Federally assisted housing projects, where the mortgage of ($3,000 or more) is insured under section 221(d)(3) or 236 of the National Housing Act, or housing financed or assisted by direct loan or tax abatement under similar provisions of state or local laws.

2) Low-income rental housing for which a depreciation deduction for rehabilitation expenditures was allowed.

3) Low-income rental housing held for occupancy by families or individuals eligible to receive subsidies under section 8 of the United States Housing Act of 1937, as amended, or under provisions of state or local laws that authorize similar subsidies for low-income families, and

4) Housing financed or assisted by direct loan or insured under Title V of the Housing Act of 1949.

The applicable percentage for low-income housing is 100% minus 1% for each full month the property was held over 100 full months. If you have held low-income housing at least 16 years and 8 months, the applicable percentage is zero and no ordinary income will result from its disposition.

Foreclosure. If low-income housing is disposed of because of foreclosure or similar proceedings, the monthly applicable percentage reduction is figured as follows for the property on the starting date of the proceedings.

Example. On June 1, 1985, you acquired low-income housing property. On April 3, 1996 (130 months after the property was acquired), foreclosure proceedings were started on the property and on December 2, 1997 (150 months after the property was acquired), the property was disposed of as a result of the foreclosure proceedings. The property qualifies for a reduced applicable percentage because it was held more than 100 full months. The applicable percentage reduction is 30% (130 months minus 100 months) rather than 50% (150 months less 100 months) because it does not apply after April 3, 1996, the starting date of the foreclosure proceedings. Therefore, 70% of the additional depreciation is treated as ordinary income.

Holding period. The holding period used to figure the applicable percentage for low-income housing you acquired generally starts on the day after it is acquired. Thus, if you bought low-income housing on January 1, 1981, the holding period starts on January 2, 1981. If you sold it on January 2, 1997, the holding period is exactly 192 full months. The applicable percentage for additional depreciation is 8%, or 100% minus one percent for each full month the property was held over 100 full months.

Constructed, reconstructed, or erected property. The holding period used to figure the applicable percentage for low-income housing you constructed, reconstructed, or erected starts on the first day of the month it is placed in service in a trade or business, in an activity for the production of income, or in a personal activity.

Property acquired by gift or received in a tax-free transfer. For low-income housing you acquired by gift or in a tax-free transfer whose basis is figured by reference to the basis in the hands of the transferor, the holding period, for the purpose of the applicable percentage, includes the holding period of the transferor.

If the adjusted basis of the property in your hands just after acquiring it is more than its adjusted basis to the transferor just before transferring it, the 100-month period of the excess is figured as if it were a separate improvement. See Low-Income Housing With Two or More Elements, next.

Low-Income Housing With Two or More Elements

If low-income housing property has more than one separate element, the gain to be reported as ordinary income is the sum of the ordinary income figured for each element.

The three types of separate elements are:

1) A separate improvement (defined later),
2) The basic section 1250 property plus improvements not qualifying as separate improvements, and
3) The units placed in service at different times before all the section 1250 property is finished. For example, this happens when a taxpayer builds an apartment building of 100 units, and places 30 units in service (available for renting) on January 4, 1996, 50 on July 18, 1996, and the remaining 20 on January 18, 1997. As a result, the apartment house consists of three separate elements.

36-month test for separate improvements. A separate improvement is each improvement (qualifying under 1-year test, below) added to the capital account of the property, if the total of the improvements during the 36-month period ending on the last day of any tax year is more than the greater of:

1) One-fourth of the adjusted basis of the property at the start of the first day of the 36-month period, or the first day of the holding period of the property, whichever is later,
2) One-tenth of the unadjusted basis (adjusted basis plus depreciation and amortization adjustments) of the property at the start of the period determined in (1), or
3) $5,000.

1-year test. An addition to the capital account for any tax year (including a short tax year) is treated as an improvement only if the sum of all additions for the year is more than the larger of $2,000, or 1% of the unadjusted basis of the property. The unadjusted basis is figured as of the start of that tax year or the holding period of the property, whichever is later. In applying the 36-month test, improvements in any one of the 3 years are omitted entirely if the total improvements in that year do not qualify under the 1-year test.

Example. The unadjusted basis of a calendar year taxpayer’s property was $300,000 on January 1, 1985. During that year, the taxpayer made improvements A, B, and C, which cost $1,000, $600, and $700, respectively. Since the sum of the improvements, $2,300, is less than 1% of the unadjusted basis ($300,000), the improvements in 1985 do not satisfy the 1-year test and are not treated as improvements for the 36-month test. However, if improvement C had cost $1,500, the sum of the 1985 improvements would have been $3,100, it would then be necessary to apply the 36-month test to figure if the improvements must be treated as separate improvements.

Addition to the capital account. Any addition to the capital account made after the initial acquisition or completion of the property by you or any person who held the property during a period included in your holding period is to be considered when figuring the total amount of separate improvements.

The addition to the capital account of depreciable real property is the gross addition not reduced by amounts attributable to replaced property. Thus, if a roof with an adjusted basis of $20,000 is replaced by a new roof costing $50,000, the improvement is the gross addition to the account, $50,000, and the net addition of $30,000. The $20,000 adjusted basis of the old roof is no longer reflected in the basis of the property. The status of an addition to the capital account is not affected by whether it is treated as a separate property for determining depreciation deductions.

Whether an expenditure is treated as an addition to the capital account may depend on the final disposition of the entire property.
If the expenditure item property and the basic property are sold in two separate transactions, the entire section 1250 property is treated as consisting of two distinct properties.

