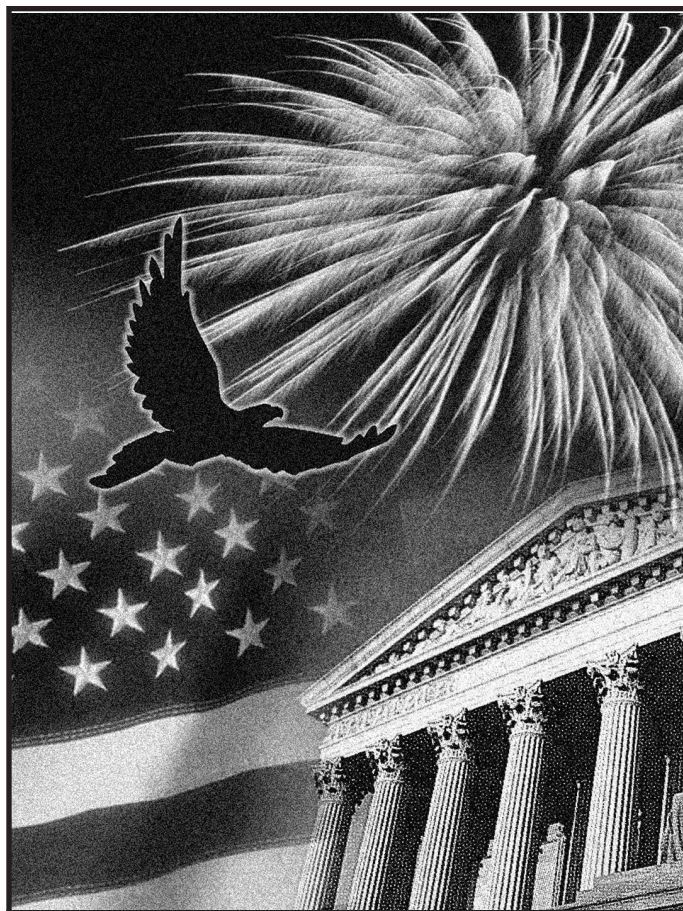




Publication 544

# Sales and Other Dispositions of Assets

For use in preparing  
**2024** Returns



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## Future Developments

For the latest information about developments related to Pub. 544, such as legislation enacted after it was published, go to [IRS.gov/Pub544](https://www.irs.gov/pub544).

## Important Reminders

**Dispositions of U.S. real property interests by foreign persons.** If you are a foreign person or firm and you sell or otherwise dispose of a U.S. real property interest, the buyer (or other transferee) may have to withhold income tax on the amount you receive for the property (including cash, the FMV of other property, and any assumed liability). Corporations, partnerships, trusts, and estates may

also have to withhold on certain U.S. real property interests they distribute to you. You must report these dispositions and distributions and any income tax withheld on your U.S. income tax return.

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

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

**Photographs of missing children.** The Internal Revenue Service is a proud partner with the [National Center for Missing & Exploited Children® \(NCMEC\)](#). Photographs of missing children selected by the Center may appear in this publication on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling 1-800-THE-LOST (1-800-843-5678) if you recognize a child.

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## Introduction

You dispose of property when any of the following occur.

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

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

- How to figure a gain or loss on the sale, exchange, and other disposition of property.
- Whether your gain or loss is ordinary or capital.
- How to treat your gain or loss when you dispose of business property.
- How to report a gain or loss on your tax return.

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

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

- Most transactions involving stocks, bonds, options, forward and futures contracts, and similar investments. See chapter 4 of Pub. 550, Investment Income and Expenses.

- Sale of your main home. See Pub. 523, Selling Your Home.
- Installment sales. See Pub. 537, Installment Sales.
- Transfers of property at death. See Pub. 559, Survivors, Executors, and Administrators.

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

**Comments and suggestions.** We welcome your comments about this publication and suggestions for future editions.

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# 1.

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## Gain or Loss

### Topics

This chapter discusses:

- Sales and exchanges
- Abandonments
- Foreclosures and repossessions
- Involuntary conversions
- Nontaxable exchanges
- Transfers to spouse
- Rollovers, exclusions, and deferrals of certain capital gains

### Useful Items

You may want to see:

#### Publication

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

#### Form (and Instructions)

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

See [How To Get Tax Help](#) at the end of this publication for information about getting publications and forms.

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## Sales and Exchanges

A sale is a transfer of property for money or a mortgage, note, or other promise to pay money. An exchange is a

transfer of property for other property or services. Property sold or exchanged may include the sale of a portion of a Modified Accelerated Cost Recovery System (MACRS) asset (discussed later).

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

## Gain or Loss From Sales and Exchanges

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

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

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

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

**Inherited property.** If you inherited property and received a Schedule A (Form 8971) that indicates that the

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

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

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

**Fair market value (FMV).** 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 is being forced to buy or sell. If parties with adverse interests place a value on property in an arm's-length transaction, that is strong evidence of FMV. If there is a stated price for services, this price is treated as the FMV unless there is evidence to the contrary.

**Example 1.** You used a building in your business that cost you \$70,000. You made certain permanent improvements at a cost of \$20,000 and deducted depreciation totaling \$10,000. You sold the building for \$100,000 plus property having an FMV of \$20,000. The buyer assumed your real estate taxes of \$3,000 and a mortgage of \$17,000 on the building. The selling expenses were \$4,000. Your gain on the sale is figured as follows.

Amount realized:		
Cash	\$100,000	
FMV of property received	20,000	
Real estate taxes assumed by buyer	3,000	
Mortgage assumed by buyer	17,000	
Total	140,000	
Minus: Selling expenses	(4,000)	\$136,000
Adjusted basis:		
Cost of building	\$70,000	
Improvements	20,000	
Total	\$90,000	
Minus: Depreciation	(10,000)	
Adjusted basis		\$80,000
<b>Gain on sale</b>		<b>\$56,000</b>

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

Amount realized:	
Cash	\$1,000
Adjusted basis:	
Cost of elevator	\$5,000
Minus: Depreciation	(2,500)
Adjusted basis	\$2,500
<b>Loss on sale</b>	<b>\$1,500</b>

**Example 3.** You own a bulldozer that cost you \$30,000. You use the bulldozer in your business. The bulldozer is a MACRS asset. You replaced the old bucket on the bulldozer and sold it for \$800. You determine the cost of the portion of the bulldozer attributable to the old bucket is \$4,000. Depreciation deducted on the old bucket portion of the bulldozer was \$3,800 before its sale. The sale of the bucket is a sale of a portion of a MACRS asset, the bulldozer. Your gain on the sale of the bucket is figured as follows.

Amount realized:	
Cash	\$800
Adjusted basis:	
Cost of bucket	\$4,000
Minus: Depreciation	(3,800)
Adjusted basis	\$200
<b>Gain on sale</b>	<b>\$600</b>

**Amount recognized.** Your gain or loss realized from a sale or exchange of property is usually a recognized gain or loss for tax purposes. This includes a gain or loss realized from a sale or exchange of a portion of a MACRS asset. Recognized gains must be included in gross income. Recognized losses are deductible from gross income. However, your gain or loss realized from certain exchanges of property is not recognized for tax purposes.

See [Nontaxable Exchanges](#), later. Also, a loss from the sale or other disposition of property held for personal use is not deductible, except in the case of a casualty or theft loss.

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

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

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

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

## Bargain Sale

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

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

Adjusted basis of entire property	×	Amount realized (FMV of part sold)	
			FMV of entire property

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

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

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

Sales price	2,000
Minus: Adjusted basis of part sold (\$4,000 × (\$2,000 ÷ \$10,000))	(800)
<b>Gain on the sale</b>	<b>\$1,200</b>

## Property Used Partly for Business or Rental

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

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

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

## Property Changed to Business or Rental Use

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

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

Figure the loss you can deduct as follows.

1. Use the lesser of the property's adjusted basis or FMV at the time of the change.
2. Add to (1) the cost of any improvements and other increases to basis since the change.
3. Subtract from (2) depreciation and any other decreases to basis since the change.
4. Subtract the amount you realized on the sale from the result in (3). If the amount you realized is more than the result in (3), treat this result as zero.

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

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

Lesser of adjusted basis or FMV at time of the change	\$70,000
Plus: Cost of any improvements and any other additions to basis after the change	-0-
	\$70,000
Minus: Depreciation and any other decreases to basis after the change	(12,620)
	\$57,380
Minus: Amount you realized from the sale	(55,000)
<b>Deductible loss</b>	<b>\$2,380</b>

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

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

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

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## Partial Dispositions of MACRS Property

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

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

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

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

- Sale of a portion of a MACRS asset.
- Involuntary conversion of a portion of a MACRS asset, other than from a casualty or theft.
- Like-kind exchange of a portion of a MACRS asset (Form 4797, line 5 or 16).

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## Abandonments

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

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

**Partial disposition election.** You make a partial disposition election by reporting the loss (or gain) on your timely filed original tax return, including extensions, for the tax year in which the portion of a MACRS asset is abandoned. If you make a partial disposition election for an asset included in one of the asset classes 00.11 through 00.4 of Rev-

enue Procedure 87-56, you must classify the replacement portion under the same asset class as the disposed portion of the asset. The adjusted basis of the disposed portion of the asset is used to figure gain or loss. See *Adjusted Basis* in Pub. 551 for more details and examples.

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

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



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

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

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

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

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

**Forms 1099-A and 1099-C.** If you abandon property that secures a loan and the lender knows the property has been abandoned, the lender should send you Form 1099-A showing information you need to figure your loss from the abandonment. However, if your debt is canceled and the lender must file Form 1099-C, the lender may include the information about the abandonment on that form instead of on Form 1099-A, and send you Form 1099-C only. The lender must file Form 1099-C and send you a copy if the amount of debt canceled is \$600 or more and the lender is a financial institution, a credit union, a federal government agency, or any organization that has a significant trade or business of lending money. For abandonments of property and debt cancellations occurring in 2024, these forms should be sent to you by January 31, 2025.

# Foreclosures and Repossessions

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

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



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

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

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

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

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

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

You are treated as receiving ordinary income from the canceled debt for the part of the debt that is more than the FMV. The amount realized does not include the canceled debt that is your income from cancellation of debt. See [Cancellation of debt](#), later.

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

**Cancellation of debt.** If property that is repossessed or foreclosed on secures a debt for which you are personally liable (recourse debt), you must generally report as ordinary income the amount by which the canceled debt is more than the FMV 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.



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

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

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

File Form 982 to report the income exclusion.

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

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

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

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

**Forms 1099-A and 1099-C.** A lender who acquires an interest in your property in a foreclosure or repossession should send you Form 1099-A showing the information you need to figure your gain or loss. However, if the lender also cancels part of your debt and must file Form 1099-C, the lender may include the information about the foreclosure or repossession on that form instead of on Form 1099-A and send you Form 1099-C only. The lender must file Form 1099-C and send you a copy if the amount of debt canceled is \$600 or more and the lender is a financial institution, a credit union, a federal government agency, or any organization that has a significant trade or business of lending money. For foreclosures or repossessions occurring in 2024, these forms should be sent to you by January 31, 2025.

## Involuntary Conversions

An involuntary conversion occurs when your property is destroyed, stolen, condemned, or disposed of under the threat of condemnation and you receive other property or money in payment, such as insurance or a condemnation award. Involuntary conversions are also called involuntary exchanges.  
Gain or loss from an involuntary conversion of your property is usually recognized for tax purposes unless the

property is your main home. You report the gain or deduct the loss on your tax return for the year you realize it. You cannot deduct a loss from an involuntary conversion of property you held for personal use unless the loss resulted from a casualty or theft.  
However, depending on the type of property you receive, you may not have to report a gain on an involuntary conversion. Generally, you do not report the gain if you receive property that is similar or related in service or use to the converted property. Your basis for the new property is the same as your basis for the converted property. This means that the gain is deferred until a taxable sale or exchange occurs.

If you receive money or property that is not similar or related in service or use to the involuntarily converted property and you buy qualifying replacement property within a certain period of time, you can elect to postpone reporting the gain on the property purchased.  
If a portion of a MACRS asset you own is involuntarily converted and gain is not recognized in whole or in part, the partial disposition rules in Regulations section 1.168(i)-8 apply.

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

## Condemnations

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

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

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

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

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

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

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

## Gain or Loss From Condemnations

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

If your net condemnation award is more than the adjusted basis of the condemned property, you have a gain.

You can postpone reporting gain from a condemnation if you buy replacement property. If only part of your property is condemned, you can treat the cost of restoring the remaining part to its former usefulness as the cost of replacement property. See [Postponement of Gain](#), later.

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



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

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

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

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

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

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

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

**Net condemnation award.** A net condemnation award is the total award you received, or are considered to have received, for the condemned property minus your expenses of obtaining the award. If only a part of your property was condemned, you must also reduce the award by any special assessment levied against the part of the

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

Keep for Your Records



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

property you retain. This is discussed later under [Special assessment retained 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 specific amount of severance damages in writing. If this is not done, all proceeds from the condemning authority are considered awarded for your condemned property.

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

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

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

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

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

**Net severance damages.** To figure your net severance damages, you must first reduce your severance

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

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

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

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

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

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

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

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

**Example.** You were awarded \$4,000 for the condemnation of your property and \$1,000 for severance

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

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

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

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

	Residential Part	Business Part
1) Condemnation award received . . . . .	\$12,000	\$12,000
2) Minus: Legal expenses, \$200 . . . . .	(100)	(100)
3) Net condemnation award . . . . .	\$11,900	\$11,900
4) Adjusted basis:		
1/2 of original cost, \$25,000 . . . . .	\$12,500	\$12,500
Plus: 1/2 of cost of roof, \$1,000 . . . . .	500	500
Total . . . . .	\$13,000	\$13,000
5) Minus: Depreciation . . . . .		(4,600)
6) Adjusted basis, business part . . . . .		\$8,400
7) (Loss) on residential property . . . . .	(\$1,100)	
8) Gain on business property . . . . .		\$3,500

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

Postponement of Gain

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

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

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

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



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

**Postponing gain on severance damages.** If you received severance damages for part of your property because another part was condemned and you buy replacement property, you can elect to postpone reporting gain. See [Treatment of severance damages](#), earlier. You can postpone reporting all your gain if the replacement property costs at least as much as your net severance damages plus your net condemnation award (if resulting in gain).

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

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

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

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

This rule applies to the following taxpayers.

1. C corporations.
2. Partnerships in which more than 50% of the capital or profits interest is owned by C corporations.

3. All others (including individuals, partnerships (other than those in (2)), and S corporations) if the total realized gain for the tax year on all involuntarily converted properties on which there is realized gain of more than \$100,000.

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

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

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

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

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

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

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

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

**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 all of the following information.

- Whether the properties are of similar service to you.
- The nature of the business risks connected with the properties.

- 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 built on other land you already owned. You rented out the new building for use as a wholesale grocery warehouse. The replacement property is also rental property, so the two properties are considered similar or related in service or use if there is a similarity in all of the following areas.

- Your management activities.
- The amount and kind of services you provide to your tenants.
- The nature of your business risks connected with the properties.

**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.

A fee simple property interest is generally a property interest that entitles the owner 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 real property.** You can elect 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 bought to replace a destroyed billboard and leased property on which the billboard was located qualify as property of a like-kind.

You can make this election only if you did not claim a section 179 deduction for the display. Also, you cannot cancel this election unless you get the consent of the IRS.

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 to display a commercial or other advertisement to the public.

**Substituting replacement property.** Once you designate certain property as replacement property on your tax return, you cannot substitute other qualified property. But, if your previously designated replacement property does not qualify, you can substitute 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 stock entitled to vote and at least 80% of the total number of shares of all other classes of stock of the corporation.

**Basis adjustment to corporation's property.** The basis of property held by the corporation at the time you acquired control must be reduced by your postponed gain, if any. You are not required to reduce the adjusted basis of the corporation's properties below your adjusted basis in the corporation's stock (determined after reduction by your postponed 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).
3. All other property.

If two or more properties fall in the same class, allocate the reduction to each property in proportion to the adjusted basis of all the properties in that class. The reduced basis of any single property cannot be less than zero.

**Main home replaced.** If your gain from a condemnation of your main home is more than you can exclude from your income (see [Main home condemned](#) under *Gain or Loss From Condemnations*, earlier), you can postpone reporting the rest of the gain by buying replacement property that is similar or related in service or use. The replacement property must cost at least as much as the amount realized from the condemnation minus the excluded gain.

You must reduce the basis of your replacement property by the postponed gain. Also, if you postpone reporting any part of your gain under these rules, you are treated as having owned and used the replacement property as your main home for the period you owned and used the condemned property as your main home.

**Example.** City authorities condemned your home that you had used as a personal residence for 5 years prior to the condemnation. The city paid you a condemnation award of \$400,000. Your adjusted basis in the property was \$80,000. You realize a gain of \$320,000 (\$400,000 – \$80,000). You purchased a new home for \$100,000. You can exclude \$250,000 of the realized gain from your gross income. The amount realized is then treated as being \$150,000 (\$400,000 – \$250,000) and the gain realized is \$70,000 (\$150,000 amount realized – \$80,000 adjusted basis). You must recognize \$50,000 of the gain (\$150,000 amount realized – \$100,000 cost of new home). The remaining \$20,000 of realized gain is postponed. Your basis in the new home is \$80,000 (\$100,000 cost – \$20,000 gain postponed).

**Replacement period.** To postpone reporting your gain from a condemnation, you must buy replacement property within a certain period of time. This is the replacement period.

The replacement period for a condemnation begins on the earlier of the following dates.

- The date on which you disposed of the condemned property.
- The date on which the threat of condemnation began.

The replacement period generally ends 2 years after the end of the first tax year in which any part of the gain on the condemnation is realized. However, see the exceptions below.

**Real property held for use in a trade or business or for investment.** If 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 end 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 replace the condemned property by acquiring control of a corporation owning property that is similar or related in service or use.

**Main home in disaster area.** For your main home (or its contents) located in a federally declared disaster area, the replacement period generally ends 4 years after the close of the first tax year in which any part of your gain is realized.

For more information, go to [IRS.gov/UAC/Tax-Relief-in-Disaster-Situations](https://www.irs.gov/UAC/Tax-Relief-in-Disaster-Situations).

**Weather-related sales of livestock in an area eligible for federal assistance.** Generally, if the sale or exchange of livestock is due to drought, flood, or other weather-related conditions in an area eligible for federal assistance, the replacement period ends 4 years after the close of the first tax year in which you realize any part of your gain from the sale or exchange.

If the weather-related conditions continue for longer than 3 years, the replacement period may be extended on a regional basis until the end of your first drought-free year for the applicable region. See Notice 2006-82, 2006-39 I.R.B. 529, available at [IRS.gov/irb/2006-39\\_IRB#NOT-2006-82](https://www.irs.gov/irb/2006-39_IRB#NOT-2006-82).

Each year, the IRS publishes a list of counties, districts, cities, or parishes for which exceptional, extreme, or severe drought was reported during the preceding 12 months. If you qualified for a 4-year replacement period for livestock sold or exchanged on account of drought and your replacement period is scheduled to expire at the end of 2024 (or at the end of the tax year that includes August 31, 2024), see Notice 2024-70, 2024-43 I.R.B. 1001, available at [IRS.gov/irb/2024-43\\_IRB#NOT-2024-70](https://www.irs.gov/irb/2024-43_IRB#NOT-2024-70). The replacement period will be extended under Notice 2006-82 if the applicable region is on the list included in Notice 2024-70.

**Determining when gain is realized.** If you are a cash basis taxpayer, you realize gain when you receive payments that are more than your basis in the property. If the condemning authority makes deposits with the court, you realize gain when you withdraw (or have the right to withdraw) amounts that are more than your basis.

This applies even if the amounts received are only partial or advance payments and the full 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 earlier year when either of the following occurs.

- All events have occurred that fix the right to the condemnation award and the amount can be determined with reasonable accuracy.
- 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 with the 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 bought before the condemnation.** If you buy 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 bought 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, 2023, city authorities notified you that your property would be condemned. On June 5, 2023, you acquired property to replace the property to be condemned. You still had the new property when the city took possession of your old property on September 4, 2024. You have made a replacement within the replacement period.

**Extension.** You should request an extension before the end of the replacement period. However, you can file your request within a reasonable time after the replacement period ends if you have a good reason for the delay. An extension may be granted if you can show there is reasonable cause for not making the replacement within the replacement period.

Ordinarily, requests for extensions aren't made or granted until near the end of the replacement period or the extended replacement period. Extensions are usually limited to 1 year. The high market value or scarcity of replacement property isn't sufficient grounds for granting an extension. If your replacement property is being constructed and you clearly show that the construction can't be completed within the replacement period, you may be granted an extension of the period.

Send your request to the address where you filed your return, addressed as follows.

Extension Request for Replacement Period of  
Involuntarily Converted Property  
Area Director  
Attn: Area Technical Services, Compliance Function

The submission should include a cover sheet with the following information.

- Attention: SB/SE Field Examination Area Director [Your State].
- Subject: 1033 Extension Request for Replacement Period of Involuntarily Converted Property.

- Sender's name, title, phone number, and address.
- Date.
- Number of pages (including cover sheet).

Your request must contain all the details outlining your need for the extension, to include, but not limited to:

- Name, address, and social security number or taxpayer identification number of the taxpayer;
- Legal descriptions of property converted;
- Date property was converted;
- Adjusted basis of converted property;
- Date(s) and amount(s) of payment(s) received;
- Copy of return that related to the deferral of the gain; and
- Statement of action taken to replace the property.

**Election to postpone gain.** Report your election to postpone reporting your gain, along with all necessary details, on a statement attached to your return for the tax year in which you realize the gain.

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

***Replacement property acquired after return filed.***

If you buy the replacement property after you file your return reporting your election to postpone reporting the gain, attach a statement to your return for the year in which you buy the property. The statement should contain detailed information on the replacement property.

***Amended return.*** If you elect to postpone reporting gain, you must file an amended return for the year of the gain (individuals file Form 1040-X) in either of the following situations.

- You do not buy replacement property within the replacement period. On your amended return, you must report the gain and pay any additional tax due.
- The replacement property you buy costs less than the amount realized for the condemned property (minus the gain you excluded from income if the property was your main home). On your amended return, you must report the part of the gain you cannot postpone reporting and pay any additional tax due.

***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 director for your area that you have replaced, or intend not to replace, the condemned property within the replacement period.

***Changing your mind.*** You can change your mind about reporting or postponing the gain at any time before the end of the replacement period. If you decide to make an election after filing the tax return and after making the payment of the tax due for the year or years in which any of the gain on the involuntary conversion is realized, and before the expiration of the period with which the

converted property must be replaced, file a claim for refund for such year or years.

***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 realized 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 reporting the \$4,000 of gain equal to the amount you spent for the replacement property. You should file a claim for refund on Form 1040-X (or other applicable amended return). Include a statement explaining that you previously reported the entire gain from the condemnation, but you now want to report only the part of the gain equal to the condemnation proceeds not spent for replacement property (\$1,000).

## Reporting a Condemnation Gain or Loss

Generally, you report gain or loss from a condemnation on your return for the year you realize the gain or loss.

**Personal-use property.** Report gain from a condemnation of property you held for personal use (other than excluded gain from a condemnation of your main home or postponed gain) on Form 8949 or Schedule D (Form 1040), as applicable. See the Instructions for Form 8949 and the Instructions for Schedule D (Form 1040).

Do not report loss from a condemnation of personal-use property. But, if you received a Form 1099-S (for example, showing the proceeds of a sale of real estate under threat of condemnation), you must show the transaction on Form 8949 and Schedule D (Form 1040), as applicable, even though the loss is not deductible. See the Instructions for Schedule D (Form 1040) and the Instructions for Form 8949.

**Business property.** Report gain (other than postponed gain) or loss from a condemnation of property you held for business or profit on Form 4797. If you had a gain, you may have to report all or part of it as ordinary income. See [Like-kind exchanges and involuntary conversions](#) in chapter 3.

## Nontaxable Exchanges

Certain exchanges of property are not taxable. This means any gain from the exchange is not recognized, and any loss cannot be deducted. Your gain or loss will not be recognized until you sell or otherwise dispose of the property you receive.

## Like-Kind Exchanges

Generally, if you exchange real property you hold for use in a trade or business or hold for investment solely for other like-kind real property held for use in a trade or business or investment, you do not recognize the gain or loss

from the exchange. However, if you receive non-like-kind property or money as part of the exchange, you recognize gain to the extent of the value of the other property or money you received in the exchange. See [Qualifying Property](#), later, for details on property that qualifies and for exceptions.

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 given up (relinquished property) and the property received (replacement property) must be both of the following.

- Qualifying property.
- Like-kind property.

These two requirements are discussed later.

Additional requirements apply to exchanges in which the property received as like-kind property is not received immediately upon the transfer of the property given up. See [Deferred Exchange](#), later.

If the like-kind exchange involves the receipt of money or unlike property or the assumption of your liabilities, see [Partially Nontaxable Exchanges](#), later.

If the like-kind exchange involves a portion of a MACRS asset and gain is not recognized in whole or in part, the partial disposition rules in Regulations section 1.168(i)-8 apply. See [Partial Dispositions of MACRS Property](#), earlier.

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

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

**Basis of property received.** If you acquire property in a like-kind exchange, the basis of the property you receive is generally the same as the basis of the property you transferred. See Pub. 551 for more information on basis.

**Example.** You exchanged real estate held for investment with an adjusted basis of \$225,000 for other real estate held for investment. The basis of your new property is the same as the basis of the old property, \$225,000.

For the basis of property received in an exchange that is only partially nontaxable, see [Partially Nontaxable Exchanges](#), later.

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

**Reporting the exchange.** Report the exchange of like-kind property, even though no gain or loss is recog-

nized, on Form 8824. The Instructions for Form 8824 explain how to report the details of the exchange.

If you have any recognized gain because you received money or non-like-kind property, report it on Form 8949, Schedule D (Form 1040), or Form 4797, as applicable. See chapter 4. You may have to report the recognized gain as ordinary income from depreciation recapture. See [Like-kind exchanges and involuntary conversions](#) in chapter 3.

**Exchange expenses.** Exchange expenses generally include the closing costs you pay on the disposition of the property given up such as brokerage commissions, attorney fees, and deed preparation fees. Subtract these expenses from the consideration received to figure the amount realized on the exchange. If you receive cash or non-like-kind property in addition to the like-kind real property and realize a gain on the exchange, subtract the expenses from the cash or FMV of the non-like-kind property. Then use the net amount to figure the recognized gain. See [Partially Nontaxable Exchanges](#), later.

Exchange expenses also include the closing costs you pay on the acquisition of replacement property. In addition, some expenses and receipts that may be reflected on the closing statement (for example, property taxes, rent prorations, security deposits, and repairs) are not exchange expenses. See [Partially Nontaxable Exchanges](#), later, and *Like-Kind Exchanges* in Pub. 551.

## Qualifying Property

The nonrecognition rules for like-kind exchanges apply only to exchanges of real property, as defined in Regulations section 1.1031(a)-1(a)(3), held for investment or for productive use in your trade or business and is not held primarily for sale.

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

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

- Real property used for personal purposes, such as your home.
- Real property held primarily for sale.
- Any personal or intangible property that is not defined as an interest in real property in Regulations section 1.1031(a)-3(a)(5).

You may have a nontaxable exchange under other rules. See [Other Nontaxable Exchanges](#), later.

A dwelling unit (home, apartment, condominium, or similar property) may, for purposes of a like-kind exchange, qualify as property held for productive use in a trade or business or for investment purposes if certain requirements are met. See Revenue Procedure 2008-16,

An exchange of the assets of a business for the assets of a similar business cannot be treated as an exchange of one property for another property except to the extent the transaction includes an exchange of like-kind real property. Whether you engaged in a like-kind exchange depends on an analysis of each asset involved in the exchange. The exchange of noncash assets that are not real property is considered non-like-kind property received or paid. See also [Multiple-Property Exchanges](#), later.

## Like-Kind Property

To qualify for the nonrecognition rules, there must be an exchange of like-kind property. Like-kind properties are properties of the same nature or character, even if they differ in grade or quality. The exchange of real estate for real estate is an exchange of like-kind 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 longer 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 or character of the two property interests is the same.

## Foreign Real Property Exchanges

Real property located in the United States and real property located outside the United States are not considered like-kind property. 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 reporting gain on the condemnation. See [Postponement of Gain](#) under *Involuntary Conversions*, earlier.

## Deferred Exchange

A deferred exchange is an exchange in which you transfer property you use in business or hold for investment and later receive like-kind property you will use in business or hold for investment. The property you receive is the replacement property. The transaction must be an exchange of property for property rather than a transfer of property

for money used to buy replacement property. In addition, the replacement property will not be treated as like-kind property unless the identification and the receipt requirements (discussed later) are met.

If, before you receive the replacement property, you actually or constructively receive money or non-like-kind property in full consideration for the property you transfer, 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 bought the replacement property instead of having acquired it through a like-kind exchange.

If, before you receive the replacement property, you actually or constructively receive money or non-like-kind property in less than full consideration for the property you transfer, the transaction will be treated as a partially taxable exchange. See [Partially Nontaxable Exchanges](#), later.

**Actual and constructive receipt.** For purposes of a deferred exchange, you actually receive money or non-like-kind property when you receive the money or non-like-kind property or receive the economic benefit of the money or non-like-kind property. You constructively receive money or non-like-kind property when the money or non-like-kind property is credited to your account, set apart for you, or otherwise made available for you so that you can draw upon it at any time or so that you can draw upon it if you give notice of intention to do so. You do not constructively receive money or non-like-kind property if your control of receiving it is subject to substantial limitations or restrictions. However, you constructively receive money or non-like-kind property when the limitations or restrictions lapse, expire, or are waived.

The following rules also apply.

- Whether you actually or constructively receive money or non-like-kind property is determined without regard to your method of accounting.
- Actual or constructive receipt of money or non-like-kind property by your agent is actual or constructive receipt by you.
- Whether you actually or constructively receive money or non-like-kind property is determined without regard to certain arrangements you make to ensure the other party carries out its obligations to transfer the replacement property to you. See [Safe Harbors Against Actual and Constructive Receipt in Deferred Exchanges](#), 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. This period of time is called the identification period. Any property received during the identification period 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 exchange period begin on the date of the earliest transfer.

**Identifying replacement property.** You must identify the replacement property in a signed written document and deliver it to the person obligated to transfer the replacement property or any other person involved in the exchange other than you or a disqualified person. See [Disqualified persons](#), later. You must clearly describe the replacement property in the written document. For example, use the legal description or street address for real property. In the same manner, you can cancel 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. However, regardless of the number of properties you give up, the maximum number of replacement properties you can identify is:

- Three properties regardless of their FMV; or
- Any number of properties whose total 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 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 exchange period, but only if the FMV of the property is at least 95% of the total FMV of all identified replacement properties. FMV is determined on the earlier of the date you received the property or the last day of the exchange period. See [Receipt requirement](#), later.

**Disregard incidental property.** For purposes of the identification requirement, do not treat property incidental to a larger item of property as separate from the larger item when you identify replacement property. Property is incidental if it meets both of the following tests.

- If, in a standard commercial transaction, it is typically transferred with the larger item; and
- The total FMV of all the incidental property is not more than 15% of the total FMV of the larger item of property.

For example, furniture, laundry machines, and other miscellaneous items of personal property will not be treated as separate property from an apartment building with an FMV of \$1,000,000, if the total FMV of the furniture, laundry machines, and other personal property does not exceed \$150,000.

**Note.** This rule applies only for purposes of determining whether the identification requirement is met. It does not apply for purposes of determining whether the incidental property is like-kind or non-like-kind for purposes of any gain recognized on the exchange. See [Partially Nontaxable Exchanges](#), later, for information on gain recognition

relating to the non-like-kind property received in a like-kind exchange.

**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.

**Receipt requirement.** The property must be received by the earlier of the following dates.

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

This period of time is called the exchange period. You must receive substantially the same property that met the identification requirement, discussed earlier.

**Replacement property produced after identification.** In some cases, the replacement property may have been produced after you identified it (as described earlier under [Replacement property to be produced](#)). In that case, to determine whether the property you received was substantially the same property that met the identification requirement, the property will be considered substantially the same property as identified only if, had production been completed on or before the date you received the replacement property:

- The property received would have been considered substantially the same property as identified, and
- To the extent the property is considered real property under local law.

Do not take into account any variations due to usual production changes. Substantial changes in the property to be produced, however, will disqualify it.

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.

**Interest income.** Generally, in a deferred exchange, if the amount of money or property you are entitled to receive depends upon the length of time between when you transfer the property given up and when you receive the replacement property, you are treated as being entitled to receive interest or a growth factor. The interest or growth factor will be treated as interest, regardless of whether it is paid in like-kind property, money, or non-like-kind property. Include this interest in your gross income according to your method of accounting.

If you transferred property in a deferred exchange and an exchange facilitator holds exchange funds for you and pays you all the earnings on the exchange funds according to an escrow agreement, trust agreement, or exchange agreement, you must take into account all items of

income, deduction, and credit attributable to the exchange funds.

If, in accordance with an escrow agreement, trust agreement, or exchange agreement, an exchange facilitator holds exchange funds for you and keeps some or all of the earnings on the exchange funds in accordance with the escrow agreement, trust agreement, or exchange agreement, you will be treated as if you had loaned the exchange funds to the exchange facilitator. You must include in income any interest that you receive and, if the loan is a below-market loan, you must include in income any imputed interest.

Exchange funds include relinquished property, cash, or cash equivalent that secures an obligation of a transferee to transfer replacement property, or proceeds from a transfer of relinquished property, held in a qualified escrow account, qualified trust, or other escrow account, trust, or fund in a deferred exchange.

An exchange facilitator is a qualified intermediary, transferee, escrow holder, trustee, or other person that holds exchange funds for you in a deferred exchange under the terms of an escrow agreement, trust agreement, or exchange agreement.

For more information relating to the current taxation of qualified escrow accounts, qualified trusts, and other escrow accounts, trusts, and funds used during deferred exchanges of like-kind property, see Regulations sections 1.468B-6 and 1.7872-16. If the exchange facilitator is a qualified intermediary, see [Safe Harbors Against Actual and Constructive Receipt in Deferred Exchanges](#), later.

**Disqualified persons.** A disqualified person is a person who is any of the following.

1. Your agent at the time of the transaction.
2. A person who is related to you under the rules discussed in chapter 2 under *Nondeductible loss*, substituting “10%” for “50%.”
3. A person who is related to a person who is your agent at the time of the transaction under the rules discussed in chapter 2 under *Nondeductible Loss*, substituting “10%” for “50%.”

For purposes of (1) above, a person who has acted as your employee, attorney, accountant, investment banker or broker, or real estate agent or broker within the 2-year period ending on the date of the transfer of the first of the relinquished properties is your agent at the time of the transaction. However, solely for purposes of whether a person is a disqualified person as your agent, the following services for you are not taken into account.

- Services with respect to exchanges of property intended to qualify for nonrecognition of gain or loss as like-kind exchanges.
- Routine financial, title insurance, escrow, or trust services by a financial institution, title insurance company, or escrow company.

The rule in (3) above does not apply to a bank or a bank affiliate if it would otherwise be a disqualified person

under the rule in (3) solely because it is a member of the same controlled group (as determined under section 267(f) of the Internal Revenue Code, substituting “10%” for “50%”) as a person that has provided investment banking or brokerage services to the taxpayer within the 2-year period ending on the date of the transfer of the first of the relinquished properties. For this purpose, a bank affiliate is a corporation whose principal activity is rendering services to facilitate exchanges of property intended to qualify for nonrecognition of gain under section 1031 of the Internal Revenue Code and all of whose stock is owned by either a bank or a bank-holding company.

## Safe Harbors Against Actual and Constructive Receipt in Deferred Exchanges

The following arrangements will not result in actual or constructive receipt of money or non-like-kind property in a deferred exchange.

- Security or guarantee arrangements.
- Qualified escrow accounts or qualified trusts.
- Qualified intermediaries.
- Interest or growth factors.

**Security or guarantee arrangements.** You will not actually or constructively receive money or non-like-kind property before you actually receive the like-kind replacement property just because your transferee's obligation to transfer the replacement property to you is secured or guaranteed by one or more of the following.

1. A mortgage, deed of trust, or other security interest in property (other than in cash or a cash equivalent).
2. A standby letter of credit that satisfies all the following requirements.
  - a. Not negotiable, whether by the terms of the letter of credit or under applicable local law.
  - b. Not transferable (except together with the evidence of indebtedness that it secures), whether by the terms of the letter of credit or under applicable local law.
  - c. Issued by a bank or other financial institution.
  - d. Serves as a guarantee of the evidence of indebtedness that is secured by the letter of credit.
  - e. May not be drawn on in the absence of a default in the transferee's obligation to transfer the replacement property to you.
3. A guarantee by a third person.

The protection against actual and constructive receipt ends when you have an immediate ability or unrestricted right to receive money or non-like-kind property under the security or guarantee arrangement.

**Qualified escrow account or qualified trust.** You will not actually or constructively receive money or non-like-kind property before you actually receive the

like-kind replacement property just because your transferor's obligation is secured by cash or cash equivalent if the cash or cash equivalent is held in a qualified escrow account or qualified trust. This rule applies for the amounts held in the qualified escrow account or qualified trust even if you receive money or non-like-kind property directly from a party to the exchange.

An escrow account is a qualified escrow account if both of the following conditions are met.

- The escrow holder is neither you nor a disqualified person. See [Disqualified persons](#), earlier.
- The escrow agreement expressly limits your rights to receive, pledge, borrow, or otherwise obtain the benefits of the cash or cash equivalent held in the escrow account. For more information on how to satisfy this condition, see [Additional restrictions on safe harbors](#), later.

A trust is a qualified trust if both of the following conditions are met.

- The trustee is neither you nor a disqualified person. See [Disqualified persons](#), earlier. For purposes of whether the trustee of a trust is a disqualified person, the relationship between you and the trustee created by the qualified trust will not be considered a relationship between you and a related person.
- The trust agreement expressly limits your rights to receive, pledge, borrow, or otherwise obtain the benefits of the cash or cash equivalent held by the trustee. For more information on how to satisfy this condition, see [Additional restrictions on safe harbors](#), later.

The protection against actual and constructive receipt ends when you have an immediate ability or unrestricted right to receive, pledge, borrow, or otherwise obtain the benefits of the cash or cash equivalent held in the qualified escrow account or qualified trust.

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

A qualified intermediary is a person who is not a disqualified person (discussed earlier) and who enters into a written exchange agreement with you and, as required by that agreement:

- Acquires the property you give up,
- Transfers the property you give up,
- Acquires the replacement property, and
- Transfers the replacement property to you.