**Unadjusted basis.** In figuring the unadjusted basis as of a certain date, include the actual cost of all previous additions to the capital account plus those that did not qualify as separate improvements. However, the cost of components retired before that date is not included in the unadjusted basis.

**Holding period.** The following guidelines are used for figuring the applicable percentage for property with two or more elements.

1. The holding period of a separate element placed in service before the entire section 1250 property is finished starts on the first day of the month that the separate element is placed in service.

2. The holding period for each separate improvement qualifying as a separate element starts on the day after the improvement is acquired or, for improvements added, reconstructed, or erected, the first day of the month that the improvement is placed in service.

3. The holding period for each improvement not qualifying as a separate element takes the holding period of the basic property.

If an improvement by itself does not meet the 1-year test (greater of $2,000 or 1% of the unadjusted basis), but it does qualify as a separate improvement that is a separate element (when grouped with other improvements made during the tax year), determine the start of its holding period as follows. Use the first day of a calendar month that is the closest first day to the middle of the tax year. If there are two first days of a month that are equally close to the middle of the year, use the earlier date.

### Figuring ordinary income attributable to each separate element

- **Figure ordinary income attributable to each separate element as follows:**
  - **Step 1.** Divide the element's additional depreciation after 1975 by the sum of all the elements’ additional depreciation after 1975 to determine a percentage.
  - **Step 2.** Multiply the percentage figured in Step 1 by the lesser of the additional depreciation after 1975 or the gain from disposition of the entire property (the difference between the fair market value, or amount realized, and the adjusted basis).
  - **Step 3.** Multiply the result in Step 2 by the applicable percentage for the element.

#### Example.
You sold low-income housing property at a gain of $25,000 that is subject to the ordinary income rules of section 1250. The property consisted of four elements (W, X, Y, and Z). The additional depreciation for each element is: W—$12,000; X—None; Y—$6,000; and Z—$6,000. The sum of the additional depreciation for all the elements (Step 1) is $24,000. The depreciation deducted on element X was $4,000 less than it would have been under the straight line method. Additional depreciation on the property as a whole is $20,000 ($24,000 minus $4,000). Because $20,000 is lower than the $25,000 gain on the sale, $20,000 is used in Step 2. The applicable percentages to be used in Step 3 for the elements are: W—68%; X—85%; Y—92%; and Z—100%.

From these facts, the sum of the ordinary income for each element is computed as follows:

| Element | Ordinary Income | Step 1 | Step 2 | Step 3
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>W</td>
<td>$12,000</td>
<td>$24,000</td>
<td>68%</td>
<td>$6,800</td>
</tr>
<tr>
<td>X</td>
<td>$0</td>
<td>$24,000</td>
<td>85%</td>
<td>0</td>
</tr>
<tr>
<td>Y</td>
<td>$6,000</td>
<td>$24,000</td>
<td>92%</td>
<td>$4,600</td>
</tr>
<tr>
<td>Z</td>
<td>$6,000</td>
<td>$24,000</td>
<td>100%</td>
<td>$5,000</td>
</tr>
</tbody>
</table>

**Sum of the ordinary income of the separate elements** $16,400

### Installment Sales

If you report the sale of property under the installment method, any depreciation recapture under section 1245 or 1250 is taxable as ordinary income in the year of sale. This applies even if no payments are received in that year. If the gain is more than the depreciation recapture income, report the rest of the gain using the rules of the installment method. For this purpose, add the recapture income to the property's adjusted basis.

If you dispose of *more than one asset* in a single transaction, you must separately figure the gain on each asset so that it may be properly reported. To do this, allocate the selling price and the payments you receive in the year of sale to each asset. Report any depreciation recapture income in the year of sale before using the installment method for any remaining gain.

For a detailed discussion of installment sales, get Publication 537.

### Gifts

If you make a *gift* of depreciable personal property or real property, you do not have to report any gain on the property. However, if the person who receives it (donee) sells or otherwise disposes of the property in a disposition that is subject to recapture, the donee must take into account the depreci- ation you deducted in figuring the gain to be reported as ordinary income.

For low-income housing, the donee must take into account the donor's holding period to figure the applicable percentage. See **Applicable Percentage** and its discussion **Holding period under Section 1250 Property** earlier.

**Disposition part gift and part sale or exchange.** If you transfer depreciable personal property or real property for less than its fair market value in a transaction considered to be partly a gift and partly a sale or exchange, and you have a gain because the amount realized is more than your adjusted basis, you must report ordinary income (up to the amount of gain) to recapture depreciation. If the depreciation (additional depreciation, if section 1250 property) is more than the gain, the balance is carried over to the transferee to be taken into account on any later disposition of the property. However, see **Bargain sales to charity**, later.

#### Example.
You transferred depreciable personal property to your son for $20,000. When transferred, the property had an adjusted basis to you of $10,000 and a fair market value of $40,000. You took depreciation of $30,000. You are considered to have made a gift of $20,000, the difference between the $40,000 fair market value and the $20,000 sale price to your son. You have a taxable gain on the transfer of $10,000 ($20,000 sale price less $10,000 adjusted basis) that must be reported as ordinary income from depreciation. Because you report $10,000 of your $30,000 depreciation as ordinary income on the transfer of the property, only the remaining $20,000 depreciation is carried over to your son for him to take into account on any later disposition of the property.

### Gift to charitable organization

If you give property to a charitable organization, you figure your deduction for your charitable contribution by reducing the fair market value of the property by the ordinary income and short-term capital gain that would have resulted had you sold the property at its fair market value at the same time the property was transferred. Your deduction for depreciable real or personal property given to a charitable organization does not include the potential ordinary gain from depreciation.