For determining whether a qualified intermediary acquires and transfers property, the following rules apply.

- A qualified intermediary is treated as acquiring and transferring property if the qualified intermediary acquires and transfers legal title to that property.

- A qualified intermediary is treated as acquiring and transferring the property you give up if the qualified intermediary (either on its own behalf or as the agent of any party to the transaction) enters into an agreement with a person other than you for the transfer of that property to that person and, pursuant to that agreement, that property is transferred to that person (that is, by direct deed from you).
- A qualified intermediary is treated as acquiring and transferring replacement property if the qualified intermediary (either on its own behalf or as the agent of any party to the transaction) enters into an agreement with the owner of the replacement property for the transfer of that property and, pursuant to that agreement, the replacement property is transferred to you (that is, by direct deed to you).

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

The written exchange agreement must expressly limit your rights to receive, pledge, borrow, or otherwise obtain the benefits of money or unlike property held by the qualified intermediary.

**Safe harbor method for reporting gain or loss when qualified intermediary defaults.** Generally, if a qualified intermediary is unable to meet its contractual obligations to you or otherwise causes you not to meet the deadlines for identifying or receiving replacement property in a deferred or reverse exchange, your transaction may not qualify as a tax-free deferred exchange. In that case, any gain may be taxable in the current year.

However, if a qualified intermediary defaults on its obligation to acquire and transfer replacement property because of bankruptcy or receivership proceedings, and you meet the requirements of Revenue Procedure 2010-14, you may be treated as not having actual or constructive receipt of the proceeds of the exchange in the year of sale of the property you gave up. If you meet the requirements, you can report the gain in the year or years payments (or debt relief treated as payments) are received, using the safe harbor gross profit ratio method. See Revenue Procedure 2010-14, 2010-12 I.R.B. 456, available at [IRS.gov/irb/2010-12\\_IRB#RP-2010-14](https://www.irs.gov/irb/2010-12_IRB#RP-2010-14).

**Multiple-party transactions involving related persons.** If you transfer property given up to a qualified intermediary in exchange for replacement property formerly owned by a related person, you may not be entitled to nonrecognition treatment if the related person receives cash or non-like-kind property for the replacement property. (See [Like-Kind Exchanges Between Related Persons](#), later.)

**Interest or growth factors.** You will not be in actual or constructive receipt of money or non-like-kind property before you actually receive the like-kind replacement property just because you are or may be entitled to receive any interest or growth factor in the deferred exchange. This rule applies only if the agreement under which you are or

may be entitled to the interest or growth factor expressly limits your rights to receive the interest or growth factor during the exchange period. See *Additional restrictions on safe harbors* next.

**Additional restrictions on safe harbors.** In order to come within the protection of the safe harbors against actual and constructive receipt of money and non-like-kind property discussed above, the agreement must provide that you have no rights to receive, pledge, borrow, or otherwise obtain the benefits of money or non-like-kind property before the end of the exchange period. However, the agreement can provide you with the following limited sets of rights.

- If you have not identified replacement property by the end of the identification period, you can have rights to receive, pledge, borrow, or otherwise obtain the benefits of the cash or cash equivalent after the end of the identification period.
- If you have identified replacement property, you can have rights to receive, pledge, borrow, or otherwise obtain the benefits of the cash or cash equivalent when or after you receive all the replacement property you are entitled to receive under the exchange agreement.
- If you have identified replacement property, you can have rights to receive, pledge, borrow, or otherwise obtain the benefits of the cash or cash equivalent on the occurrence of a contingency that is related to the exchange, provided for in writing, and beyond your control or the control of any disqualified person other than the person obligated to transfer the replacement property.

## Like-Kind Exchanges Using Qualified Exchange Accommodation Arrangements

The like-kind exchange rules do not generally apply to an exchange in which you acquire replacement property (new property) before you transfer relinquished property (property you give up). However, if you use a qualified exchange accommodation arrangement (QEAA), the transfer may qualify as a like-kind exchange. For details, see Revenue Procedure 2000-37, 2000-40 I.R.B. 308, as modified by Revenue Procedure 2004-51, 2004-33 I.R.B. 294, available at [IRS.gov/irb/2004-33\\_IRB#RP-2004-51](https://www.irs.gov/irb/2004-33_IRB#RP-2004-51).

Under a QEAA, either the replacement property or the relinquished property is transferred to an exchange accommodation titleholder (EAT), discussed later, who is treated as the beneficial owner of the property. However, for transfers of qualified indications of ownership (defined later), the replacement property held in a QEAA may not be treated as property received in an exchange if you previously owned it within 180 days of its transfer to the EAT. If the property is held in a QEAA, the IRS will accept the qualification of property as either replacement property or relinquished property and the treatment of an EAT as the beneficial owner of the property for federal income tax purposes.

**Requirements for a QEAA.** Property is held in a QEAA only if all of the following requirements are met.

- You have a written agreement.
- The time limits for identifying and transferring the property are met.
- The qualified indications of ownership of property are transferred to an EAT.

**Written agreement.** Under a QEAA, you and the EAT must enter into a written agreement no later than 5 business days after the qualified indications of ownership (discussed later) are transferred to the EAT. The agreement must provide all of the following.

- The EAT is holding the property for your benefit in order to facilitate an exchange under the like-kind exchange rules and Revenue Procedure 2000-37, as modified by Revenue Procedure 2004-51.
- You and the EAT agree to report the acquisition, holding, and disposition of the property on your federal income tax returns in a manner consistent with the agreement.
- The EAT will be treated as the beneficial owner of the property for all federal income tax purposes.

Property can be treated as being held in a QEAA even if the accounting, regulatory, or state, local, or foreign tax treatment of the arrangement between you and the EAT is different from the treatment required by the written agreement, as discussed above.

**Bona fide intent.** When the qualified indications of ownership of the property are transferred to the EAT, it must be your bona fide intent that the property held by the EAT represents either replacement property or relinquished property in an exchange intended to qualify for nonrecognition of gain (in whole or in part) or loss under the like-kind exchange rules.

**Time limits for identifying and transferring property.** Under a QEAA, the following time limits for identifying and transferring the property must be met.

1. No later than 45 days after the transfer of qualified indications of ownership of the replacement property to the EAT, you must identify the relinquished property in a manner consistent with the principles for deferred exchanges. See [Identification requirement](#), earlier, under *Deferred Exchange*.
2. One of the following transfers must take place no later than 180 days after the transfer of qualified indications of ownership of the property to the EAT.
  - a. The replacement property is transferred to you (either directly or indirectly through a qualified intermediary, defined earlier under [Qualified intermediary](#)).
  - b. The relinquished property is transferred to a person other than you or a disqualified person. A disqualified person is either of the following.

- i. 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 within the 2-year period before the transfer of the relinquished property.
- ii. A person who is related to you or your agent under the rules discussed in chapter 2 under [Nondeductible Loss](#), substituting “10%” for “50%.”

3. The combined time period the relinquished property and replacement property are held in the QEAA cannot be longer than 180 days.

**Exchange accommodation titleholder (EAT).** The EAT must meet all of the following requirements.

- Hold qualified indications of ownership (defined next) at all times from the date of acquisition of the property until the property is transferred (as described in (2), earlier).
- Be someone other than you or a disqualified person (as defined in (2b), earlier).
- Be subject to federal income tax. If the EAT is treated as a partnership or S corporation, more than 90% of its interests or stock must be owned by partners or shareholders who are subject to federal income tax.

**Qualified indications of ownership.** Qualified indications of ownership are any of the following.

- Legal title to the property.
- Other indications of ownership of the property that are treated as beneficial ownership of the property under principles of commercial law (for example, a contract for deed).
- Interests in an entity that is disregarded as an entity separate from its owner for federal income tax purposes (for example, a single-member limited liability company) and that holds either legal title to the property or other indications of ownership.

**Other permissible arrangements.** Property will not fail to be treated as being held in a QEAA as a result of certain legal or contractual arrangements, regardless of whether the arrangements contain terms that typically would result from arm’s-length bargaining between unrelated parties for those arrangements. For a list of those arrangements, see Revenue Procedure 2000-37.

## Partially Nontaxable Exchanges

In a like-kind exchange in which you realize a gain, if in addition to receiving like-kind property, you also receive money or non-like-kind property, you may have a partially nontaxable exchange. If you realize a gain on the exchange, you must recognize the gain you realize (see [Amount recognized](#), earlier) to the extent of the money and the FMV of the non-like-kind property you receive in the exchange. If you realize a loss on the exchange, no

loss is recognized. However, see [Non-like-kind property given up](#), later.

The gain recognized (taxable amount) on the disposition of the like-kind property you give up is the smaller of the following amounts.

1. The amount of gain realized. See [Gain or Loss From Sales and Exchanges](#), earlier.
2. The limit of recognized gain. To figure the limit on recognized gain, add the money you received and the FMV of any non-like-kind property you received. Reduce this amount (but not below zero) by any exchange expenses (closing costs) you paid. Compare that amount to your gain realized.

**Example.** You exchange real estate held for investment with an FMV of \$110,000 and an adjusted basis of \$80,000 for other real estate you now hold for investment. The FMV of the real estate you received was \$100,000. You also received \$10,000 in cash. You paid \$5,000 in exchange expenses.

FMV of like-kind property received . . . . .	\$100,000
Add: Cash received . . . . .	10,000
Total received . . . . .	\$110,000
Minus: Exchange expenses paid . . . . .	(5,000)
Amount realized . . . . .	\$105,000
Minus: Adjusted basis of property you transferred . . . . .	(80,000)
<b>Realized gain . . . . .</b>	<b>\$25,000</b>

Although the total gain realized on the transaction is \$25,000, the recognized (taxable) gain is only \$5,000, figured as follows.

Money received (cash) . . . . .	\$10,000
Minus: Exchange expenses paid . . . . .	(5,000)
<b>Recognized gain . . . . .</b>	<b>\$5,000</b>

**Assumption of liabilities.** For purposes of figuring your realized gain, add any liabilities assumed by the other party to your amount realized. Subtract any liabilities of the other party that you assume from your amount realized.

For purposes of figuring the limit of recognized gain, if the other party to a nontaxable exchange assumes any of your liabilities, you will be treated as if you received money in the amount of the liability. You can decrease (but not below zero) the amount of money you are treated as receiving by the amount of the other party’s liabilities that you assume and by any cash you pay or the FMV of non-like-kind property you give up. For more information on the assumption of liabilities, see section 357(d) of the Internal Revenue Code. For more information on the treatment of the assumption of liabilities in a sale or exchange, see Regulations section 1.1031(d)-2.

**Example.** The facts are the same as in the previous example, except the property you gave up was subject to a \$30,000 mortgage for which you were personally liable. The other party in the trade agreed to assume the mortgage. Figure the gain realized as follows.

FMV of like-kind property received	\$100,000
Cash	10,000
Mortgage assumed by other party	30,000
Total received	\$140,000
Minus: Exchange expenses	(5,000)
Amount realized	\$135,000
Minus: Adjusted basis of property you transferred	(80,000)
<b>Realized gain</b>	<b>\$55,000</b>

The realized gain is recognized (taxable) gain only up to \$35,000, figured as follows.

Money received (cash)	\$10,000
Money received (liability assumed by other party)	30,000
Total money and unlike property received	\$40,000
Minus: Exchange expenses paid	(5,000)
<b>Recognized gain</b>	<b>\$35,000</b>

**Example.** The facts are the same as in the previous example, except the property you received had an FMV of \$140,000 and was subject to a \$40,000 mortgage that you assumed. Figure the gain realized as follows.

FMV of like-kind property received	\$140,000
Cash	10,000
Mortgage assumed by other party	30,000
Total received	\$180,000
Minus: Exchange expenses	(5,000)
Amount realized	\$175,000
Minus: Adjusted basis of property you transferred	(80,000)
Minus: Mortgage you assumed	(40,000)
<b>Realized gain</b>	<b>\$55,000</b>

The realized gain is recognized (taxable) gain only up to \$5,000, figured as follows.

Money received (cash)	\$10,000
Money received (net liabilities assumed by other party):	
Mortgage assumed by other party	\$30,000
Minus: Mortgage you assumed	(40,000)
Total (not below zero)	\$0
Total money and unlike property received	\$10,000
Minus: Exchange expenses paid	(5,000)
<b>Recognized gain</b>	<b>\$5,000</b>

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

**Example.** You exchange stock and real estate you held for investment for real estate you also intend to hold for investment. The stock you transfer has an FMV of \$1,000 and an adjusted basis of \$4,000. The real estate you exchange has an FMV of \$19,000 and an adjusted basis of \$15,000. The real estate you receive has an FMV of \$20,000. Your realized gain on the exchange is \$4,000, the FMV of the real estate received (\$20,000) less the sum of the adjusted basis of the real estate given up

(\$15,000) and the FMV of the stock you transferred (\$1,000). You do not recognize gain on the exchange of the real estate because it qualifies as a nontaxable exchange. However, you must recognize (report on your return) a \$3,000 loss on the stock because it is non-like-kind property.

**Non-like-kind property received.** If, in addition to like-kind property, you receive non-like-kind property, you must recognize gain on the non-like-kind property you receive.

**Example.** You exchange real estate you held for investment for real estate you intend to hold for investment. The real estate you exchange has an FMV of \$20,000 and an adjusted basis of \$16,000. You receive real estate with an FMV of \$18,000 and other non-like-kind property with an FMV of \$2,000. The amount of gain realized on the exchange is \$4,000. The amount of gain recognized is limited to the lesser of the realized gain or the FMV of other non-like-kind property received, or \$2,000 calculated as follows

FMV of like-kind property received	\$18,000
Add: FMV of non-like-kind property received	2,000
Total	\$20,000
Less: Adjusted basis of property given up	(16,000)
Realized gain	\$4,000
<b>Recognized gain</b>	<b>\$2,000</b>

**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 both of the following amounts.
  - a. Any additional costs you incur.
  - b. Any liabilities you assumed on the like-kind property received, and
  - c. Any gain you recognize on the exchange.
2. Subtract both of the following amounts.
  - a. Any money and the FMV of any non-like-kind property you receive.
  - b. Any liabilities assumed by the other party on the like-kind property given up, and
  - c. Any loss you recognize on the exchange on non-like-kind property given up.

This basis is first allocated to the non-like-kind property received, other than money, up to its FMV on the date of the exchange. The rest is allocated to the basis of the like-kind property.

For more information on basis, see Pub. 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 do either of the following.

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

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

**Residual group.** An exchange group is made up of all the like-kind real properties included in the exchange. If the total FMV of the properties transferred in all of the exchange groups differs from the aggregate FMV of the properties received in all of the exchange groups (taking liabilities into account), a residual group is created. The residual group consists of any money or non-like-kind property transferred in the exchange or money or non-like-kind property received in the exchange, but not both.

**Excess liabilities** All liabilities assumed as part of the exchange are offset against all liabilities of which you are relieved. If there are excess liabilities assumed, the excess amount is netted against the FMV of the properties received in the exchange group. If there are excess liabilities of which you are relieved, the excess amount is allocated among the exchange groups (but not to the residual group) in proportion to the aggregate FMV of the properties received by the taxpayer in the exchange groups.

**Exchange group surplus.** Once the real properties are placed into an exchange group, their FMVs are compared to determine whether there is an exchange group surplus or deficiency. An exchange group surplus is the excess of the aggregate FMV of the properties received (less excess liabilities assumed) over the FMV of the properties transferred. An exchange group deficiency is the excess of the FMV of the properties transferred over the FMV of the properties received (less excess liabilities assumed).

**Gain or loss realized.** The gain or loss realized for each exchange group and the residual group is the difference between the aggregate FMV of the properties transferred and their aggregate adjusted basis. The gain realized with respect to the exchange group is recognized to the extent of the lesser of the gain realized or any exchange group deficiency. Losses realized with respect to an exchange group are not recognized. Gain or loss realized with respect to any non-like-kind property in the residual group is recognized as provided in section 1001 of the Internal Revenue Code or any other applicable provision.

**Example.** You exchange real estate property A with an adjusted basis of \$10,000 and FMV of \$30,000 for properties B, C, and D and \$5,000 in cash. Property B consists of \$20,000 of like-kind property, Property C is like-kind property valued at \$5,000, and Property D is non-like-kind property valued at \$2,500. Property A is subject to a liability of \$5,000, that is relieved in the transfer, and Property B

is subject to a liability of \$7,500 that you assume. The exchange group is made up of the following.

<u>Relinquished Property</u>	
Property A .....	\$30,000
<u>Replacement Properties</u>	
Property B .....	\$20,000
Property C .....	5,000
Net liabilities assumed .....	(2,500)
<b>Total .....</b>	<b><u>\$22,500</u></b>

Because the FMV of the relinquished property, \$30,000, is greater than the FMV of the replacement properties (less net liabilities assumed), \$22,500, the exchange group has a \$7,500 exchange group deficiency.

The gain realized is computed as follows.

FMV relinquished Property A .....	\$30,000
Basis .....	(10,000)
<b>Gain realized .....</b>	<b><u>\$20,000</u></b>

Gain of \$7,500 is recognized on the exchange, the lesser of the exchange group deficiency of \$7,500 and gain realized of \$20,000.

A residual group is created in the amount of \$7,500, consisting of the \$5,000 in cash received in the exchange and Property D (\$2,500). Because no non-like-kind property in the residual group is relinquished, there is no gain or loss on the residual group.

The basis of the replacement properties acquired in a multiple-property exchange is the aggregate adjusted basis of the relinquished properties, increased by any gain recognized, increased by the exchange group surplus or decreased by the exchange group deficiency, and increased by any excess liabilities you assumed on the replacement property. The aggregate basis is allocated proportionately to each real property received in accordance with its FMV. For more information on basis see Pub. 551.

### Like-Kind Exchanges Between Related Persons

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

**Related persons.** Under these rules, related persons include, for example, you and a member of your family (spouse, siblings, 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.



*An exchange structured to avoid the related party rules is not a like-kind exchange.*

For more information on related persons, see [Nondeductible Loss](#) under *Sales and Exchanges Between Related Persons* in chapter 2.

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

However, because this was a like-kind exchange and you received no cash or non-like-kind property in the exchange, you recognize no gain on the exchange. Your basis in the real property you received is \$80,000 (the \$65,000 adjusted basis of the real property given up plus the \$15,000 you paid). Your sister recognizes gain only to the extent of the money she received, \$15,000. Her basis in the real property she received was \$70,000 (the \$70,000 adjusted basis of the real property she exchanged minus the \$15,000 received, plus the \$15,000 gain recognized).

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

Additionally, your sister must report on her 2024 tax return \$130,000, which is the \$145,000 gain on the 2023 exchange minus the \$15,000 she recognized in 2023. Her adjusted basis in the property is increased to \$200,000 (its \$70,000 basis plus the \$130,000 gain recognized).

**Two-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 any of the following events.

- The holding of a put on the property.
- The holding by another person of a right to acquire the property.
- 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 rules for related persons.** The following kinds of property dispositions are excluded from these rules.

- Dispositions due to the death of either related person.
- Involuntary conversions.
- 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 certain circumstances, the exchange may be treated as a tax-free contribution of property to a partnership. See Pub. 541, Partnerships.

An interest in a partnership that has a valid election to be excluded from being treated as a partnership for federal tax purposes is treated as an interest in each of the partnership assets and not as a partnership interest. See Pub. 541.

### 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 Pub. 550 for more information on the tax treatment of income from these investments.

### Insurance Policies and Annuities

No gain or loss is recognized if you make any of the following exchanges, and if the insured or the annuitant is the same under both contracts.