You also may have to reduce the fair market value of the contributed property by the long-term capital gain (including any section 1231 gain) that would have resulted had the property been sold. For more information, see **Giving Property That Has Increased in Value in Publication 526, Charitable Contributions**.

### Bargain sales to charity

If you transfer section 1245 or section 1250 property to a charitable organization for less than its fair market value and a deduction for the contribution part of the transfer is allowable, your ordinary income from depreciation is figured under special rules. First, figure the ordinary income as if you had sold the property at its fair market value. Then, allocate that amount between the sale and the donation. Thus, parts of the transfer in the same proportion that you allocated your adjusted basis in the property to figure your gain. (See **Bargain Sales as Gifts under Gain or Loss From Sales and Exchanges in chapter 1.**) Report as ordinary income the lesser of the ordinary income allocated to the sale or your gain from the sale.

#### Example.
You sold section 1245 property in a bargain sale to a charitable organization and are allowed a deduction for your contribution. Your gain on the sale was $1,200, figured by allocating 20% of your adjusted basis in the property to the part sold. If you had sold the property at its fair market value, your ordinary income would have been $5,000. Your ordinary income is $1,000 ($5,000 × 20%) and your section 1231 gain is $200 ($1,200 − $1,000).

### Transfers at Death

When a taxpayer dies, no gain is reported on depreciable personal property or real property that is transferred to his or her estate or beneficiary. For information on the tax liability of a decedent, get **Publication 559, Survivors, Executors, and Administrators**.

However, if the decedent disposed of the property while alive and, because of his or her method of accounting or for any other reason, the gain from the disposition is reportable by the estate or beneficiary, it must be reported in the same way the decedent disposed of the property.
would have had to report it if he or she were still alive.

Ordinary income due to depreciation must be reported on a transfer from an executor, administrator, or trustee to an heir, beneficiary, or other individual if the transfer is a sale or exchange on which gain is realized.

**Example 1.** Janet Smith owned depreciable property that, upon her death, was inherited by her son. Her ordinary income because of depreciation is reportable on the transfer, even though the value used for estate tax purposes is more than the adjusted basis of the property to Janet when she died. However, if she sold the property before her death and realized a gain and, because of her method of accounting, the proceeds from the sale are income in respect of a decedent reportable by her son, he must report ordinary income because of depreciation.

**Example 2.** The trustee of a trust created by a will transfers depreciable property to a beneficiary in satisfaction of a specific bequest. Even though you deducted a value of $9,000 at the date used for estate tax purposes, the $1,000 increase in value to the date of distribution is a gain realized by the trust. Ordinary income because of depreciation must be reported by the trust on the transfer.

**Like-Kind Exchanges and Involuntary Conversions**

A like-kind exchange of your depreciable property, or an involuntary conversion of the property into similar or related property, will not result in your having to report ordinary income because of depreciation unless money or property other than like-kind, similar, or related property is also received in the transaction. For information on like-kind exchanges and involuntary conversions, see chapter 1.

**Depreciable personal property.** If you have a gain from either a like-kind exchange or an involuntary conversion of your depreciable personal property, the amount to be reported as ordinary income because of depreciation, figured under the rules explained earlier (see Section 1245 Property), is limited to the sum of:

1. The gain that must be included in income under the rules for like-kind exchanges or involuntary conversions, plus

2. The fair market value of the like-kind, similar, or related property other than depreciable personal property acquired in the transaction.

**Example 1.** You bought a new machine for $4,300 cash plus your old machine for which you were allowed a $1,360 trade-in. The old machine cost you $5,000 2 years ago. You took depreciation deductions of $3,950 ($5,000 cost – $1,050 adjusted basis) in year 2. Even though you deducted depreciation had the transaction been a cash sale, less the cost (or fair market value in an exchange) of the depreciable real property acquired.

The ordinary income not reported for the year of the disposition is carried over to the depreciable real property acquired in the like-kind exchange or involuntary conversion as additional depreciation from the property disposed of. Further, to figure the applicable percentage of additional depreciation on low-income housing to be treated as ordinary income, the holding period starts over for the new property.

**Example.** The state paid you $116,000 when it condemned your depreciable real property for public use. You bought other real property similar in use to the property condemned for $110,000 ($15,000 for depreciable real property and $95,000 for land). You also bought stock for $5,000 to get control of a corporation owning property similar in use to the property condemned. You choose to postpone the tax on the gain. If the transaction had been a sale, under the rules described earlier, $20,000 would have been reportable as ordinary income because of additional depreciation.

The ordinary income to be reported is $6,000, which is the larger of:

1. The gain that must be reported under the rules for involuntary conversions, $1,000 ($116,000 – $115,000), plus the fair market value of stock bought as qualified replacement property, $5,000, for a total of $6,000, or

2. The fair market value of the like-kind, similar, or related property other than depreciable real property acquired in the transaction, which is $95,000.

**Basis of property acquired.** If the ordinary income that you have to report because of additional depreciation is limited, the total basis of the property you acquired is its fair market value (its cost, if bought to replace property involuntarily converted into money), minus the gain on which tax is postponed. If you acquired more than one item of property, allocate the total basis among the properties in proportion to their fair market value (their cost, in an involuntary conversion into money). However, if you acquired both depreciable real property and other property, allocate the total basis as follows:

1. Subtract the ordinary income because of additional depreciation that you do not have to report from the fair market value (or cost) of the depreciable real property acquired.

2. Add the fair market value (or cost) of the other property acquired to the result in (1).

3. Divide the result in (1) by the result in (2).

4. Multiply the total basis by the result in (3). This is the basis of the depreciable real property acquired. If you acquired more than one item of depreciable real property, allocate this basis amount among the properties in proportion to their fair market value (or cost). If you acquired more than one item of other property, allocate this basis amount among the properties in proportion to their fair market value (or cost). If you acquired more than one item of other property, allocate this basis amount among the properties in proportion to their fair market value (or cost).

5. Subtract the result in (4) from the total basis. This is the basis of the other property acquired. If you acquired more than one item of other property, allocate this basis amount among the properties in proportion to their fair market value (or cost).

**Example 1.** In 1986, low-income housing property that you acquired and placed in service in 1981 was destroyed by fire, and you received a $90,000 insurance payment. The property’s adjusted basis was $38,400, with additional depreciation of $14,932. On De-
December 1, 1986, you used the insurance payment to acquire and place in service replacement low-income housing property. Your realized gain from the involuntary conversion was $51,600 ($90,000 − $38,400). You are not required to report the gain from the involuntary conversion rules. Under the rules for depreciation recapture on real property, the ordinary gain was $14,932, but you did not have to report any of it because of the limit for involuntary conversions.

The basis of the replacement low-income housing property was its $90,000 cost less the $51,600 gain on which you postponed tax, or $38,400. The $14,932 ordinary gain that you did not report is treated as additional depreciation on the replacement property. When you dispose of the property, your holding period for figuring the applicable percentage of additional depreciation to report as ordinary income will have begun December 2, 1986, the day after you acquired the property.

Example 2. John Adams gets a $90,000 fire insurance payment for depreciable real property (office building) with an adjusted basis of $30,000. He uses the whole payment to buy property similar in use, spending $42,000 for depreciable real property and $48,000 for land. He chooses to postpone tax on the $60,000 gain realized on the involuntary conversion. Of this gain, $10,000 is ordinary income because of additional depreciation on the $60,000 gain, and $50,000 is treated because of the limit for involuntary conversions of depreciable real property. The basis of the property bought is $30,000 ($90,000 − $60,000), allocated as follows:

1) The $42,000 cost of depreciable real property less $10,000 ordinary income that does not have to be reported is $32,000.
2) The $48,000 cost of other property (land) plus the $32,000 figured in (1) is $80,000.
3) The $32,000 figured in (1) divided by the $80,000 figured in (2) is 0.4.
4) The basis of the depreciable real property is $12,000. This is the $30,000 total basis multiplied by the 0.4 figured in (3).
5) The basis of the other property (land) is $18,000. This is the $30,000 total basis less the $12,000 figured in (4).

The ordinary income that is not reported ($10,000) is carried over as additional depreciation to the depreciable real property that was bought, and may be taxed as ordinary income on a later disposition.

Multiple Properties
If you dispose of both depreciable property and other property in one transaction and realize a gain, you must allocate the amount realized between the two types of property in proportion to their respective fair market values to figure the part of your gain to be reported as ordinary income because of depreciation. Special rules apply to the allocation of the amount realized on the sale of a business that includes a group of assets. See chapter 2.

In general, if a buyer and seller have adverse interests as to the allocation of the amount realized between the depreciable property and other property, any arm’s-length agreement between them will establish the allocation.

In the absence of an agreement, the allocation should be made by taking into account the appropriate facts and circumstances. These include, but are not limited to, a comparison between the depreciable property and all the other property being disposed of in the transaction. The comparison should take into account:

1) The original cost and reproduction cost of construction, erection, or production,
2) The remaining economic useful life,
3) The state of obsolescence, and
4) The anticipated expenditures required to maintain, renovate, or modernize the properties.

Like-kind exchanges and involuntary conversions. If you dispose of and acquire both depreciable personal property and other property (other than depreciable real property) in a like-kind exchange or involuntary conversion, the amount realized is allocated the following way. The amount that is allocated to the depreciable personal property disposed of is treated as consisting of, first, the fair market value of the depreciable personal property acquired and, second (to the extent of any remaining balance), the fair market value of the other property acquired. The amount allocated to the other property disposed of is treated as consisting of the fair market value of all property acquired that has not already been taken into account.

If you dispose of and acquire depreciable real property and other property in a like-kind exchange or involuntary conversion, the amount realized is allocated the following way. The amount that is allocated to each of the three types of property (depreciable real property, depreciable personal property, or other property) disposed of is treated as consisting of, first, the fair market value of that type of property acquired and, second (to the extent of any remaining balance), any excess fair market value of the other types of property acquired. (If the excess fair market value is more than the remaining balance of the amount realized and is from both of the other two types of property, you can apply the excess in any manner you choose.)

Example. A fire destroyed your property having a total fair market value of $50,000 and consisting of machinery worth $30,000 and nondepreciable property worth $20,000. You received an insurance payment of $40,000 and immediately used it with $10,000 of your own funds (or a total of $50,000) to buy machinery with a fair market value of $15,000 and nondepreciable property with a fair market value of $35,000. The adjusted basis of the destroyed machinery was $5,000 and your depreciation on it was $35,000. You choose to postpone tax on your gain from the involuntary conversion. You must report $9,000 as ordinary income because of depreciation arising from this transaction, figured as follows:

1) The $40,000 insurance payment must be allocated between the machinery and the other property destroyed, in proportion to the fair market value of each. The amount allocated to the machinery is 30,000/50,000 of $40,000, or $24,000. The amount allocated to the other property is 20,000/50,000 of $40,000, or $16,000. Your gain on the involuntary conversion of the machinery is $24,000 less $5,000 adjusted basis, or $19,000.