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

- A qualified long-term care insurance contract for another qualified long-term care insurance contract.

In addition, if certain conditions are met, no gain or loss is recognized on the direct transfer of a portion of the cash surrender value of an existing annuity contract for a second contract, regardless of whether the contracts are issued by the same or different companies. For more information on the applicable contracts, see Revenue Procedure 2011-38, 2011-30 I.R.B. 66, available at [IRS.gov/irb/2011-30\\_IRB#RP-2011-38](https://www.irs.gov/irb/2011-30_IRB#RP-2011-38).

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 Pub. 575, Pension and Annuity Income; or Pub. 571, Tax-Sheltered Annuity Plans (403(b) Plans) 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, you can treat a cash distribution and reinvestment as meeting the nonrecognition or nontaxable transfer rules if all of the following requirements are met.

1. When 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, if less, the maximum permitted under the state proceeding.
3. You reinvest the distribution within 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.
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 do both of the following.

1. Give to the issuer of the new policy or contract a statement that includes all of the following information.
  - a. The gross amount of cash distributed.
  - b. The amount reinvested.

- c. Your investment in the affected policy or contract on the date of the initial cash distribution.

2. Attach the following items to your timely filed tax return for the year of the initial distribution.

- a. A statement titled "Election under Revenue Procedure 92-44" that includes the name of the issuer and the policy number (or similar identifying number) of the new policy or contract.
- b. A copy of the statement given to the issuer of the new policy or contract.

## Property Exchanged for Stock

If you transfer property to a corporation in exchange for stock in that corporation (other than nonqualified preferred stock, described later), and immediately afterward you are in control of the corporation, the exchange is usually not taxable. This rule applies to transfers by one person and to transfers by a group. It does not apply in the following situations.

- The corporation is an investment company.
- You transfer the property in a bankruptcy or similar proceeding in exchange for stock used to pay creditors.
- The stock is received in exchange for the corporation's debt (other than a security) or for interest on the corporation's debt (including a security) that accrued while you held the debt.

This rule also applies to the transfer of a portion of a MACRS asset in exchange for stock in a corporation you control immediately after the exchange. See the partial disposition rules in Regulations section 1.168(i)-8.

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



*The control requirement can be met even though there are successive transfers of property and stock. For more information, see Revenue Ruling 2003-51, 2003-21 I.R.B. 938.*

**Example 1.** You and an investor buy property for \$100,000. You both organize a corporation when the property has an FMV 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 recognized by you, the investor, or the corporation.

**Example 2.** You and an investor transfer the property with a basis of \$100,000 to a corporation in exchange for stock with an FMV of \$300,000. This represents only 75% of each class of stock of the corporation. The other 25% was already issued to someone else. You and the investor recognize a taxable gain of \$200,000 on the transaction.

**Services rendered.** The term “property” does not include services rendered or to be rendered to the issuing corporation. The value of stock received for services is income to the recipient.

**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 recognized 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 FMV is at least 10% of the FMV 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 exchange 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 to recognize gain. You must recognize gain only up to the amount of money plus the FMV of the other property you receive. The rules for figuring the recognized 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 recognized gain may have to be reported as ordinary income from depreciation. See chapter 3.

**Note.** You cannot recognize or deduct a loss.

**Nonqualified preferred stock.** Nonqualified preferred stock is treated as property other than stock. Generally, it is preferred stock with any of the following features.

- The holder has the right to require the issuer or a related person to redeem or buy the stock.
- The issuer or a related person is required to redeem or buy the stock.
- The issuer or a related person has the right to redeem or buy 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.

**Liabilities.** If the corporation assumes your liabilities, the exchange is generally not treated as if you received money or other property. There are two exceptions to this treatment.

- If the liabilities the corporation assumes are more than your adjusted basis in the property you transfer, gain is recognized up to the difference. However, for this purpose, exclude liabilities assumed that give rise to a deduction when paid, such as a trade account payable or interest.
- 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.

For more information on the assumption of liabilities, see section 357(d) of the Internal Revenue Code.

**Example.** You transfer property to a corporation for stock. Immediately after the transfer, you control the corporation. You also receive \$10,000 in the exchange. Your adjusted basis in the transferred property is \$20,000. The stock you receive has an FMV of \$16,000. The corporation also assumes a \$5,000 mortgage on the property for which you are personally liable. Gain is realized as follows.

FMV of stock received . . . . .	\$16,000
Cash received . . . . .	10,000
Liability assumed by corporation . . . . .	5,000
Total received . . . . .	\$31,000
Minus: Adjusted basis of property transferred . . . . .	(20,000)
<b>Realized gain . . . . .</b>	<b>\$11,000</b>

The liability assumed is not treated as money or other property. The recognized gain is limited to \$10,000, the cash received.

## Transfers to Spouse

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 to the following.

- The recipient of the transfer is a nonresident alien.
- A transfer in trust to the extent the liabilities assumed and the liabilities on the property are more than the property’s adjusted basis.
- A transfer of certain stock redemptions, as discussed in Regulations section 1.1041-2.

Any transfer of property to a spouse or former spouse on which gain or loss is not recognized is treated by the recipient as a gift and is not considered a sale or exchange. The recipient’s basis in the property will be the same as the adjusted basis of the property to the giver immediately before the transfer. This carryover basis rule

applies whether the adjusted basis of the transferred property is less than, equal to, or greater than either its FMV at the time of transfer or any consideration paid by the recipient. This rule applies for determining loss as well as gain. Any gain recognized on a transfer in trust increases the basis.

For more information on transfers to a spouse, see *Property Settlements* in Pub. 504, *Divorced or Separated Individuals*.

## Gains on Sales of Qualified Small Business Stock

If you sell qualified small business stock, you may be able to roll over your gain tax free or exclude part of the gain from your income. Qualified small business stock is stock originally issued by a qualified small business after August 10, 1993, that meets all seven tests listed in chapter 4 of Pub. 550.



*The election to roll over gain or to exclude part of the gain from income is not allowed to C corporations.*

**Rollover of gain.** You can elect to roll over a capital gain from the sale of qualified small business stock held longer than 6 months into other qualified small business stock. If you make this election, the gain from the sale is generally recognized only to the extent the amount realized is more than the cost of the replacement qualified small business stock bought within 60 days of the date of sale. You must reduce your basis in the replacement qualified small business stock by the gain not recognized.

**Exclusion of gain.** You may be able to exclude from your gross income 50% of your gain from the sale or exchange of qualified small business stock you held more than 5 years. The exclusion can be up to 75% for stock acquired after February 17, 2009, and up to 100% for stock acquired after September 27, 2010. The exclusion can be up to 60% for certain empowerment zone business stock for gain attributable to periods on or before December 31, 2018. The 60% exclusion doesn't apply to gain attributable to periods after December 31, 2018.

Your gain from the stock of any one issuer that is eligible for the exclusion is limited to the greater of the following amounts.

- Ten times your basis in all qualified stock of the issuer you sold or exchanged during the year.
- \$10 million (\$5 million for married individuals filing separately) minus the gain from the stock of the same issuer you used to figure your exclusion in earlier years.

**More information.** For more information on sales of small business stock, see chapter 4 of Pub. 550. See the Instructions for Schedule D and the Instructions for Form 8949 for information on how to report the gain.

## Exclusion of Gain From Sale of DC Zone Assets

If you sold or exchanged a District of Columbia Enterprise Zone (DC Zone) asset acquired after 1997 and before 2012, and held it for more than 5 years, you may be able to exclude the qualified capital gain that you would otherwise include in income.

**DC Zone asset.** A DC Zone asset is any of the following.

- DC Zone business stock.
- DC Zone partnership interest.
- DC Zone business property.

**Qualified capital gain.** The qualified capital gain is any gain recognized on the sale or exchange of a DC Zone asset that is a capital asset or property used in a trade or business. It does not include any of the following gains.

- Gain treated as ordinary income under section 1245 of the Internal Revenue Code.
- Section 1250 gain figured as if section 1250 applied to all depreciation rather than the additional depreciation.
- Gain attributable to real property, or an intangible asset, which is not an integral part of a DC Zone business.
- Gain from a related-party transaction. See [Sales and Exchanges Between Related Persons](#) in chapter 2.
- Gain attributable to periods after December 31, 2016.

See the Instructions for Schedule D and the Instructions for Form 8949 for details on how to report the sale and exclusion. Report the sale or exchange of DC Zone business property on Form 4797. See the Instructions for Form 4797 for details.

## Special Rules for Qualified Opportunity Funds (QOFs)

### Deferral of Gain Invested in a QOF

If you realized an eligible capital gain from a sale or exchange with an unrelated person and, during the 180-day period beginning on the date the gain is realized, you invested any portion of the gain in a QOF, you may be able to temporarily defer such eligible capital gain that would otherwise be includible in the current year's taxable income. If you make the election to defer gain by investing in a QOF, the eligible capital gain is included in taxable income only to the extent, if any, the amount of realized gain exceeds the aggregate amount invested in a QOF during the 180-day period. See the Instructions for Form 8949 for details on how to report tax on an election to defer an eligible gain invested in a QOF.

If you elect to defer tax on an eligible capital gain by investing in a QOF, you will also need to complete Form

8997, Initial and Annual Statement of Qualified Opportunity Fund (QOF) Investments. See Form 8997 and its instructions for more information.

## Previously Deferred Gain Invested in a QOF

If you previously made an election to defer the inclusion of capital gain in gross income by investing such capital gain in a QOF, and now you have sold or exchanged the QOF investment, you must now include in income the deferred gain. If you held the QOF investment for more than 5 years, you may be able to exclude, in part, the capital gain that you would otherwise include in income. See the Instructions for Form 8949 for details on how to report the deferred gain.

If you disposed of your investment in a QOF, you will also need to complete Form 8997. See Form 8997 and its instructions for more information.

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# Ordinary or Capital Gain or Loss

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## Introduction

You must classify your gains and losses as either ordinary or capital, and your capital gains or losses as either short term or long term. You must do this to figure your net capital gain or loss.

For individuals, a net capital gain may be taxed at a different tax rate than ordinary income. See [Capital Gains Tax Rates](#) in chapter 4. Your deduction for a net capital loss may be limited. See [Treatment of Capital Losses](#) in chapter 4.

**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.** Section 1231 transactions are sales and exchanges of real or depreciable property held longer than 1 year and used in a trade or business. They also include certain involuntary conversions of business or investment property, including capital assets. See [Section 1231 Gains and Losses](#) in chapter 3 for more information.

## Topics

This chapter discusses:

- Capital assets

- Noncapital assets
- Sales and exchanges between related persons
- 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
- ☐ **8949** Sales and Other Dispositions of Capital Assets

See [How To Get Tax Help](#) at the end of this publication for information about getting publications and forms.

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## Capital Assets

Almost everything you own and use for personal purposes, pleasure, or investment is a capital asset. For exceptions, see [Noncapital Assets](#), later.

The following items are examples of capital assets.

- Stocks and bonds.
- A home owned and occupied by you and your family.
- Household furnishings.
- A car used for pleasure or commuting.
- Coin or stamp collections.
- Gems and jewelry.
- Gold, silver, and other metals.
- Timber grown on your home property or investment property, even if you make casual sales of the timber.

**Personal-use property.** Generally, 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.

**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 for the production of income. See [Business assets](#), later, under *Noncapital Assets*.

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

## Noncapital Assets

A noncapital asset is property that is not a capital asset. The following kinds of property are not capital assets.

1. Stock in trade, inventory, and other property you hold mainly for sale to customers in your trade or business. Inventories are discussed in Pub. 538, Accounting Periods and Methods. But, see the *TIP*, later.
2. Accounts or notes receivable acquired in the ordinary course of a trade or business for services rendered or from the sale of any properties described in (1) above.
3. Depreciable property used in your trade or business or as rental property (including section 197 intangibles, defined later), even if the property is fully depreciated (or amortized). Sales of this type of property are discussed in chapter 3.
4. Real property used in your trade or business or as rental property, even if the property is fully depreciated.
5. A patent; invention; model or design (whether or not patented); a secret formula or process; a copyright; a literary, musical, or artistic composition; a letter; a memorandum; or similar property such as drafts of speeches, recordings, transcripts, manuscripts, drawings, or photographs:
  - a. Created by your personal efforts;
  - b. Prepared or produced for you (in the case of a letter, a memorandum, or similar property); or
  - c. Received 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.But, see the *TIP*, later.
6. U.S. Government publications 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 the normal sales price.
7. Any commodities derivative financial instrument (discussed later) held by a commodities derivatives dealer unless it meets both of the following requirements:
  - a. It is established to the satisfaction of the IRS that the instrument has no connection to the activities of the dealer as a dealer.
  - b. The instrument is clearly identified in the dealer's records as meeting (a) above by the end of the day on which it was acquired, originated, or entered into.
8. Any hedging transaction (defined later) that is clearly identified as a hedging transaction by the end of the

day on which it was acquired, originated, or entered into.

9. Supplies of a type you regularly use or consume in the ordinary course of your trade or business.
10. Property deducted under the de minimis safe harbor for tangible property (discussed later).



*You can elect to treat as capital assets certain self-created musical compositions or copyrights you sold or exchanged. See chapter 4 of Pub. 550 for details.*

**Property held mainly for sale to customers.** Stock in trade, inventory, and other properties you hold mainly for sale to customers in your trade or business are not capital assets. Inventories are discussed in Pub. 538.

**Business assets.** Real property and depreciable property used in your trade or business or for the production of income (including section 197 intangibles, defined later under [Dispositions of Intangible Property](#)) are not capital assets. The sale or disposition of business property is discussed in chapter 3.

**Letters and memoranda.** Letters, memoranda, and similar property (such as drafts of speeches, recordings, transcripts, manuscripts, drawings, or photographs) are not treated as capital assets (as discussed earlier) if your personal efforts created them or if they were prepared or produced for you. Nor is this property a capital asset if your basis in it is determined by reference to the person who created it or the person for whom it was prepared. For this purpose, letters and memoranda addressed to you are considered prepared for you. If letters or memoranda are prepared by persons under your administrative control, they are considered prepared for you whether or not you review them.

**Commodities derivative financial instrument.** A commodities derivative financial instrument is a commodities contract or other financial instrument for commodities (other than a share of corporate stock; a beneficial interest in a partnership or trust; a note, bond, debenture, or other evidence of indebtedness; or a section 1256 contract) the value or settlement price of which is calculated or determined by reference to a specified index (as defined in section 1221(b) of the Internal Revenue Code).

**Commodities derivatives dealer.** A commodities derivatives dealer is a person who regularly offers to enter into, assume, offset, assign, or terminate positions in commodities derivatives financial instruments with customers in the ordinary course of a trade or business.

**Hedging transaction.** A hedging transaction is any transaction you enter into in the normal course of your trade or business primarily to manage any of the following.

1. Risk of price changes or currency fluctuations involving ordinary property you hold or will hold.

2. Risk of interest rate or price changes or currency fluctuations for borrowings you make or will make, or ordinary obligations you incur or will incur.

**Property deducted under the de minimis safe harbor for tangible property.** If you deducted the costs of a property under the de minimis safe harbor for tangible property, then upon its sale or disposition, this property is not treated as a capital asset under section 1221. Generally, any gain on the disposition of this property is treated as ordinary income and is reported in Part II of Form 4797.

## Sales and Exchanges Between Related Persons

This section discusses the rules that may apply to the sale or exchange of property between related persons. If these rules apply, gains may be treated as ordinary income and losses may not be deductible. See [Transfers to Spouse](#) in chapter 1 for rules that apply to spouses.

### Gain Is Ordinary Income

If a gain is recognized on the sale or exchange of property to a related person, the gain may be ordinary income even if the property is a capital asset. It is ordinary income if the sale or exchange is a depreciable property transaction or a controlled partnership transaction.

**Depreciable property transaction.** Gain on the sale or exchange of property, including a leasehold or a patent application, that is depreciable property in the hands of the person who receives it is ordinary income if the transaction is either directly or indirectly between any of the following pairs of entities.

1. A person and the person's controlled entity or entities.
2. A taxpayer and any trust in which the taxpayer (or his or her spouse) 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. An executor and a beneficiary of an estate unless the sale or exchange is in satisfaction of a pecuniary bequest (a bequest for a sum of money).
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).

**Controlled entity.** A person's controlled entity is either of the following.

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 directly or indirectly owned by or for that person.

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 transaction.** 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 either of the following pairs of entities.

- A partnership and a person who directly or indirectly owns more than 50% of the capital interest or profits interest in the partnership.
- Two partnerships if the same persons directly or indirectly own more than 50% of the capital interests or profits interests in both partnerships.

**Determining ownership.** In the transactions under [Depreciable property transaction](#) and [Controlled partnership transaction](#), earlier, use the following rules to determine the ownership of stock or a partnership interest.

1. Stock or a partnership interest directly or indirectly owned by or for a corporation, partnership, estate, or trust is considered owned proportionately by or for its shareholders, partners, or beneficiaries. (However, for a partnership interest owned by or for a C corporation, this applies only to shareholders who directly or indirectly own 5% or more in value of the stock of the corporation.)
2. An individual is considered as owning the stock or partnership interest directly or indirectly owned by or for his or her family. Family includes only siblings, half siblings, spouse, ancestors, and lineal descendants.
3. For purposes of applying (1) or (2) above, stock or a partnership interest constructively owned by a person under (1) is treated as actually owned by that person. But stock or a partnership interest constructively owned by an individual under (2) is not treated as

owned by the individual for reapplying (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 persons is not deductible. This applies to both direct and indirect transactions, but not to distributions of property from a corporation in a complete liquidation. For the list of related persons, see *Related persons* next.

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

**Related persons.** The following is a list of related persons.

1. Members of a family, including siblings, half siblings, spouse, ancestors (parents, grandparents, etc.), and lineal descendants (children, grandchildren, etc.).
2. An individual and a corporation if the individual directly or indirectly owns 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 if the trust or the grantor of the trust directly or indirectly owns 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 the 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. 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 directly or indirectly own more than 50% of the capital interests or profits interests in both partnerships.
13. A person and a partnership if the person directly or indirectly owns more than 50% of the capital interest or profits interest in the partnership.

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

**Controlled groups.** Losses on transactions between members of the same controlled group described in (3), earlier, 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 directly or indirectly owns any of the outstanding stock of a corporation or an interest in a partnership for a loss on a sale or exchange, the following rules apply.

1. Stock or a partnership interest directly or indirectly owned by or for a corporation, partnership, estate, or trust is considered owned proportionately by or for its shareholders, partners, or beneficiaries. (However, for a partnership interest owned by or for a C corporation, this applies only to shareholders who directly or indirectly own 5% or more in value of the stock of the corporation.)
2. An individual is considered as owning the stock or partnership interest directly or indirectly owned by or for his or her family. Family includes only siblings, half siblings, spouse, ancestors, and lineal descendants.
3. An individual owning (other than by applying (2)) any stock in a corporation is considered to own the stock directly or indirectly owned by or for his or her partner.
4. For purposes of applying (1), (2), or (3), stock or a partnership interest constructively owned by a person under (1) is treated as actually owned by that person. But stock or a partnership interest constructively owned by an individual under (2) or (3) is not treated as owned by the individual for reapplying either (2) or (3) to make another person the constructive owner of that stock or partnership interest.