2) The $24,000 allocated to the machinery disposed of is treated as consisting of the $15,000 fair market value of the replacement machinery bought and $9,000 of the fair market value of other property bought in the transaction. All $16,000 allocated to the other property disposed of is treated as consisting of the fair market value of the other property that was bought.

3) Your potential ordinary income because of depreciation is $19,000, the gain on the machinery, because it is less than the $35,000 depreciation. However, the amount you must report as ordinary income is limited to the $9,000 included in the amount you realized for the machinery that represents the fair market value of property other than the depreciable property you bought.

5. Reporting Gains and Losses

Introduction
This chapter explains how to report capital gains and losses and ordinary gains and losses from sales and exchanges, and other dispositions of property.

Although this discussion refers to Schedule D (Form 1040), the rules discussed here also apply to taxpayers other than individuals. However, the rules for property held for personal use will usually not apply to taxpayers other than individuals.

Topics
This chapter discusses:
- Information returns
- Schedule D (Form 1040)
- Form 4797

Useful Items
You may want to see:
- Publication
  - 550 Investment Income and Expenses
  - 537 Installment Sales
- Form (and Instructions)
  - Schedule D (Form 1040) Capital Gains and Losses
  - 4684 Casualties and Thefts
  - 4797 Sales of Business Property
  - 6252 Installment Sale Income
  - 8824 Like-Kind Exchanges
- See chapter 6 for information about getting these publications and forms.
Information Returns

If you sell or exchange certain assets, you should receive an information return showing the proceeds of the sale. This information is also provided to the Internal Revenue Service.

Form 1099–B. If you sold stocks, bonds, commodities, etc., you should receive Form 1099–B or an equivalent statement. Whether or not you receive Form 1099–B, you must report all taxable sales of stocks, bonds, commodities, etc., on Schedule D. For more information on figuring gains and losses from these transactions, see chapter 4 in Publication 550.

Form 1099–S. Information reporting must be provided on certain real estate transactions. Generally, the person responsible for closing the transaction must report on Form 1099–S sales or exchanges of the following:

1. Land (improved or unimproved), including air space,
2. An inherently permanent structure, including any residential, commercial, or industrial building,
3. A condominium unit and its appurtenant fixtures and common elements (including land), or

If you sold or exchanged the above types of property, the reporting person must give you a copy of Form 1099–S or a statement containing the same information as the Form 1099–S.

If you receive or will receive property or services in addition to gross proceeds (cash or notes) in this transaction, the person reporting it does not have to value that property or those services. In that case, the gross proceeds reported on Form 1099–S will be less than the sales price of the property you sold. Figure any gain or loss according to the sales price, which is the total amount you realized on the transaction.

Schedule D (Form 1040)
Use Schedule D to report sales, exchanges, and other dispositions of capital assets.

Form 4797
Use Form 4797 to report gain or loss from a sale, exchange, or involuntary conversion of property used in your trade or business or held for the production of rents or royalties. Form 4797 can be used with Form 1040, 1065, 1120, or 1120S.

Section 1231 gains and losses. Any section 1231 gains and losses are shown in Part I of Form 4797. It also includes ordinary gain figured in Part III.

Ordinary income due to depreciation recapture. The ordinary income due to the recapture of depreciation on personal property and additional depreciation on real property (as discussed in chapter 4) is figured in Part III. The ordinary income is carried to Part II of Form 4797 as an ordinary gain. Any remaining gain is carried to Part I as section 1231 gain, unless it is from a casualty or theft. Any remaining gain that is from a casualty or theft is carried to Form 4684.

Example
Jane Smith is single. At the beginning of 1997, she owned and operated Jane’s Dress Shop. On March 16, she traded the land and building where she operated her dress shop for other land and a building. She then opened the J. Smith Hardware Store. Jane also sold all the equipment she had used in her dress shop, as well as a vacant lot across the street from the shop used for customer parking. She reports these transactions as shown in the filled-in Form 4797 and Form 8824 at the end of this chapter.

Form 4797
Jane sold the equipment she used in her dress shop for $3,000. She originally paid $6,000 for it on January 20, 1986, and had fully depreciated it. Therefore, she realized a gain of $3,000. Because the gain was less than the $6,000 depreciation taken, all her gain is ordinary income from depreciation. This amount is reported in Part III of Form 4797 and entered in Part II on line 13.

The adjusted basis of the vacant lot (acquired in 1977) was $6,000, and its sales price was $8,000. Jane reports her $2,000 gain from the sale in Part I of Form 4797.

Because the sale occurred before May 7, 1997, the gain is a 28% rate gain.

Jane had a nonrecaptured net section 1231 loss of $1,200. She shows this amount in Part I on line 8. Since the net section 1231 gain of $2,000 is more than the nonrecaptured loss, that gain is treated as ordinary gain only up to the amount of the loss. Therefore, the loss amount of $1,200 on line 8 is entered as an ordinary gain in Part II of Form 4797 on line 12. The loss is also subtracted from the $2,000 gain on line 7. The $800 balance is entered on line 9.

Form 8824
Because Jane entered into a like-kind exchange by trading her business real property for other business real property, she must report the transaction on Form 8824 and attach the form to her tax return.

On lines 16 and 17 of Form 8824, Jane enters the fair market value (FMV) of her new property, $120,000, consisting of $95,000 for the building and $25,000 for the land. On line 18 she enters the adjusted basis of the old property, $60,000.
property, $100,000, consisting of $75,384 for the building and $24,616 for the land. Her realized gain on line 19 is $20,000. Under the like-kind exchange rules, this gain is not recognized. Jane enters “–0–” on line 20.