**Indirect transactions.** You cannot 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 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 person.** If, in a purchase or exchange, you received property from a related person who had a loss that was not allowable and you later sell or exchange the property at a gain, you generally recognize the gain only to the extent it is more than the loss previously disallowed to the related person. This rule

applies only to the original transferee. This rule does not apply if the sale or exchange is subject to the wash sale rules of section 1091. In addition, this rule does not apply if the gain or loss with respect to the property received from a related person is *not* subject to federal income tax in the hands of the transferor immediately before the transfer but *is* subject to federal income tax in the hands of the transferee immediately after the transfer.

**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 gain that is more than the \$2,400 loss not allowed to your brother.

**Example 2.** Assume the same facts as in *Example 1*, except that you sell the stock for \$6,900 instead of \$10,500. Your recognized loss is only \$700 (\$7,600 – \$6,900). You cannot deduct the loss not allowed to your brother.

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## Other Dispositions

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

### Sale of a Business

The sale of a business is usually not a sale of one asset. Instead, all 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 used in the business, or 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. The sale of real property or depreciable property used in the business and held longer than 1 year results in gain or loss from a section 1231 transaction (discussed in chapter 3). 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 will be treated as ordinary gain or loss. For more information, see *Disposition of Partner's Interest* in Pub. 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 of Pub. 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 liqui-

dating 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 FMV.

In certain cases in which the distributee is a corporation in control of the distributing corporation, the distribution may not be taxable. For more information, see section 332 of the Internal Revenue Code and the related regulations.

**Allocation of consideration paid for a business.** The sale of a trade or business for a lump sum is considered a sale of each individual asset rather than of a single asset. Except for assets exchanged under any nontaxable exchange rules, both the buyer and seller of a business must use the residual method (explained later) to allocate the consideration to each business asset transferred. This method determines gain or loss from the transfer of each asset and how much of the consideration is for goodwill and certain other intangible property. It also determines the buyer's basis in the business assets.

**Consideration.** The buyer's consideration is the cost of the assets acquired. The seller's consideration is the amount realized (money plus the FMV of property received) from the sale of assets.

**Residual method.** The residual method must be used for any transfer of a group of assets that constitutes a trade or business and for which the buyer's basis is determined only by the amount paid for the assets. This applies to both direct and indirect transfers, such as the sale of a business or the sale of a partnership interest in which the basis of the buyer's share of the partnership assets is adjusted for the amount paid under section 743(b) of the Internal Revenue Code. Section 743(b) applies if a partnership has an election in effect under section 754 of the Internal Revenue Code.

A group of assets constitutes a trade or business if either of the following applies.

- Goodwill or going concern value could, under any circumstances, attach to them.
- The use of the assets would constitute an active trade or business under section 355 of the Internal Revenue Code.

The residual method provides for the consideration to be reduced first by the amount of Class I assets (defined below). The consideration remaining after this reduction must be allocated among the various business assets in a certain order. See *Classes of assets* next for the complete order.

**Classes of assets.** The following definitions are the classifications for deemed or actual asset acquisitions. Allocate the consideration among the assets in the following order. The amount allocated to an asset, other than a Class VII asset, cannot exceed its FMV on the purchase date. The amount you can allocate to an asset is also subject to any applicable limits under the Internal Revenue Code or general principles of tax law.

- Class I assets are cash and general deposit accounts (including checking and savings accounts but excluding certificates of deposit).

- Class II assets are certificates of deposit, U.S. Government securities, foreign currency, and actively traded personal property, including stock and securities.
- Class III assets are accounts receivable, other debt instruments, and assets that you mark to market at least annually for federal income tax purposes. However, see Regulations section 1.338-6(b)(2)(iii) for exceptions that apply to debt instruments issued by persons related to a target corporation, contingent debt instruments, and debt instruments convertible into stock or other property.
- Class IV assets are property of a kind that would properly be included in inventory if on hand at the end of the tax year, or property held by the taxpayer primarily for sale to customers in the ordinary course of business.
- Class V assets are all assets other than Class I, II, III, IV, VI, and VII assets.  
**Note.** Furniture and fixtures, buildings, land, vehicles, and equipment, which constitute all or part of a trade or business are generally Class V assets.
- Class VI assets are section 197 intangibles (other than goodwill and going concern value).
- Class VII assets are goodwill and going concern value (whether the goodwill or going concern value qualifies as a section 197 intangible).

If an asset described in one of the classifications above can be included in more than one class, include it in the lower-numbered class. For example, if an asset is described in both Class II and Class IV, choose Class II.

**Example.** The total paid in the sale of the assets of Company SKB is \$21,000. No cash or deposit accounts or similar accounts were sold. The company's U.S. Government securities sold had a FMV of \$3,200. The only other asset transferred (other than goodwill and going concern value) was inventory with an FMV of \$15,000. Of the \$21,000 paid for the assets of Company SKB, \$3,200 is allocated to U.S. Government securities, \$15,000 to inventory assets, and the remaining \$2,800 to goodwill and going concern value.

**Agreement.** The buyer and seller may enter into a written agreement as to the allocation of any consideration or the FMV of any of the assets. This agreement is binding on both parties unless the IRS determines the amounts are not appropriate.

**Reporting requirement.** Both the buyer and seller involved in the sale of business assets must report to the IRS the allocation of the sales price among section 197 intangibles and the other business assets. Use Form 8594 to provide this information. Generally, the buyer and seller should each attach Form 8594 to their federal income tax return for the year in which the sale occurred. See the Instructions for Form 8594.

## 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 longer 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 3. See chapter 1 of Pub. 946, *How To Depreciate Property*, for information on intangible property that can and cannot be depreciated. Gain or loss on dispositions of other intangible property is ordinary or capital 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 intangible assets acquired after August 10, 1993 (after July 25, 1991, if chosen), 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 the following assets.

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

**Dispositions.** You cannot deduct a loss from the disposition or worthlessness of a section 197 intangible 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 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 by a fraction, the numerator (top number) of which is the retained intangible's adjusted basis on the date of the loss and the denominator (bottom number) 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 acquired in the same transaction as the intangible sold.

**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.

**Anti-churning rules.** Anti-churning rules prevent a taxpayer from converting section 197 intangibles that do not qualify for amortization into property that would qualify for amortization. However, these rules do not apply to the part of the basis of property acquired by certain related persons if the transferor elects to do both of the following.

- Recognize gain on the transfer of the property.
- Pay income tax on the gain at the highest tax rate.

If the transferor is a partnership or S corporation, the partnership or S corporation (not the partners or shareholders) can make the election. But each partner or shareholder must pay the tax on his or her share of gain.

To make the election, you, as the transferor, must attach a statement containing certain information to your income tax return for the year of the transfer. You must file the tax return by the due date (including extensions). You must also notify the transferee of the election in writing by the due date of the return.

If you timely filed your return without making the election, you can make the election by filing an amended return within 6 months after the due date of the return (excluding extensions). Attach the statement to the amended return and enter "Filed pursuant to section 301.9100-2" at the top of the statement. File the amended return at the same address the original return was filed.

For more information about making the election, see Regulations section 1.197-2(h)(9).

## Patents

The transfer of a patent by an individual is treated as a sale or exchange of a capital asset held longer than 1 year. 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 4.

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

- You are the holder of the patent.

- You transfer the patent other than by gift, inheritance, or devise.
- You transfer all substantial rights to the patent or an undivided interest in all such rights.
- You do not transfer the patent to a related person.

**Note.** For dispositions after December 31, 2017, certain patents are not treated as capital assets. See [Noncapital Assets](#), earlier. Also, see [Patents and copyrights](#) in chapter 3.

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

- The individual whose effort created the patent property and who qualifies as the original and first inventor.
- The individual who bought 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.

All substantial rights to a patent are not transferred if any of the following apply to the transfer.

- The rights are limited geographically within a country.
- The rights are limited to a period less than the remaining life of the patent.
- 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.
- 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.** This tax treatment does not apply if the transfer is directly or indirectly between you and a related person as defined earlier in the list under [Nondeductible Loss](#), with the following changes.

1. Members of your family include your spouse, ancestors, and lineal descendants, but not your siblings or half siblings.
2. Substitute "25% or more" ownership for "more than 50%."

If you fit within the definition of a related person independent of family status, the sibling exception in (1), earlier, does not apply. For example, a transfer between siblings as beneficiary and fiduciary of the same trust is a transfer between related persons. The sibling 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 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.

**Significant power, right, or continuing interest.** If you keep any significant power, right, or continuing interest in the subject matter of a franchise, trademark, or trade name that you transfer or renew, the amount you receive is ordinary royalty income rather than an amount realized from a sale or exchange.

A 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.

- A right to disapprove any assignment of the interest, or any part of it.
- A right to end the agreement at will.
- 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.
- A right to make the recipient sell or advertise only your products or services.
- A right to make the recipient buy most supplies and equipment from you.
- A right to receive 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, the gain is normally ordinary income. However, you may receive capital gain treatment on at least part of the proceeds, provided you meet certain requirements. See section 1237 of the Internal Revenue Code.

## Timber

Standing timber held as investment property is a capital asset. Gain or loss from its sale is reported as a capital gain or loss on Form 8949 and Schedule D (Form 1040), as applicable. 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 reported on Schedule F (Form 1040).

Different rules apply if you owned the timber longer than 1 year and elect to either:

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

Timber is considered cut on the date when, in the ordinary course of business, the quantity of felled timber is first definitely determined. This is true whether the timber is cut under contract or whether you cut it yourself.

Under the rules discussed below, disposition of the timber is treated as a section 1231 transaction. See chapter 3. 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 rules discussed below.

**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 can elect to treat the cutting of timber as a section 1231 transaction in the year the timber 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 elect this treatment, you must:

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

**Making the election.** You make the election on your return for the year the cutting takes place by including in income the gain or loss on the cutting and including a computation of the gain or loss. You do not have to make the election in the first year you cut timber. You can 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 cancel it.

If you previously elected to treat the cutting of timber as a sale or exchange, you may revoke this election without the consent of the IRS. The prior election (and revocation) is disregarded for purposes of making a subsequent election. See Form T (Timber), Forest Activities Schedule, for more information.

**Gain or loss.** Your gain or loss on the cutting of standing timber is the difference between its adjusted basis for depletion and its FMV 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 the related regulations.

**Example.** In April 2024, you had owned 4,000 MBF (1,000 board feet) of standing timber longer than 1 year. It had an adjusted basis for depletion of \$40 per MBF. You are a calendar-year taxpayer. On January 1, 2024, the timber had an FMV of \$350 per MBF. It was cut in April for sale. On your 2024 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 gain or as ordinary gain. You figure your gain as follows.

FMV of timber January 1, 2024 . . . . .	\$1,400,000
Minus: Adjusted basis for depletion . . . . .	(160,000)
<b>Section 1231 gain . . . . .</b>	<b>\$1,240,000</b>

The FMV becomes your basis in the cut timber, and a later sale of the cut timber including any by-product or tree tops will result in ordinary business income or loss.

**Outright sales of timber.** Outright sales of timber by landowners qualify for capital gains treatment using rules similar to the rules for certain disposal of timber under a contract with retained economic interest (defined below). However, for outright sales, the date of disposal is not deemed to be the date the timber is cut because the landowner can elect to treat the payment date as the date of disposal (see below).

**Cutting contract.** You must treat the disposal of standing timber under a cutting contract as a section 1231 transaction if all of the following apply to you.

- You are the owner of the timber.
- You held the timber longer than 1 year before its disposal.
- You kept an economic interest in the timber.

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

The difference between the amount realized from the disposal of the timber and its adjusted basis for depletion is treated as gain or loss on its sale. Include this amount on Form 4797 along with your other section 1231 gains or losses to figure whether it is treated as capital or ordinary gain or loss.

**Date of disposal.** The date of disposal is the date the timber is cut. However, for outright sales by landowners or

if you receive payment under the contract before the timber is cut, you can elect to treat the date of payment as the date of disposal.

This election applies only to figure the holding period of the timber. It has no effect on the time for reporting gain or loss (generally when the timber is sold or exchanged).

To make this election, attach a statement to the tax return filed by the due date (including extensions) for the year payment is received. The statement must identify the advance payments subject to the election and the contract under which they were made.

If you timely filed your return for the year you received payment without making the election, you can still make the election by filing an amended return within 6 months after the due date for that year's return (excluding extensions). Attach the statement to the amended return and enter "Filed pursuant to section 301.9100-2" at the top of the statement. File the amended return at the same address the original return was filed.

**Owner.** The owner of timber is any person who owns an interest in it, 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.

**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.

See Form T (Timber) and its separate instructions for more information about dispositions of timber.

## 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 their 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

You must treat the disposal of coal (including lignite) or iron ore mined in the United States as a section 1231 transaction if both of the following apply to you.

- You owned the coal or iron ore longer than 1 year before its disposal.
- You kept an economic interest in the coal or iron ore.

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 disposal of the coal or iron ore and the adjusted basis you use to figure cost depletion (increased

by certain expenses 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 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 depletion 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 directly or indirectly dispose of the coal or iron ore to any of the following persons.

- A related person whose relationship to you would result in the disallowance of a loss (see [Nondeductible Loss](#) under *Sales and Exchanges Between Related Persons*, earlier).
- An individual, trust, estate, partnership, association, company, or corporation owned 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 is treated as ordinary income. This applies if substantially all of your expected return is attributable to the time value of your net investment (like interest on a loan) and the transaction is any of the following.

- An applicable straddle (generally, any set of offsetting positions with respect to personal property, including stock).
- A transaction in which you acquire property and, at or about the same time, you contract to sell the same or substantially identical property at a specified price.
- 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 Pub. 550.

## Digital Assets

Digital assets are any digital representations of value that are recorded on a cryptographically secured distributed ledger or any similar technology. For example, digital

assets include non-fungible tokens (NFTs) and virtual currencies, such as cryptocurrencies and stable-coins. If a particular asset has the characteristics of a digital asset, it will be treated as a digital asset for federal income tax purposes.

The general tax principles that apply to property transactions apply to transactions using digital assets. Transactions involving digital assets include, but are not limited to:

- The receipt of digital assets as payment for goods or services provided;
- The receipt or transfer of a digital asset for free (without providing any consideration) that does not qualify as a bona fide gift;
- The receipt of new digital assets as a result of mining and staking activities;
- The receipt of digital assets as a result of a hard fork;
- An exchange of digital assets for property, goods, or services;
- An exchange or trade of digital assets for other digital assets;
- A sale of digital assets; and
- Any other disposition of a financial interest in digital assets.

If, in 2024, you engaged in any transaction involving digital assets, check “Yes” next to the question on digital assets on page 1 of Form 1040 or 1040-SR. On the left side of Form 1040 or 1040-SR, you will see the heading “Digital Assets.” See the Instructions for Form 1040. Also, if you disposed of any digital assets in 2024 that were held as a capital asset through a sale, exchange, or transfer, use Form 8949 to figure your capital gain or loss and report it on Schedule D (Form 1040). See the Instructions for Form 8949.

If you received digital assets as compensation for your services, you must report the income as wages on Form 1040 or 1040-SR, line 1a. If you received digital assets for sales to customers in a trade or business, you must generally report the income on Schedule C (Form 1040) for a sole proprietorship. You should report income from digital assets the same way as you would report similar income.

If you received ordinary income in connection with digital assets that isn't reported elsewhere on your return, see the instructions for Form 1040, Schedule 1, line 8v.

For additional information on digital assets, see the Instructions for Form 1040 or go to [IRS.gov/DigitalAsset](https://www.irs.gov/DigitalAsset).

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### 3.

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## Ordinary or Capital Gain or Loss for Business Property

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### 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 the 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

### Useful Items

You may want to see:

#### Publication

- ☐ **537** Installment Sales
- ☐ **547** Casualties, Disasters, and Thefts
- ☐ **551** Basis of Assets
- ☐ **946** How To Depreciate Property

#### Form (and Instructions)

- ☐ **4797** Sales of Business Property

See [How To Get Tax Help](#) at the end of this publication for information about getting publications and forms.

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## Section 1231 Gains and Losses

Section 1231 gains and losses are the taxable gains and losses from section 1231 transactions (discussed later). 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.*



*Only gain in excess of the recapture amount is considered section 1231 gain.*

**Section 1231 transactions.** The following transactions result in gain or loss subject to section 1231 treatment.

- **Sales or exchanges of real property or depreciable personal property.** This property must be used in a trade or business and held longer than 1 year. Generally, property held for the production of rents or royalties is considered to be used in a trade or business. This property must also be either real property or of a kind that is subject to depreciation under section 167 of the Internal Revenue Code. See section 1231 for details. 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 longer 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 longer.
- **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 longer.
- **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 longer than 1 year. You cannot keep any right or option to directly or indirectly reacquire the land (other than a right customarily incident to a mortgage or other security transaction). Growing crops sold with a lease on the land, though sold to the same person in the same transaction, are not included.
- **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 longer than 1 year. It must be business property or a capital asset held in connection with a trade or business or a transaction entered into for profit, such as investment property. It cannot be property held for personal use.
- **Casualties and thefts.** The casualty or theft must have affected 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 longer than 1 year. However, if your

casualty or theft losses are more than 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 Pub. 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 1-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 your business. Any gain or loss resulting from their not being returned may be capital or ordinary, depending on your section 1231 transactions.

**Patents and copyrights.** The sale of a patent; invention; model or design (whether or not patented); a secret formula or process; a copyright; a literary, musical, or artistic composition; or similar property is not a section 1231 transaction if your personal efforts created the property, or if you acquired the property in a way that entitled you to the basis of the previous owner whose personal efforts created it (for example, if you receive the property as a gift). The sale of such property results in ordinary income and is generally reported in Part II of Form 4797.

**Property deducted under the de minimis safe harbor for tangible property.** If you deducted the costs of a property under the de minimis safe harbor for tangible property (currently \$2,500 or less or \$5,000 or less if you have an applicable financial statement), then upon its sale or disposition, this property is not treated as property used in the trade or business under section 1231. Generally, any gain on the disposition of this property is treated as ordinary income and is reported in Part II of Form 4797.

**Example.** In 2024, you paid \$1,000 for a machine that you used in your business. You deducted the \$1,000 cost of the machine on your 2024 income tax return under the de minimis safe harbor for tangible property. In 2026, you sold the machine for \$1,500. Because you deducted the cost of the machine under the de minimis safe harbor, this property is not treated as property used in the trade or business under section 1231. Upon sale of the machine, you must report the \$1,500 as ordinary gain on line 10 of Form 4797.

**Treatment as ordinary or capital.** To determine the treatment of section 1231 gains and losses, combine all of 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 applied against a net section 1231 gain. Therefore, if in any of your 5 preceding tax years you had section 1231 losses, a net gain for the current year from the sale of section 1231 assets is ordinary gain to the extent of your prior losses. These losses are applied against your net section 1231 gain beginning with the earliest loss in the 5-year period.

**Example.** In 2024, you have a \$2,000 net section 1231 gain. To figure how much you have to report as ordinary income and long-term capital gain, you must first determine your section 1231 gains and losses from the previous 5-year period. From 2019 through 2023, you had the following section 1231 gains and losses.

Year	Amount
2019	-0-
2020	-0-
2021	(\$2,500)
2022	-0-
2023	\$1,800

You use this information to figure how to report your section 1231 gain for 2024 as shown below.

1) Net section 1231 gain (2024)	\$2,000
2) Net section 1231 loss (2021)	(\$2,500)
3) Net section 1231 gain (2023)	1,800
4) Remaining net section 1231 loss from prior 5 years	(\$700)
5) Gain treated as ordinary income	\$700
6) Gain treated as long-term capital gain	\$1,300

## 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 depreciation or amortization allowed or allowable on your property. This includes the date and manner of acquisition, cost or other basis, depreciation or amortization, and all other adjustments that affect basis.

On property you acquired in a nontaxable exchange or as a gift, your records must also indicate the following information.

- Whether the adjusted basis was figured using depreciation or amortization you claimed on other property.
- Whether the adjusted basis was figured using depreciation or amortization another person claimed.

**Corporate distributions.** For information on property distributed by corporations, see *Distributions to Shareholders* in Pub. 542, Corporations.

**General asset accounts.** Different rules apply to dispositions of property you depreciated using a general asset account. For information on these rules, see Pub. 946.

**Special rules for certain qualified section 179 real property.** If you sold or otherwise disposed of qualified real property for which you elected under section 179 of the Internal Revenue Code to treat the cost of such property as an expense, special rules apply. This includes special rules for determining gain or loss and determining if the basis of the property is treated as section 1245 or 1250 property.

## 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.

Any gain recognized that is more than the part that is ordinary income from depreciation is a section 1231 gain. See [Treatment as ordinary or capital](#) under *Section 1231 Gains and Losses*, earlier.

**Section 1245 property defined.** Section 1245 property includes any property that is or has been subject to an allowance for depreciation or amortization and that is any of the following types of property.

1. Personal property (either tangible or intangible).
2. Other tangible property (except buildings and their structural components, discussed later) used as any of the following.
  - 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).
  - c. A facility in any of the activities in (a) for the bulk storage of fungible commodities (discussed later).
3. Where applicable, that part of real property (not included in (2)) with an adjusted basis reduced by (but not limited to) the following.
  - a. Amortization of certified pollution control facilities.
  - b. The section 179 expense deduction.

- c. Deduction for qualified clean-fuel vehicles and certain refueling property (as in effect before repeal by Public Law 113-295).
  - d. Deduction for capital costs incurred in complying with Environmental Protection Agency sulfur regulations.
  - e. Deduction for certain qualified refinery property if in effect before the repeal by the Tax Increase Prevention Act of 2014. (Repealed by Public Law 113-295, section 221(a)(34)(A), except with regard to deductions made prior to December 19, 2014.)
  - f. Any applicable deduction for qualified energy efficient commercial building property. See section 179D of the Internal Revenue Code.
  - g. Amortization of railroad grading and tunnel bores, if in effect before the repeal by the Revenue Reconciliation Act of 1990. (Repealed by Public Law 99-514, Tax Reform Act of 1986, section 242(a).)
  - h. Certain expenditures for childcare facilities if in effect before repeal by the Omnibus Budget Reconciliation Act of 1990, Public Law 101-508, section 11801(a)(13) (except with regard to deductions made prior to November 5, 1990).
  - i. Expenditures to remove architectural and transportation barriers to the handicapped and elderly.
  - j. Deduction for qualified tertiary injectant expenses.
  - k. Certain reforestation expenditures.
  - l. Deduction for election to expense qualified advanced mine safety equipment property.
  - m. Any deduction for qualified film, television, or live theatrical productions allowed under section 181 of the Internal Revenue Code.
4. Single purpose agricultural (livestock) or horticultural structures.
  5. Storage facilities (except buildings and their structural components) used in distributing petroleum or any primary product of petroleum.
  6. Any railroad grading or tunnel bore.

**Buildings and structural components.** Section 1245 property does not include buildings and structural components. The term “building” includes a house, barn, warehouse, or garage. The term “structural component” includes walls, floors, windows, doors, central air conditioning systems, light fixtures, etc.

Do not treat a structure that is essentially machinery or equipment as a building or structural component. Also, do not treat a structure that houses property used as an integral part of an activity as a building or structural component if the structure's use is so closely related to the property's use that the structure can be expected to be replaced when the property it initially houses is replaced.

The fact that the structure is specially designed to withstand the stress and other demands of the property and

cannot be used economically for other purposes indicates it is closely related to the use of the property it houses. 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 but as section 1245 property.

**Facility for bulk storage of fungible commodities.** This term includes oil or gas storage tanks and grain storage bins. Bulk storage means the storage of a commodity in a large mass before it is used. For example, if a facility is used to store oranges that have been sorted and boxed, it is not used for bulk storage. To be fungible, a commodity must be such that each of its parts is essentially interchangeable and each of its parts is indistinguishable from another part.

Stored materials that vary in composition, size, and weight are not fungible. Materials are not fungible if 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. For example, the storage of different grades and forms of aluminum scrap is not storage of fungible commodities.

### Gain Treated as Ordinary Income

The gain treated as ordinary income on the sale, exchange, or involuntary conversion of section 1245 property, including a sale and leaseback transaction, is the lesser of the following amounts.

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

A limit on this amount for gain on like-kind exchanges and involuntary conversions is explained later.

For any other disposition of section 1245 property, ordinary income is the lesser of (1), earlier, or the amount by which its FMV is more than 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.

**Depreciation taken on other property or taken by other taxpayers.** Depreciation and amortization include the amounts you claimed on the section 1245 property as well as the following depreciation and amortization amounts.

- Amounts you claimed on property you exchanged for, or converted to, your section 1245 property in a like-kind exchange or involuntary conversion.
- Amounts a previous owner of the section 1245 property claimed if your basis is determined with reference to that person's adjusted basis (for example, the donor's depreciation deductions on property you received as a gift).

**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. Any special depreciation allowance you claimed.
- 3. Amortization deductions for any of the following costs.
  - a. Acquiring a lease.
  - b. Lessee improvements.
  - c. Certified pollution control facilities.
  - d. Certain reforestation expenses.
  - e. Section 197 intangibles.
- 4. The section 179 deduction.
- 5. Deductions for all of the following costs.
  - a. Removing barriers to the disabled and the elderly.
  - b. Tertiary injectant expenses.
  - c. Qualified depreciable clean-fuel vehicles and refueling property (minus the amount of any recaptured deduction).
  - d. Environmental cleanup costs.
  - e. Certain reforestation expenses.
  - f. Qualified disaster expenses.
- 6. Any basis reduction for the investment credit (minus any basis increase for credit recapture).
- 7. Any basis reduction for the qualified electric vehicle credit (minus any basis increase for credit recapture).

**Example.** You file your returns on a calendar-year basis. In February 2022, you bought and placed in service for 100% use in your business a light-duty truck (5-year property) that cost \$10,000. You used the half-year convention, and your MACRS deductions for the truck were \$2,000 in 2022 and \$3,200 in 2023. You did not take the section 179 deduction. You sold the truck in May 2024 for \$7,000. The MACRS deduction in 2024, the year of sale, is \$960 (1/2 of \$1,920). Figure the gain treated as ordinary income as follows.

1) Amount realized . . . . .	\$7,000
2) Cost (February 2022) . . . . .	\$10,000
3) Depreciation allowed or allowable (MACRS deductions: \$2,000 + \$3,200 + \$960) . . . . .	6,160
4) Adjusted basis (subtract line 3 from line 2) . . . . .	\$3,840
5) Gain realized (subtract line 4 from line 1) . . . . .	\$3,160
6) <b>Gain treated as ordinary income (lesser of line 3 or line 5) . . . . .</b>	<b>\$3,160</b>

**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 from 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. However, 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 from depreciation, you can treat any number of units of section 1245 property in a single depreciation account as one item if the total ordinary income from 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 can figure the ordinary income from depreciation as if the 50 machines and 25 trucks were one item.

However, if five 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 from depreciation.

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

## Section 1250 Property

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.

**Section 1250 property defined.** 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 subject to an allowance for depreciation. A fee simple interest in land is not included because it is not depreciable.

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

## Additional Depreciation

If you hold section 1250 property longer than 1 year, the additional depreciation is the actual depreciation adjustments that are more than the depreciation figured using the straight-line method. For a list of items treated as depreciation adjustments, see [Depreciation and amortization under Gain Treated as Ordinary Income](#), earlier. For the treatment of unrecaptured section 1250 gain, see [Capital Gains Tax Rates](#), later.

If you hold section 1250 property for 1 year or less, all the depreciation is additional depreciation. You will not have additional depreciation if any of the following conditions apply to the property disposed of.

- You figured depreciation for the property using the straight-line method or any other method that does not result in depreciation that is more than the amount figured by the straight-line method; you held the property longer than 1 year; and, if the property was qualified property, you made a timely election not to claim any special depreciation allowance. In addition, if the property was in a renewal community, you must not have elected to claim a commercial revitalization deduction for property placed in service before January 1, 2010.
- The property was residential low-income rental property you held for 16 $\frac{2}{3}$  years or longer. For low-income rental housing on which the special 60-month depreciation for rehabilitation expenses was allowed, the 16 $\frac{2}{3}$  years start when the rehabilitated property is placed in service.
- You chose the alternate ACRS method for the property, which was a type of 15-, 18-, or 19-year real property covered by the section 1250 rules.
- The property was residential rental property or nonresidential real property placed in service after 1986 (or after July 31, 1986, if the choice to use MACRS was made); you held it longer than 1 year; and, if the property was qualified property, you made a timely election not to claim any special depreciation allowance.

These properties are depreciated using the straight-line method. In addition, if the property was in a renewal community, you must not have elected to claim a commercial revitalization deduction.

**Depreciation taken by other taxpayers or on other property.** Additional depreciation includes all depreciation adjustments to the basis of section 1250 property whether allowed to you or another person (as carryover basis property).

**Example.** You give your child section 1250 property on which you took \$2,000 in depreciation deductions, of which \$500 is additional depreciation. Immediately after the gift, your child's adjusted basis in the property is the same as yours 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, your child sells the property. At the time of sale, the additional depreciation is \$700 (\$500 allowed to you plus \$200 allowed to your child).

**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 your hands) is generally the amount 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 lesser 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.** A wing of your 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.

**Figuring straight-line depreciation.** The useful life and salvage value you would have used to figure straight-line depreciation are the same as those used under the depreciation method you actually used. 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.

Salvage value and useful life are not used for the ACRS method of depreciation. Figure straight-line depreciation for ACRS real property by using its 15-, 18-, or 19-year recovery period as the property's useful life.

The straight-line method is applied without any basis reduction for the investment credit.

**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 includes all renewal periods. This inclusion of the renewal periods cannot extend the lease period taken into account to a period that is longer than the remaining useful life of the improvement. The same rule applies to the cost of acquiring a lease.

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.

## 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 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 percentage is zero and no ordinary income because of additional depreciation before 1970 will result from its disposition.

**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%. The percentage for periods before 1976 is zero. Therefore, no ordinary income because of additional depreciation before 1976 will result from a disposition of residential rental property.

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

- Federally assisted housing projects if the mortgage 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.
- Low-income rental housing for which a depreciation deduction for rehabilitation expenses was allowed.
- 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.
- 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 for at least 16 years and 8 months, the 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 if you disposed of the property on the starting date of the proceedings.

**Example.** On June 1, 2024, you acquired low-income housing property. On April 3, 2023 (130 months after the property was acquired), foreclosure proceedings were started on the property, and on December 3, 2023 (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 minus 100 months) because it does not apply after April 3, 2023, 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 generally starts on the day after you acquired it. For example, if you bought low-income housing on January 1, 2008, the holding period starts on January 2, 2008. If you sold it on January 2, 2024, the holding period is exactly 192 full months. The applicable percentage for additional depreciation is 8%, or 100% minus 1% for each full month the property was held over 100 full months.

**Holding period for 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 the basis of which is figured by reference to the basis in the hands of the transferor, the holding period for 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 holding period of the difference 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 you dispose of low-income housing property that has two or more separate elements, the applicable percentage used to figure ordinary income because of additional depreciation may be different for each element. The gain to be reported as ordinary income is the sum of the ordinary income figured for each element.

The following are the types of separate elements.

- A separate improvement (defined below).
- The basic section 1250 property plus improvements not qualifying as separate improvements.
- The units placed in service at different times before all of 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, 2021; 50 on July 18, 2021; and the remaining 20 on January 18, 2022.

As a result, the apartment house consists of three separate elements.

**The 36-month test for separate improvements.** A separate improvement is any improvement (qualifying under *The 1-year test* below) added to the capital account of the property, but only if the total of the improvements during the 36-month period ending on the last day of any tax year is more than the greatest of the following amounts.

1. 25% 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. 10% of the unadjusted basis (adjusted basis plus depreciation and amortization adjustments) of the property at the start of the period determined in (1).
3. \$5,000.

**The 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 greater 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 1 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 of this year. During the year, the taxpayer made improvements A, B, and C, which cost \$1,000, \$600, and \$700, respectively. The sum of the improvements, \$2,300, is less than 1% of the unadjusted basis (\$3,000), so the improvements 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 these improvements would have been \$3,100. Then, it would 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. For example, 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 not 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 expense is treated as an addition to the capital account may depend on the final disposition of the

entire property. If the expense 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.** Use the following guidelines for figuring the applicable percentage for property with two or more elements.

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

Step 2. Multiply the percentage figured in Step 1 by the lesser of the additional depreciation after 1975 for the entire property or the gain from disposition of the entire property (the difference between the FMV 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 at a gain of \$25,000 low-income housing property subject to the ordinary income rules of section 1250. The property consisted of four elements (W, X, Y, and Z).

Step 1. 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 is \$24,000.

Step 2. 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 – \$4,000). \$20,000 is lower than the \$25,000 gain on the sale, so \$20,000 is used in Step 2.

Step 3. 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 figured as follows.

	Step 1	Step 2	Step 3	Ordinary income
W . . . .	0.50	\$10,000	68%	\$ 6,800
X . . . .	-0-	-0-	85%	-0-
Y . . . .	0.25	5,000	92%	4,600
Z . . . .	0.25	5,000	100%	5,000
<b>Sum of ordinary income of separate elements . . . . .</b>				<b>\$16,400</b>

### 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 amount realized that is more than the adjusted basis of the property. In any other disposition of the property, figure the FMV that is more than the adjusted basis.
2. Figure the additional depreciation for the periods after 1975.
3. Multiply the lesser of (1) or (2) by the applicable percentage, discussed earlier under [Applicable Percentage](#). Stop here if this is residential rental property or if (2) is equal to or more than (1). This is the gain treated as ordinary income because of additional depreciation.
4. Subtract (2) from (1).
5. Figure the additional depreciation for periods after 1969 but before 1976.
6. Add the lesser of (4) or (5) to the result in (3). This is the gain treated as ordinary income because of additional depreciation.

A limit on the amount treated as ordinary income for gain on like-kind exchanges and involuntary conversions is explained later.

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

**Corporations.** Corporations, other than S corporations, must recognize an additional amount as ordinary income on the sale or other disposition of section 1250 property. The additional amount treated as ordinary income is 20% of the excess of the amount that would have been ordinary income if the property were section 1245 property over the amount treated as ordinary income under section 1250.

Report this additional ordinary income on Form 4797, Part III, line 26f.

## 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, include the recapture income in your installment sale basis to determine your gross profit on the installment sale.

If you dispose of more than one asset in a single transaction, you must figure the gain on each asset separately 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, see Pub. 537.

## Gifts

If you make a gift of depreciable personal property or real property, you do not have to report income on the transaction. However, if the person who receives it (donee) sells or otherwise disposes of the property in a disposition subject to recapture, the donee must take into account the depreciation 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.

**Part gift and part sale or exchange.** If you transfer depreciable personal property or real property for less than its FMV 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 sale 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 an FMV 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 FMV and the \$20,000 sale price to your son. You have a taxable gain on the transfer of \$10,000 (\$20,000 sale price minus \$10,000 adjusted basis) that must be reported as ordinary income from depreciation. You report \$10,000 of your \$30,000 depreciation

as ordinary income on the transfer of the property, so 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 FMV of the property by the ordinary income and short-term capital gain that would have resulted had you sold the property at its FMV at the time of the contribution. Thus, your deduction for depreciable real or personal property given to a charitable organization does not include the potential ordinary gain from depreciation.

You may also have to reduce the FMV 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 Pub. 526.

**Bargain sale to charity.** If you transfer section 1245 or 1250 property to a charitable organization for less than its FMV and a deduction for the contribution part of the transfer is allowable, your ordinary income from depreciation is figured under different rules. First, figure the ordinary income as if you had sold the property at its FMV. Then, allocate that amount between the sale and the contribution parts of the transfer in the same proportion that you allocated your adjusted basis in the property to figure your gain. See [Bargain Sale](#) 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 FMV, 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 transferred to his or her estate or beneficiary. For information on the tax liability of a decedent, see Pub. 559.

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 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, a beneficiary, or other individual if the transfer is a sale or exchange on which gain is realized.

**Example 1.** You owned depreciable property that, upon your death, was inherited by your child. No ordinary income from 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 you when you died. However, if you sold the property before your death and realized a gain and if, because of your method of accounting, the proceeds from the sale are income in respect of a decedent reportable by your child, your child must report ordinary income from depreciation.

**Example 2.** The trustee of a trust created by a will transfers depreciable property to a beneficiary in satisfaction of a specific bequest of \$10,000. If the property had a value of \$9,000 at the date used for estate tax valuation purposes, the \$1,000 increase in value to the date of distribution is a gain realized by the trust. Ordinary income from 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 generally not result in your having to report ordinary income from depreciation unless money or property other than like-kind, similar, or related property is also received in the transaction. However, section 1245 recapture may occur when property that is not section 1245 property is received as part of a like-kind exchange or involuntary conversion even if no gain would otherwise be recognized. See the examples below for more information.



*The nonrecognition rules for like-kind exchanges only apply to exchanges of real property held for investment or for productive use in your trade or business and not held primarily for sale.*

## Ordinary Income Recapture in Like-Kind Exchanges

If you dispose of section 1245 or 1250 property in a like-kind exchange that is subject to ordinary income recapture (see *Depreciation Recapture*, earlier), a portion of your gain may be reportable as ordinary income.

**Section 1245 property.** If property is disposed of and the gain computed on the like-kind exchange is not recognized in whole or in part, the amount of gain recaptured as ordinary income under section 1245(b)(4) is the lesser of:

- The ordinary income recapture computed on the section 1245(a)(1) property, or
- The sum of the gain recognized on the like-kind exchange, plus the FMV of property acquired that is not section 1245 property.

**Example.** You exchange real property with an FMV of \$100,000 and basis of \$50,000 for real property with an FMV of \$60,000 and \$40,000 cash. The gain realized on

the exchange is \$50,000. The gain recognized on the like-kind exchange is \$40,000 (the cash received). The property you dispose of consists of section 1245 and section 1250 property. The section 1245 property has a basis of \$10,000 and an adjusted basis of \$0. The property received consists of \$45,000 of section 1250 property and \$15,000 of section 1245 property. The section 1245 ordinary income recapture is computed as follows.

Lesser of recomputed basis or amount realized on section 1245 property . . . . .	\$10,000
Adjusted basis of section 1245 property . . . . .	0
Ordinary income recapture under section 1245(a)(1) . . . . .	10,000
Gain recognized on like-kind exchange . . . . .	40,000
Plus: FMV of section 1250 property received . . . . .	45,000
<b>Section 1245(b)(4) limit . . . . .</b>	<b>\$85,000</b>

The lesser of the two amounts (\$10,000) recaptured as ordinary income.

In some instances, the amount recaptured for Section 1245 is greater than the gain otherwise recognized on the exchange. See the following example.