However, because there is additional depreciation on the old building of $19,010, Jane must determine whether any of her gain has to be recognized as ordinary income under the recapture rules. The old building has a FMV of $90,000. Had the transaction been a cash sale, Jane's ordinary income due to the additional depreciation would have been limited to the realized gain on the building, $14,616 ($90,000 − $75,384). That amount is less than the $95,000 FMV of the new building and, therefore, there is no ordinary income recognized on the exchange. The $14,616 ordinary income that does not have to be reported is carried over to the new building as additional depreciation. Jane enters “–0–” on line 21 of Form 8824 and on line 16 of Form 4797.

All of Jane's $20,000 gain is deferred (line 24). The basis of her new property (line 25) is $100,000, the same as the adjusted basis of her old property. Of that amount, $79,167 ($95,000 ÷ $120,000) is allocated to the building and $20,833 ($25,000 ÷ $120,000) is allocated to the land.

Summary
The entries in Part II, Form 4797, show an ordinary gain of $4,200, which is carried to line 14, Form 1040.
The entries in Part I, Form 4797, result in a gain of $800 from section 1231 transactions. This is treated as long-term capital gain and carried to line 11, Schedule D (Form 1040).
**Form 4797**

**Sales of Business Property**

(Also Involuntary Conversions and Recapture Amounts Under Sections 179 and 280F(b)(2))

> Attach to your tax return. > See separate instructions.

---

**Part I**: Sales or Exchanges of Property Used in a Trade or Business and Involuntary Conversions From Other Than Casualty or Theft—Property Held More Than 1 Year

<table>
<thead>
<tr>
<th>(a) Description of property</th>
<th>(b) Date acquired (mo., day, yr.)</th>
<th>(c) Date sold (mo., day, yr.)</th>
<th>(d) Gross sales price</th>
<th>(e) Depreciation allowed or allowable since acquisition</th>
<th>(f) Cost or other basis, plus improvements and expense of sale</th>
<th>(g) GAIN or (LOSS) for entire year. Subtract (f) from the sum of (d) and (e)</th>
<th>(h) 28% RATE GAIN or (LOSS)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Store</td>
<td>10-1-77</td>
<td>3-16-97</td>
<td>8,000</td>
<td>0</td>
<td>6,000</td>
<td>2,000</td>
<td>2,000</td>
</tr>
<tr>
<td>Gain, if any, from Form 4684, line 39</td>
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<tr>
<td>Section 1231 gain from installment sales from Form 6252, line 26 or 37</td>
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<tr>
<td>Section 1231 gain or (loss) from like-kind exchanges from Form 8824</td>
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<td>Gain, if any, from line 32, from other than casualty or theft</td>
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<tr>
<td>Combine lines 2 through 6 in columns (g) and (h). Enter gain or (loss) here, and on the appropriate line as follows:</td>
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<tr>
<td><strong>Partnerships</strong>—Enter the gain or (loss) on Form 1065, Schedule K, lines 6a and 6b. Skip lines 8, 9, 11, and 12 below.</td>
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<tr>
<td><strong>S corporations</strong>—Report the gain or (loss) following the instructions for Form 1120S, Schedule K, lines 5 and 6. Skip lines 8, 9, 11, and 12 below, unless line 7, column (g) is a gain and the S corporation is subject to the capital gains tax.</td>
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<tr>
<td>All others—If line 7, column (g) is zero or a loss, enter that amount on line 11 below and skip lines 8 and 9. If line 7, column (g) is a gain and you did not have any prior year section 1231 losses, or they were recaptured in an earlier year, enter the gain or (loss) in each column as a long-term capital gain or (loss) on Schedule D and skip lines 8, 9, and 12 below.</td>
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<tr>
<td>Nonrecaptured net section 1231 losses from prior years (see instructions)</td>
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<tr>
<td>Subtract line 8 from line 7. If zero or less, enter 0. Also enter on the appropriate line as follows (see instructions):</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td><strong>S corporations</strong>—Enter only the gain in column (g) on Schedule D (Form 1120S), line 14, and skip lines 11 and 12 below.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>All others—If line 9, column (g) is zero, enter the gain in column (g) on line 12 below. If line 9, column (g) is more than zero, enter the amount from line 8, column (g) on line 12 below, and enter the gain or (loss) in each column of line 9 as a long-term capital gain or (loss) on Schedule D.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* Corporations (other than S corporations) should not complete column (h). Partnerships and S corporations must complete column (h). All others must complete column (h) only if line 7, column (g), is a gain. 28% rate gain or loss includes all gains and losses in column (g) from sales, exchanges, or conversions (including installment payments received) either (a) before 5/7/97 or (b) after 7/28/97 for assets held more than 1 year but not more than 18 months.

---

**Part II**: Ordinary Gains and Losses

10 Ordinary gains and losses not included on lines 11 through 17 (include property held 1 year or less):

| 11 Loss, if any, from line 7, column (g) | 12 Gain, if any, from line 7, column (g) or amount from line 8, column (g) if applicable | 13 Gain, if any, from line 31 | 14 Net gain or (loss) from Form 4684, lines 31 and 38a | 15 Ordinary gain from installment sales from Form 6252, line 25 or 36 | 16 Ordinary gain or (loss) from like-kind exchanges from Form 8824 | 17 Recapute of section 179 expense deduction for partners and S corporation shareholders from property dispositions by partnerships and S corporations (see instructions) | 18 Combine lines 10 through 17 in column (g). Enter gain or (loss) here, and on the appropriate line as follows:

**a** For all except individual returns: Enter the gain or (loss) from line 18 on the return being filed.

**b** For individual returns:

(1) If the loss on line 11 includes a loss from Form 4684, line 35, column (b)(ii), enter that part of the loss here and on line 22 of Schedule A (Form 1040). Identify as from "Form 4797, line 18b(1)." See instructions.

(2) Redetermine the gain or (loss) on line 18, excluding the loss, if any, on line 18b(1). Enter here and on Form 1040, line 14.

18b(1) 4,200

18b(2) 4,200

---

For Paperwork Reduction Act Notice, see separate instructions.

Cat. No. 13086L

Form 4797 (1997)
Part III  Gain From Disposition of Property Under Sections 1245, 1250, 1252, 1254, and 1255

19  (a) Description of section 1245, 1250, 1252, 1254, or 1255 property:
    A  Store equipment
    B
    C
    D

These columns relate to the properties on lines 19A through 19D.

<table>
<thead>
<tr>
<th></th>
<th>Property A</th>
<th>Property B</th>
<th>Property C</th>
<th>Property D</th>
</tr>
</thead>
<tbody>
<tr>
<td>20</td>
<td>Gross sales price (Note: See line 1 before completing.)</td>
<td>20</td>
<td>3,000</td>
<td></td>
</tr>
<tr>
<td>21</td>
<td>Cost or other basis plus expense of sale</td>
<td>21</td>
<td>6,000</td>
<td></td>
</tr>
<tr>
<td>22</td>
<td>Depreciation (or depletion) allowed or allowable</td>
<td>22</td>
<td>6,000</td>
<td></td>
</tr>
<tr>
<td>23</td>
<td>Adjusted basis. Subtract line 22 from line 21</td>
<td>23</td>
<td>-0-</td>
<td></td>
</tr>
</tbody>
</table>

24 Total gain. Subtract line 23 from line 20

25 If section 1245 property:
   a Depreciation allowed or allowable from line 22
   b Enter the smaller of line 24 or 25a

26 If section 1250 property: If straight line depreciation was used, enter -0- on line 26g, except for a corporation subject to section 291.
   a Additional depreciation after 1975 (see instructions)
   b Applicable percentage multiplied by the smaller of line 24 or line 26a (see instructions)
   c Subtract line 26a from line 24. If residential rental property or line 24 is not more than line 26a, skip lines 26d and 26e
   d Additional depreciation after 1969 and before 1976
   e Enter the smaller of line 26c or 26d
   f Section 291 amount (corporations only)
   g Add lines 26b, 26c, and 26d

27 If section 1252 property: Skip this section if you did not dispose of farmland or if this form is being completed for a partnership.
   a Soil, water, and land clearing expenses
   b Line 27a multiplied by applicable percentage (see instructions)
   c Enter the smaller of line 24 or 27b

28 If section 1254 property:
   a Intangible drilling and development costs, expenditures for development of mines and other natural deposits, and mining exploration costs (see instructions)
   b Enter the smaller of line 24 or 27b

29 If section 1255 property:
   a Applicable percentage of payments excluded from income under section 126 (see instructions)
   b Enter the smaller of line 24 or 27b

Summary of Part III Gains. Complete property columns A through D through line 29b before going to line 30.

30 Total gains for all properties. Add property columns A through D, line 24

31 Add property columns A through D, lines 25b, 26g, 27c, 28b, and 29b. Enter here and on line 13

32 Subtract line 31 from line 30. Enter the portion from casualty or theft on Form 4684, line 33. Enter the portion from other than casualty or theft on Form 4797, line 6, column (g), and if applicable, column (h)

Part IV  Recapture Amounts Under Sections 179 and 280F(b)(2) When Business Use Drops to 50% or Less
See instructions.

<table>
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<th></th>
<th>(a) Section 179</th>
<th>(b) Section 280F(b)(2)</th>
</tr>
</thead>
<tbody>
<tr>
<td>33</td>
<td>Section 179 expense deduction or depreciation allowable in prior years</td>
<td>33</td>
</tr>
<tr>
<td>34</td>
<td>Recomputed depreciation. See instructions</td>
<td>34</td>
</tr>
<tr>
<td>35</td>
<td>Recapture amount. Subtract line 34 from line 33. See the instructions for where to report</td>
<td>35</td>
</tr>
</tbody>
</table>
Part I Information on the Like-Kind Exchange

Note: If the property described on line 1 or line 2 is real or personal property located outside the United States, indicate the country.

1 Description of like-kind property given up ► Commercial building and land

2 Description of like-kind property received ► Commercial building and land

3 Date like-kind property given up was originally acquired (month, day, year) .................................................. 3 1 / 20 / 86

4 Date you actually transferred your property to other party (month, day, year) .................................................. 4 3 / 16 / 97

5 Date the like-kind property you received was identified (month, day, year). See instructions 5 3 / 16 / 97

6 Date you actually received the like-kind property from other party (month, day, year) ........................................ 6 3 / 16 / 97

7 Was the exchange made with a related party? If “Yes,” complete Part II. If “No,” go to Part III. See instructions.
    a Yes, in this tax year     b Yes, in a prior tax year   c No.

Part II Related Party Exchange Information

8 Name of related party Related party’s identifying number

9 During this tax year (and before the date that is 2 years after the last transfer of property that was part of the exchange), did the related party sell or dispose of the like-kind property received from you in the exchange? □ Yes □ No

10 During this tax year (and before the date that is 2 years after the last transfer of property that was part of the exchange), did you sell or dispose of the like-kind property you received? □ Yes □ No

If both lines 9 and 10 are “No” and this is the year of the exchange, go to Part III. If either line 9 or line 10 is “Yes,” the deferred gain or (loss) from line 24 must be reported on your return this tax year, unless one of the exceptions on line 11 applies. See Related party exchanges in the instructions.