**Example.** Assume the same facts as in the above example, except the property you receive consists of real property with an FMV of \$100,000 and no cash is received. Your gain realized on the exchange is \$50,000, but no gain is recognized on the exchange. Your ordinary income recapture is still \$10,000, the lesser of the recapture amount of \$10,000 and the section 1245(b)(4) limit of \$45,000 (\$0 gain recognized plus \$45,000 FMV of section 1250 property received). You must recognize the \$10,000 recapture as ordinary income. The remaining \$40,000 gain is deferred. Similar rules apply for section 1252, 1254, and 1255 property. See Regulations sections 1.1252-2(d) and 1.1254-2(d), and Temporary Regulations section 16A.1255-2(c) for details on these types of property.

**Section 1250 property.** If the property disposed of contains section 1250 property that is subject to ordinary income depreciation recapture, the amount of gain taken into account in the like-kind exchange is limited to the greater of:

- The amount of gain recognized on the like-kind exchange, or
- The amount of section 1250 recapture less the FMV of the section 1250 property acquired in the transaction.

**Example.** You exchange real property with an FMV of \$200,000 and adjusted basis of \$120,000 for real property with an FMV of \$160,000 and \$40,000 cash. The gain recognized on the exchange is \$40,000 (the amount of cash received). The property you dispose of consists of section 1250 qualified improvement property (QIP) that has a basis of \$15,000 and adjusted basis of \$0 due to the additional first-year depreciation deduction taken. Assume you compute the section 1250 recapture amount on the QIP to be \$10,000. The property you receive is solely section 1250 property. The ordinary income recapture limit is computed as the greater of the following.

Gain recognized on the like-kind exchange . . . . .	\$40,000
or	
Section 1250 Recapture . . . . .	\$10,000
Less: FMV section 1250 property received . . . . .	(160,000)
Section 1250(d)(4)(A) limit . . . . .	<u><u>\$0</u></u>

The greater of these two amounts, \$40,000, is the limit of section 1250 ordinary recapture on the like-kind exchange. The section 1250 recapture on the QIP is less than the \$40,000 limit, so the \$10,000 section 1250 recapture is reported as ordinary income.

**Example.** Assume the same facts as in the above example except you receive only real property with an FMV of \$200,000 in the exchange and no cash. The gain realized on the exchange is \$80,000 (\$200,000 less adjusted basis of \$120,000) and the gain recognized is \$0. Your section 1250 ordinary income recapture limit is the greater of the following.

Gain recognized on the like-kind exchange . . . . .	\$0
or	
Section 1250(a)(1)(A) recapture . . . . .	\$10,000
Less: FMV section 1250 property received . . . . .	200,000
Section 1250(d)(4)(A) limit . . . . .	<u><u>\$0</u></u>

Because the section 1250(d)(4)(A) recapture is limited to \$0, the \$10,000 of ordinary income recapture attaches to the property acquired in the like-kind exchange and must be recognized when you sell or otherwise dispose of the property at a gain.

**Depreciable personal property.** If you have a gain from an involuntary conversion of your depreciable personal property, the amount to be reported as ordinary income from depreciation is the amount figured under the rules explained earlier (see [Section 1245 Property](#)), limited to the sum of the following amounts.

- The gain that must be included in income under the rules for involuntary conversions.
- The FMV of the replacement property other than depreciable personal property acquired in the transaction.

**Example 1.** You bought office machinery for \$1,500 2 years ago and deducted \$780 depreciation. This year, a fire destroyed the machinery and you received \$1,200 from your fire insurance, realizing a gain of \$480 (\$1,200 – \$720 adjusted basis). You choose to postpone reporting gain, but replacement machinery cost you only \$1,000. Your taxable gain under the rules for involuntary conversions is limited to the remaining \$200 insurance payment. All your replacement property is depreciable personal property, so your ordinary income from depreciation is limited to \$200.

**Example 2.** A fire destroyed office machinery you bought for \$116,000. The depreciation deductions were \$91,640 and the machinery had an adjusted basis of \$24,360. You received a \$117,000 insurance payment, realizing a gain of \$92,640.

You immediately spent \$105,000 of the insurance payment for replacement machinery and \$9,000 for stock that qualifies as replacement property, and you choose to postpone reporting the gain. \$114,000 of the \$117,000 insurance payment was used to buy replacement property, so the gain that must be included in income under the rules for involuntary conversions is the part not spent, or \$3,000. The part of the insurance payment (\$9,000) used to buy the nondepreciable property (the stock) must also be included in figuring the gain from depreciation.

The amount you must report as ordinary income on the transaction is \$12,000, figured as follows.

1) Gain realized on the transaction (\$92,640) limited to depreciation (\$91,640) . . . . .	\$91,640
2) Gain includible in income (amount not spent) . . . . .	3,000
Plus: FMV of property other than depreciable personal property (the stock) . . . . .	9,000
	<u>12,000</u>

**Amount reportable as ordinary income (lesser of (1) or (2)) . . . . .** \$12,000

If, instead of buying \$9,000 in stock, you bought \$9,000 worth of depreciable personal property similar or related in use to the destroyed property, you would only report \$3,000 as ordinary income.

**Depreciable real property.** If you have a gain from either a like-kind exchange or involuntary conversion of your depreciable real property, ordinary income from additional depreciation is figured under the rules explained earlier (see [Section 1250 Property](#)), limited to the greater of the following amounts.

- The gain that must be reported under the rules for like-kind exchanges or involuntary conversions plus the FMV of stock bought as replacement property in acquiring control of a corporation.
- The gain you would have had to report as ordinary income from additional depreciation had the transaction been a cash sale minus the cost (or FMV 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 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 reporting the gain. If the transaction had been a sale for cash only, 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 greater of the following amounts.

1. The gain that must be reported under the rules for involuntary conversions, \$1,000 (\$116,000 – \$115,000) plus the FMV of stock bought as qualified replacement property, \$5,000, for a total of \$6,000.
2. The gain you would have had to report as ordinary income from additional depreciation (\$20,000) had this transaction been a cash sale minus the cost of the depreciable real property bought (\$15,000), or \$5,000.

The ordinary income not reported, \$14,000 (\$20,000 – \$6,000), is carried over to the depreciable real property you bought as additional depreciation.

**Basis of property acquired.** If the ordinary income you have to report because of additional depreciation is limited, the total basis of the property you acquired is its FMV (its cost, if bought to replace property involuntarily converted into money) minus the gain postponed.

If you acquired more than one item of property, allocate the total basis among the properties in proportion to their FMV (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 FMV (or cost) of the depreciable real property acquired.
2. Add the FMV (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 FMV (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 FMV (or cost).

**Example 1.** In 1999, low-income housing property that you acquired and placed in service in 1994 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 December 1, 1999, 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 chose to postpone reporting the gain under 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 minus the \$51,600 gain you postponed, or \$38,400. The \$14,932 ordinary gain you did not report is treated as additional depreciation on the replacement property. If you sold the property in 2024, your holding period for figuring the applicable percentage of additional depreciation to report as ordinary income would have begun December 2, 1999, the day after you acquired the property.

**Example 2.** You received a \$90,000 fire insurance payment for depreciable real property (office building) with an adjusted basis of \$30,000. You use the whole payment to buy property similar in use, spending \$42,000 for depreciable real property and \$48,000 for land. You choose to postpone reporting the \$60,000 gain realized on the involuntary conversion. Of this gain, \$10,000 is ordinary income from additional depreciation but is not reported 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 minus \$10,000 ordinary income not 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 minus 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 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 FMVs to figure the part of your gain to be reported as ordinary income from depreciation. Different rules may 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 all of the following facts and circumstances.

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

**Like-kind exchanges and involuntary conversions.** If you dispose of and acquire depreciable personal property and other property (other than depreciable real property) in an involuntary conversion, the amount realized is allocated in the following way:

The amount allocated to the depreciable personal property disposed of is treated as consisting of:

1. The FMV of the depreciable personal property acquired; and
2. To the extent of any remaining balance, the FMV of the other property acquired.

The amount allocated to the other property disposed of is treated as consisting of the FMV 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 in the following way.

The amount 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:

1. The FMV of that type of property acquired; and
2. To the extent of any remaining balance, the excess FMV of the other types of property acquired. If the excess FMV 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 unallocated amount in any manner you choose.

**Example.** A fire destroyed your property with a total FMV of \$50,000. It consisted 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 (for a total of \$50,000) to buy machinery with an FMV of \$15,000 and nondepreciable property with an FMV 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 reporting your gain from the involuntary conversion. You must report \$9,000 as ordinary income from 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 FMV of each. The amount allocated to the machinery is  $\$30,000/\$50,000 \times \$40,000$ , or \$24,000. The amount allocated to the

other property is  $\$20,000/\$50,000 \times \$40,000$ , or \$16,000. Your gain on the involuntary conversion of the machinery is \$24,000 minus the \$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 FMV of the replacement machinery bought and \$9,000 of the FMV of other property bought in the transaction. All \$16,000 allocated to the other property disposed of is treated as consisting of the FMV of the other property that was bought.
3. Your potential ordinary income from 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 realized for the machinery that represents the FMV of property other than the depreciable property you bought.

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## 4.

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# Reporting Gains and Losses

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## Introduction

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

Although this discussion generally refers to Schedule D (Form 1040) and Form 8949, many of 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
- Form 8949

## 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
- ☐ **1099-B** Proceeds From Broker and Barter Exchange Transactions
- ☐ **1099-S** Proceeds From Real Estate Transactions
- ☐ **4684** Casualties and Thefts
- ☐ **4797** Sales of Business Property
- ☐ **6252** Installment Sale Income
- ☐ **6781** Gains and Losses From Section 1256 Contracts and Straddles
- ☐ **8824** Like-Kind Exchanges
- ☐ **8949** Sales and Other Dispositions of Capital Assets

See [How To Get Tax Help](#) at the end of this publication for information about getting 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 IRS.

**Form 1099-B.** If you sold property, such as stocks, bonds, or certain commodities, through a broker, you should receive Form 1099-B (or a substitute statement) from the broker. Use the Form 1099-B or substitute statement to complete Form 8949 and/or Schedule D. Whether or not you receive Form 1099-B, you must report all taxable sales of stock, bonds, commodities, etc., on Form 8949 and/or Schedule D, as applicable. For more information on figuring gains and losses from these transactions, see chapter 4 of Pub. 550. For information on reporting the gains and losses, see the Instructions for Form 8949 and the Instructions for Schedule D (Form 1040), or the instructions for the applicable Schedule D.

**Form 1099-S.** An information return 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 types of property.

- Land (improved or unimproved), including air space.
- An inherently permanent structure, including any residential, commercial, or industrial building.
- A condominium unit and its related fixtures and common elements (including land).
- Stock in a cooperative housing corporation.
- Any noncontingent interest in standing timber.

If you sold or exchanged any of the above types of property, the person responsible for closing the transaction must give you a copy of Form 1099-S, or a substitute statement containing the same information as Form 1099-S. Your Form 1099-S will show the gross proceeds from the sale or exchange in box 2. See the Instructions for Form 8949 and the Instructions for Schedule D (Form

1040) for how to report these transactions. Also see chapter 2 of Pub. 550.

For more information, see chapter 4 of Pub. 550. Also, see the Instructions for Form 8949.

## Schedule D and Form 8949

**Form 8949.** Individuals, corporations, and partnerships use Form 8949 to report the following.

- Sales or exchanges of capital assets, including stocks, bonds, etc., and real estate (if not reported on another form or schedule such as Form 4684, 4797, 6252, 6781, or 8824). Include these transactions even if you did not receive a Form 1099-B or 1099-S.
- Gains from involuntary conversions (other than from casualty or theft) of capital assets not used in your trade or business.
- Nonbusiness bad debts.
- Worthlessness of a security.
- The election to defer capital gain invested in a QOF.
- The disposition of interests in QOFs.

Individuals, if you are filing a joint return, complete as many copies of Form 8949 as you need to report all of your and your spouse's transactions. You and your spouse may list your transactions on separate forms or you may combine them. However, you must include on your Schedule D the totals from all Forms 8949 for both you and your spouse.

Corporations also use Form 8949 to report their share of gain or loss from a partnership, estate, or trust.

Business entities meeting certain criteria may have an exception to some of the normal requirements for completing Form 8949.

File Form 8949 with the Schedule D for the return you are filing. This includes Schedule D of Forms 1040, 1040-SR, 1041, 1065, 8865, 1120, 1120-S, 1120-C, 1120-F, 1120-FSC, 1120-H, 1120-IC-DISC, 1120-L, 1120-ND, 1120-PC, 1120-POL, 1120-REIT, 1120-RIC, and 1120-SF; and certain Forms 990-T. See the Instructions for Form 8949 for more information.

**Schedule D.** Use Schedule D to figure the overall gain or loss from transactions reported on Form 8949, and to report certain transactions you do not have to report on Form 8949. Before completing Schedule D, you may have to complete other forms as shown below.

- Complete all applicable lines of Form 8949 before completing lines 1b, 2, 3, 8b, 9, and 10 of your applicable Schedule D. See the Instructions for Form 8949 and the Instructions for Schedule D for special provisions and exceptions to completing Form 8949. Enter on Schedule D the combined totals from all your Forms 8949.
- For a sale, exchange, or involuntary conversion of business property, complete Form 4797 (discussed later).

- For a like-kind exchange, complete Form 8824. See [Reporting the exchange](#) under *Like-Kind Exchanges* in chapter 1.
- For an installment sale, complete Form 6252. See Pub. 537.
- For an involuntary conversion due to casualty or theft, complete Form 4684. See Pub. 547.
- For a disposition of an interest in, or property used in, an activity to which the at-risk rules apply, complete Form 6198. See Pub. 925.
- For a disposition of an interest in, or property used in, a passive activity, complete Form 8582. See Pub. 925.
- For gains and losses from section 1256 contracts and straddles, complete Form 6781. See Pub. 550.

See the instructions for the Schedule D you are filing for additional reporting requirements.

**Personal-use property.** Report gain on the sale or exchange of property held for personal use (such as your home) on Form 8949 and Schedule D (Form 1040), as applicable. Loss from the sale or exchange of property held for personal use is not deductible. But, if you had a loss from the sale or exchange of real estate held for personal use for which you received a Form 1099-S, report the transaction on Form 8949 and Schedule D, as applicable, even though the loss is not deductible. See the Instructions for Schedule D (Form 1040) and the Instructions for Form 8949 for information on how to report the transaction.

## Long and Short Term

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

If you received a Form 1099-B (or substitute statement), box 2 may help you determine whether the gain or loss is short term or long term.

Generally, if you hold a capital asset 1 year or less, the gain or loss from its disposition is short term. Report it in Part I of Form 8949 and/or Schedule D, as applicable. If you hold a capital asset longer than 1 year, the gain or loss from its disposition is generally long term. Report it in Part II of Form 8949 and/or Schedule D, as applicable.

However, certain partnership interests held in connection with the performance of services may be subject to different holding period rules. See the Instructions for Form 8949 for more information.

Table 4-1. **Do I Have a Short-Term or Long-Term Gain or Loss?**

IF you hold the property...	THEN you have a...
1 year or less	short-term capital gain or loss.
more than 1 year	long-term capital gain or loss.

These distinctions are essential to correctly arrive at your net capital gain or loss. Capital losses are allowed in full against capital gains plus up to \$3,000 of ordinary income. See [Capital Gains Tax Rates](#), later.


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

**Example.** If you bought an asset on June 15, 2023, you should start counting on June 16, 2023. If you sold the asset on June 15, 2024, your holding period is not longer than 1 year, but if you sold it on June 17, 2024, your holding period is longer than 1 year.

**Patent property.** If you dispose of patent property, you are considered to have held the property longer than 1 year, no matter 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 longer than 1 year, 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.



*The date the installment payment is received determines the capital gains rate that should be applied, not the date the asset was sold under an installment contract.*

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

**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 contributory 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.

**Gift.** If you receive a gift of property and your basis in it is figured using the donor's basis, your holding period includes the donor's holding period. For more information on basis, see Pub. 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

**Table 4-2. Holding Period for Different Types of Acquisitions**

Type of acquisition:	When your holding period starts:
Stocks and bonds bought on a securities market	Day after trading date you bought security. Ends on trading date you sold security.
U.S. Treasury notes and bonds	If bought at auction, day after notification of bid acceptance. If bought through subscription, day after subscription was submitted.
Nontaxable exchanges	Day after date you acquired old property.
Gift	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.
Real property bought	Generally, day after date you received title to the property.
Real property repossessed	Day after date you originally received title to the property, but does not include time between the original sale and date of repossession.

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 Pub. 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.** Combine your short-term capital gains and losses, including your share of short-term capital gains or losses from partnerships, S corporations, and fiduciaries and any short-term capital loss carryover. Do this by adding all your short-term capital gains. Then, add all your short-term capital losses. Subtract the lesser 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 combine your long-term capital gains and losses. Include the following items.

- Net section 1231 gain from Part I of Form 4797, after any adjustment for nonrecaptured section 1231 losses from prior tax years.
- Capital gain distributions from regulated investment companies (RICs) (mutual funds) and real estate investment trusts (REITs).
- Your share of long-term capital gains or losses from partnerships, S corporations, and fiduciaries.
- Any long-term capital loss carryover.

The result from combining these items with other long-term capital gains and losses is your net long-term capital gain or loss.

**Net gain.** If the total of your capital gains is more than the total of your capital losses, the difference is taxable. Different tax rates may apply to the part that is a net capital gain. See [Capital Gains Tax Rates](#), later.

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

## Treatment of Capital Losses

If your capital losses are more than your capital gains, you can deduct the difference as a capital loss deduction even if you do not have ordinary income to offset it. The yearly limit on the amount of the capital loss an individual 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.

- Your net loss is more than the yearly limit.
- Your taxable income is less than zero.

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

**Example.** You and your spouse sold property in 2024. The sale resulted in a capital loss of \$7,000. There were no other capital transactions. On your joint 2024 return, you and your spouse can deduct \$3,000, the yearly limit. You have taxable income of \$2,000. The unused part of the loss, \$4,000 (\$7,000 – \$3,000), is carried over to 2025.

If the capital loss had been \$2,000, it would not have been more than the yearly limit. The capital loss deduction would have been \$2,000. There would be no carryover to 2025.

**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 you carry over to the next tax year is added to short-term losses occurring in that year. A long-term loss you carry over to the next tax year is added

to long-term losses occurring in that year. 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.

**Joint and separate returns.** On a joint return, the capital gains and losses of spouses 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 can 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 yearly limit discussed earlier still applies in this situation. Even if the loss is greater than the limit, the decedent's estate cannot deduct the difference or carry it over to following years.

**Corporations.** A corporation can deduct capital losses only up to the amount of its capital gains. In other words, if a corporation has a net 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 Pub. 542.

## Capital Gains Tax Rates

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

The term "net capital gain" means the amount by which your net long-term capital gain for the year is more than your net short-term capital loss. For 2024, the maximum tax rates for individuals are 0%, 15%, 20%, 25%, and 28%. Use the Qualified Dividends and Capital Gain Tax Worksheet in the Instructions for Form 1040, or the Schedule D Tax Worksheet in the Instructions for Schedule D (Form 1040), whichever applies, to figure your tax if you have qualified dividends or net capital gain.

For more information, see chapter 4 of Pub. 550. Also, see the Instructions for Schedule D (Form 1040).

**Unrecaptured section 1250 gain.** Generally, this is the part of any long-term capital gain on section 1250 property (real property) that is due to depreciation. Unrecaptured section 1250 gain cannot be more than the net section 1231 gain or include any gain otherwise treated as ordinary income. Use the Unrecaptured Section 1250

Gain Worksheet in the Instructions for Schedule D (Form 1040) to figure your unrecaptured section 1250 gain. For more information about section 1250 property and net section 1231 gain, see chapter 3.