11 If one of the exceptions below applies to the disposition, check the applicable box:
    a ☐ The disposition was after the death of either of the related parties.
    b ☐ The disposition was an involuntary conversion, and the threat of conversion occurred after the exchange.
    c ☐ You can establish to the satisfaction of the IRS that neither the exchange nor the disposition had tax avoidance as its principal purpose. If this box is checked, attach an explanation. See instructions.

Part III Realized Gain or (Loss), Recognized Gain, and Basis of Like-Kind Property Received

Caution: If you transferred and received (a) more than one group of like-kind properties, or (b) cash or other (not like-kind) property, see Reporting of multi-asset exchanges in the instructions.

Note: Complete lines 12 through 14 ONLY if you gave up property that was not like-kind. Otherwise, go to line 15.

12 Fair market value (FMV) of other property given up ................................................................. 12 120,000 00

13 Adjusted basis of other property given up ......................................................................................... 13 120,000 00

14 Gain (or loss) recognized on other property given up. Subtract line 13 from line 12. Report the gain or (loss) in the same manner as if the exchange had been a sale .................................................. 14 0

15 Cash received, FMV of other property received, plus net liabilities assumed by other party, reduced (but not below zero) by any exchange expenses you incurred. See instructions ................................................................. 15 0

16 FMV of like-kind property you received ......................................................................................... 16 120,000 00

17 Add lines 15 and 16 ......................................................................................................................... 17 240,000 00

18 Adjusted basis of like-kind property you gave up, net amounts paid to other party, plus any exchange expenses not used on line 15. See instructions ................................................................. 18 0

19 Realized gain or (loss). Subtract line 18 from line 17 ........................................................................ 19 240,000 00

20 Enter the smaller of line 15 or line 19, but not less than zero ......................................................... 20 0

21 Ordinary income under recapture rules. Enter here and on Form 4797, line 16. See instructions ................................................................................................................................. 21 0

22 Subtract line 21 from line 20. If zero or less, enter -0-. If more than zero, enter here and on Schedule D or Form 4797, unless the installment method applies. See instructions ........................................................................ 22 -0

23 Recognized gain. Add lines 21 and 22 .......................................................................................... 23 0

24 Deferred gain or (loss). Subtract line 23 from line 19. If a related party exchange, see instructions ................................................................................................................................. 24 240,000 00

25 Basis of like-kind property received. Subtract line 15 from the sum of lines 18 and 23 ......................................................................................................................................................... 25 0
6. How To Get More Information

You can get help from IRS in several ways.

**Free publications and forms.** To order free publications and forms, call 1–800–TAX–FORM (1–800–829–3676). You can also write to the IRS Forms Distribution Center nearest you. Check your income tax package for the address. Your local library or post office also may have the items you need.

For a list of free tax publications, order Publication 910, Guide to Free Tax Services. It also contains an index of tax topics and related publications and describes other free tax information services available from IRS, including tax education and assistance programs.

If you have access to a personal computer and modem, you also can get many forms and publications electronically. See Quick and Easy Access to Tax Help and Forms in your income tax package for details.

**Tax questions.** You can call the IRS with your tax questions. Check your income tax package or telephone book for the local number, or you can call 1–800–829–1040.

**TTY/TDD equipment.** If you have access to TTY/TDD equipment, you can call 1–800–829–4059 to ask questions or to order forms and publications. See your income tax package for the hours of operation.

**Evaluating the quality of our telephone services.** To ensure that IRS representatives give accurate, courteous, and professional answers, we evaluate the quality of our “800 number” telephone services in several ways.

- A second IRS representative sometimes monitors live telephone calls. That person only evaluates the IRS assistor and does not keep a record of any taxpayer’s name or tax identification number.
- We sometimes record telephone calls to evaluate IRS assistors objectively. We hold these recordings no longer than one week and use them only to measure the quality of assistance.
- We value our customers’ opinions. Throughout this year, we will be surveying our customers for their opinions on our service.
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- **17** Your Federal Income Tax (For Individuals)
- **225** Farmer’s Tax Guide
- **509** Tax Calendars for 1998
- **553** Highlights of 1997 Tax Changes
- **595** Tax Highlights for Commercial Fishermen
- **910** Guide to Free Tax Services

#### Specialized Publications
- **3** Armed Forces’ Tax Guide
- **378** Fuel Tax Credits and Refunds
- **463** Travel, Entertainment, Gift, and Car Expenses
- **501** Exemptions, Standard Deduction, and Filing Information
- **502** Medical and Dental Expenses
- **503** Child and Dependent Care Expenses
- **504** Divorced or Separated Individuals
- **505** Tax Withholding and Estimated Tax
- **508** Educational Expenses
- **514** Foreign Tax Credit for Individuals
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- **519** U.S. Tax Guide for Aliens
- **520** Scholarships and Fellowships
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### Commonly Used Tax Forms

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- **15P** Derechos del Contribuyente
- **579SP** Cómo Preparar la Declaración de Impuesto Federal
- **594SP** Comprendiendo el Proceso de Cobro
- **596SP** Crédito por Ingreso del Trabajo
- **850** English-Spanish Glossary of Words and Phrases Used in Publications Issued by the Internal Revenue Service
- **1544SP** Informe de Pagos en Efectivo en Exceso de $10,000 (Recibidos en una Ocupación o Negocio)