## Form 4797

Use Form 4797 to report the following.

- The sale or exchange of:
  1. Real property used in your trade or business;
  2. Depreciable and amortizable tangible property used in your trade or business (however, see [Disposition of depreciable property not used in trade or business](#), later);
  3. Oil, gas, geothermal, or other mineral properties; and
  4. Section 126 property.
- The involuntary conversion (from other than casualty or theft) of property used in your trade or business and capital assets held more than 1 year for business or profit (however, see [Disposition of depreciable property not used in trade or business](#), later).
- The disposition of noncapital assets (other than inventory or property held primarily for sale to customers in the ordinary course of your trade or business).
- The disposition of capital assets not reported on Schedule D.
- The gain or loss (including any related recapture) for partners and S corporation shareholders from certain section 179 property dispositions by partnerships and S corporations.
- The computation of recapture amounts under sections 179 and 280F(b)(2) of the Internal Revenue Code, when the business use of section 179 or listed property decreases to 50% or less.
- Gains or losses treated as ordinary gains or losses if you are a trader in securities or commodities and made a mark-to-market election under section 475(f) of the Internal Revenue Code.
- Election to defer a qualified section 1231 gain invested in a QOF. See the Instructions for Form 4797.

Use Form 4797 with forms such as Form 1040, 1065, 1120, or 1120-S.

**Section 1231 gains and losses.** Show any section 1231 gains and losses in Part I. Carry a net gain to Schedule D as a long-term capital gain. Carry a net loss to Part II of Form 4797 as an ordinary loss.

If you had any nonrecaptured net section 1231 losses from the preceding 5 tax years, reduce your net gain by those losses and report the amount of the reduction as an ordinary gain in Part II. Report any remaining gain on Schedule D. See [Section 1231 Gains and Losses](#) in chapter 3.

**Ordinary gains and losses.** Show any ordinary gains and losses in Part II. This includes a net loss or a recapture of losses from prior years figured in Part I of Form 4797. It also includes ordinary gain figured in Part III.

**Mark-to-market election.** If you made a mark-to-market election, you should report all gains and losses from trading as ordinary gains and losses in Part II of Form 4797, instead of as capital gains and losses on Form 8949 and Schedule D. See the Instructions for Form 4797. Also see *Special Rules for Traders in Securities* in chapter 4 of Pub. 550.

**Ordinary income from depreciation.** Figure the ordinary income from depreciation on personal property and additional depreciation on real property (as discussed in chapter 3) in Part III. Carry the ordinary income to Part II of Form 4797 as an ordinary gain. Carry any remaining gain to Part I as section 1231 gain, unless it is from a casualty or theft. Carry any remaining gain from a casualty or theft to Form 4684.

**Disposition of depreciable property not used in trade or business.** Generally, gain from the sale or exchange of depreciable property not used in a trade or business but held for investment or for use in a not-for-profit activity is capital gain. Generally, the gain is reported on Form 8949 and Schedule D. However, part of the gain on the sale or exchange of the depreciable property may have to be recaptured as ordinary income on Form 4797. Use Part III of Form 4797 to figure the amount of ordinary income recapture. The recapture amount is included on line 31 (and line 13) of Form 4797. See the instructions for Form 4797, Part III.

If the total gain for the depreciable property is more than the recapture amount, the excess is reported on Form 8949. On Form 8949, enter "From Form 4797" in column (a) of Part I (if the transaction is short term) or Part II (if the transaction is long term). Skip columns (b) and (c). In column (d), enter the excess of the total gain over the recapture amount. Leave columns (e) through (g) blank and complete column (h). If you invested this gain in a QOF and intend to elect the temporary deferral of the gain, see the Instructions for Form 8949, Form 8997 and its instructions, and the instructions for the applicable Schedule D.

Generally, loss from the sale or exchange of depreciable property not used in a trade or business but held for investment or for use in a not-for-profit activity is a capital loss. Report the loss on Form 8949 in Part I (if the transaction is short term) or Part II (if the transaction is long term). You can deduct capital losses up to the amount of your capital gains. In the case of taxpayers other than corporations, you can also deduct the lower of \$3,000 (\$1,500 if you are a married individual filing a separate return), or the excess of such losses over such gains. See the Instructions for Form 8949 and the Instructions for Schedule D (Form 1040).

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## How To Get Tax Help

If you have questions about a tax issue; need help preparing your tax return; or want to download free publications, forms, or instructions, go to [IRS.gov](https://www.irs.gov) to find resources that can help you right away.

**Preparing and filing your tax return.** After receiving all your wage and earnings statements (Forms W-2, W-2G, 1099-R, 1099-MISC, 1099-NEC, etc.); unemployment compensation statements (by mail or in a digital format) or other government payment statements (Form 1099-G); and interest, dividend, and retirement statements from banks and investment firms (Forms 1099), you have several options to choose from to prepare and file your tax return. You can prepare the tax return yourself, see if you qualify for free tax preparation, or hire a tax professional to prepare your return.

**Free options for tax preparation.** Your options for preparing and filing your return online or in your local community, if you qualify, include the following.

- **Direct File.** Direct File is a permanent option to file individual federal tax returns online—for free—directly and securely with the IRS. Direct File is an option for taxpayers in participating states who have relatively simple tax returns reporting certain types of income and claiming certain credits and deductions. While Direct File doesn't prepare state returns, if you live in a participating state, Direct File guides you to a state-supported tool you can use to prepare and file your state tax return for free. Go to [IRS.gov/DirectFile](https://www.irs.gov/DirectFile) for more information, program updates, and frequently asked questions.
- **Free File.** This program lets you prepare and file your federal individual income tax return for free using software or Free File Fillable Forms. However, state tax preparation may not be available through Free File. Go to [IRS.gov/FreeFile](https://www.irs.gov/FreeFile) to see if you qualify for free online federal tax preparation, e-filing, and direct deposit or payment options.
- **VITA.** The Volunteer Income Tax Assistance (VITA) program offers free tax help to people with low-to-moderate incomes, persons with disabilities, and limited-English-speaking taxpayers who need help preparing their own tax returns. Go to [IRS.gov/VITA](https://www.irs.gov/VITA), download the free IRS2Go app, or call 800-906-9887 for information on free tax return preparation.
- **TCE.** The Tax Counseling for the Elderly (TCE) program offers free tax help for all taxpayers, particularly those who are 60 years of age and older. TCE volunteers specialize in answering questions about pensions and retirement-related issues unique to seniors. Go to [IRS.gov/TCE](https://www.irs.gov/TCE) or download the free IRS2Go app for information on free tax return preparation.

- **MilTax.** Members of the U.S. Armed Forces and qualified veterans may use MilTax, a free tax service offered by the Department of Defense through Military OneSource. For more information, go to [MilitaryOneSource](https://MilitaryOneSource.com) ([MilitaryOneSource.mil/MilTax](https://MilitaryOneSource.com)). Also, the IRS offers Free Fillable Forms, which can be completed online and then e-filed regardless of income.

**Using online tools to help prepare your return.** Go to [IRS.gov/Tools](https://IRS.gov/Tools) for the following.

- [IRS.gov/DirectFile](https://IRS.gov/DirectFile) offers an Eligibility Checker to help you determine if Direct File is the right choice for your tax filing needs.
- The [Earned Income Tax Credit Assistant](https://IRS.gov/EITCAssistant) ([IRS.gov/EITCAssistant](https://IRS.gov/EITCAssistant)) determines if you're eligible for the earned income credit (EIC).
- The [Online EIN Application](https://IRS.gov/EIN) ([IRS.gov/EIN](https://IRS.gov/EIN)) helps you get an employer identification number (EIN) at no cost.
- The [Tax Withholding Estimator](https://IRS.gov/W4App) ([IRS.gov/W4App](https://IRS.gov/W4App)) makes it easier for you to estimate the federal income tax you want your employer to withhold from your paycheck. This is tax withholding. See how your withholding affects your refund, take-home pay, or tax due.
- The [First-Time Homebuyer Credit Account Look-up](https://IRS.gov/HomeBuyer) ([IRS.gov/HomeBuyer](https://IRS.gov/HomeBuyer)) tool provides information on your repayments and account balance.
- The [Sales Tax Deduction Calculator](https://IRS.gov/SalesTax) ([IRS.gov/SalesTax](https://IRS.gov/SalesTax)) figures the amount you can claim if you itemize deductions on Schedule A (Form 1040).



**Getting answers to your tax questions.** On [IRS.gov](https://IRS.gov), you can get up-to-date information on current events and changes in tax law.

- [IRS.gov/Help](https://IRS.gov/Help): A variety of tools to help you get answers to some of the most common tax questions.
- [IRS.gov/ITA](https://IRS.gov/ITA): The Interactive Tax Assistant, a tool that will ask you questions and, based on your input, provide answers on a number of tax topics.
- [IRS.gov/Forms](https://IRS.gov/Forms): Find forms, instructions, and publications. You will find details on the most recent tax changes and interactive links to help you find answers to your questions.
- You may also be able to access tax information in your e-filing software.

**Need someone to prepare your tax return?** There are various types of tax return preparers, including enrolled agents, certified public accountants (CPAs), accountants, and many others who don't have professional credentials. If you choose to have someone prepare your tax return, choose that preparer wisely. A paid tax preparer is:

- Primarily responsible for the overall substantive accuracy of your return,
- Required to sign the return, and

- Required to include their preparer tax identification number (PTIN).



*Although the tax preparer always signs the return, you're ultimately responsible for providing all the information required for the preparer to accurately prepare your return and for the accuracy of every item reported on the return. Anyone paid to prepare tax returns for others should have a thorough understanding of tax matters. For more information on how to choose a tax preparer, go to [Tips for Choosing a Tax Preparer](https://IRS.gov) on [IRS.gov](https://IRS.gov).*

**Employers can register to use Business Services Online.** The Social Security Administration (SSA) offers online service at [SSA.gov/employer](https://SSA.gov/employer) for fast, free, and secure W-2 filing options to CPAs, accountants, enrolled agents, and individuals who process Form W-2, Wage and Tax Statement; and Form W-2c, Corrected Wage and Tax Statement.

**Business tax account.** If you are a sole proprietor, a partnership, or an S corporation, you can view your tax information on record with the IRS and do more with a business tax account. Go to [IRS.gov/BusinessAccount](https://IRS.gov/BusinessAccount) for more information.

**IRS social media.** Go to [IRS.gov/SocialMedia](https://IRS.gov/SocialMedia) to see the various social media tools the IRS uses to share the latest information on tax changes, scam alerts, initiatives, products, and services. At the IRS, privacy and security are our highest priority. We use these tools to share public information with you. **Don't** post your social security number (SSN) or other confidential information on social media sites. Always protect your identity when using any social networking site.

The following IRS YouTube channels provide short, informative videos on various tax-related topics in English, Spanish, and ASL.

- [Youtube.com/irsvideos](https://Youtube.com/irsvideos).
- [Youtube.com/irsvideosmultilingua](https://Youtube.com/irsvideosmultilingua).
- [Youtube.com/irsvideosASL](https://Youtube.com/irsvideosASL).

**Online tax information in other languages.** You can find information on [IRS.gov/MyLanguage](https://IRS.gov/MyLanguage) if English isn't your native language.

**Free Over-the-Phone Interpreter (OPI) Service.** The IRS is committed to serving taxpayers with limited-English proficiency (LEP) by offering OPI services. The OPI Service is a federally funded program and is available at Taxpayer Assistance Centers (TACs), most IRS offices, and every VITA/TCE tax return site. The OPI Service is accessible in more than 350 languages.

**Accessibility Helpline available for taxpayers with disabilities.** Taxpayers who need information about accessibility services can call 833-690-0598. The Accessibility Helpline can answer questions related to current and future accessibility products and services available in alternative media formats (for example, braille, large print, audio, etc.). The Accessibility Helpline does not have

access to your IRS account. For help with tax law, refunds, or account-related issues, go to [IRS.gov/LetUsHelp](https://www.irs.gov/LetUsHelp).

**Alternative media preference.** Form 9000, Alternative Media Preference, or Form 9000(SP) allows you to elect to receive certain types of written correspondence in the following formats.

- Standard Print.
- Large Print.
- Braille.
- Audio (MP3).
- Plain Text File (TXT).
- Braille Ready File (BRF).

**Disasters.** Go to [IRS.gov/DisasterRelief](https://www.irs.gov/DisasterRelief) to review the available disaster tax relief.

**Getting tax forms and publications.** Go to [IRS.gov/Forms](https://www.irs.gov/Forms) to view, download, or print all the forms, instructions, and publications you may need. Or, you can go to [IRS.gov/OrderForms](https://www.irs.gov/OrderForms) to place an order.

**Mobile-friendly forms.** You'll need an IRS Online Account (OLA) to complete mobile-friendly forms that require signatures. You'll have the option to submit your form(s) online or download a copy for mailing. You'll need scans of your documents to support your submission. Go to [IRS.gov/MobileFriendlyForms](https://www.irs.gov/MobileFriendlyForms) for more information.

**Getting tax publications and instructions in eBook format.** Download and view most tax publications and instructions (including the Instructions for Form 1040) on mobile devices as eBooks at [IRS.gov/eBooks](https://www.irs.gov/eBooks).

IRS eBooks have been tested using Apple's iBooks for iPad. Our eBooks haven't been tested on other dedicated eBook readers, and eBook functionality may not operate as intended.

**Access your online account (individual taxpayers only).** Go to [IRS.gov/Account](https://www.irs.gov/Account) to securely access information about your federal tax account.

- View the amount you owe and a breakdown by tax year.
- See payment plan details or apply for a new payment plan.
- Make a payment or view 5 years of payment history and any pending or scheduled payments.
- Access your tax records, including key data from your most recent tax return, and transcripts.
- View digital copies of select notices from the IRS.
- Approve or reject authorization requests from tax professionals.
- View your address on file or manage your communication preferences.

**Get a transcript of your return.** With an online account, you can access a variety of information to help you during the filing season. You can get a transcript, review your

most recently filed tax return, and get your adjusted gross income. Create or access your online account at [IRS.gov/Account](https://www.irs.gov/Account).

**Tax Pro Account.** This tool lets your tax professional submit an authorization request to access your individual taxpayer IRS OLA. For more information, go to [IRS.gov/TaxProAccount](https://www.irs.gov/TaxProAccount).

**Using direct deposit.** The safest and easiest way to receive a tax refund is to e-file and choose direct deposit, which securely and electronically transfers your refund directly into your financial account. Direct deposit also avoids the possibility that your check could be lost, stolen, destroyed, or returned undeliverable to the IRS. Eight in 10 taxpayers use direct deposit to receive their refunds. If you don't have a bank account, go to [IRS.gov/DirectDeposit](https://www.irs.gov/DirectDeposit) for more information on where to find a bank or credit union that can open an account online.

**Reporting and resolving your tax-related identity theft issues.**

- Tax-related identity theft happens when someone steals your personal information to commit tax fraud. Your taxes can be affected if your SSN is used to file a fraudulent return or to claim a refund or credit.
- The IRS doesn't initiate contact with taxpayers by email, text messages (including shortened links), telephone calls, or social media channels to request or verify personal or financial information. This includes requests for personal identification numbers (PINs), passwords, or similar information for credit cards, banks, or other financial accounts.
- Go to [IRS.gov/IdentityTheft](https://www.irs.gov/IdentityTheft), the IRS Identity Theft Central webpage, for information on identity theft and data security protection for taxpayers, tax professionals, and businesses. If your SSN has been lost or stolen or you suspect you're a victim of tax-related identity theft, you can learn what steps you should take.
- Get an Identity Protection PIN (IP PIN). IP PINs are six-digit numbers assigned to taxpayers to help prevent the misuse of their SSNs on fraudulent federal income tax returns. When you have an IP PIN, it prevents someone else from filing a tax return with your SSN. To learn more, go to [IRS.gov/IPPIN](https://www.irs.gov/IPPIN).

**Ways to check on the status of your refund.**

- Go to [IRS.gov/Refunds](https://www.irs.gov/Refunds).
- Download the official IRS2Go app to your mobile device to check your refund status.
- Call the automated refund hotline at 800-829-1954.



*The IRS can't issue refunds before mid-February for returns that claimed the EIC or the additional child tax credit (ACTC). This applies to the entire refund, not just the portion associated with these credits.*

**Making a tax payment.** Payments of U.S. tax must be remitted to the IRS in U.S. dollars. [Digital assets](#) are **not**

accepted. Go to [IRS.gov/Payments](https://www.irs.gov/Payments) for information on how to make a payment using any of the following options.

- **IRS Direct Pay:** Pay your individual tax bill or estimated tax payment directly from your checking or savings account at no cost to you.
- **Debit Card, Credit Card, or Digital Wallet:** Choose an approved payment processor to pay online or by phone.
- **Electronic Funds Withdrawal:** Schedule a payment when filing your federal taxes using tax return preparation software or through a tax professional.
- **Electronic Federal Tax Payment System:** This is the best option for businesses. Enrollment is required.
- **Check or Money Order:** Mail your payment to the address listed on the notice or instructions.
- **Cash:** You may be able to pay your taxes with cash at a participating retail store.
- **Same-Day Wire:** You may be able to do same-day wire from your financial institution. Contact your financial institution for availability, cost, and time frames.

**Note.** The IRS uses the latest encryption technology to ensure that the electronic payments you make online, by phone, or from a mobile device using the IRS2Go app are safe and secure. Paying electronically is quick, easy, and faster than mailing in a check or money order.

**What if I can't pay now?** Go to [IRS.gov/Payments](https://www.irs.gov/Payments) for more information about your options.

- Apply for an [online payment agreement \(IRS.gov/OPA\)](https://www.irs.gov/OPA) to meet your tax obligation in monthly installments if you can't pay your taxes in full today. Once you complete the online process, you will receive immediate notification of whether your agreement has been approved.
- Use the [Offer in Compromise Pre-Qualifier](https://www.irs.gov/OIC) to see if you can settle your tax debt for less than the full amount you owe. For more information on the Offer in Compromise program, go to [IRS.gov/OIC](https://www.irs.gov/OIC).

**Filing an amended return.** Go to [IRS.gov/Form1040X](https://www.irs.gov/Form1040X) for information and updates.

**Checking the status of your amended return.** Go to [IRS.gov/WMAR](https://www.irs.gov/WMAR) to track the status of Form 1040-X amended returns.



*It can take up to 3 weeks from the date you filed your amended return for it to show up in our system, and processing it can take up to 16 weeks.*

**Understanding an IRS notice or letter you've received.** Go to [IRS.gov/Notices](https://www.irs.gov/Notices) to find additional information about responding to an IRS notice or letter.

**IRS Document Upload Tool.** You may be able use the Document Upload Tool to respond digitally to eligible IRS notices and letters by securely uploading required docu-

ments online through IRS.gov. For more information, go to [IRS.gov/DUT](https://www.irs.gov/DUT).

**Schedule LEP.** You can use Schedule LEP (Form 1040), Request for Change in Language Preference, to state a preference to receive notices, letters, or other written communications from the IRS in an alternative language. You may not immediately receive written communications in the requested language. The IRS's commitment to LEP taxpayers is part of a multi-year timeline that began providing translations in 2023. You will continue to receive communications, including notices and letters, in English until they are translated to your preferred language.

**Contacting your local TAC.** Keep in mind, many questions can be answered on IRS.gov without visiting a TAC. Go to [IRS.gov/LetUsHelp](https://www.irs.gov/LetUsHelp) for the topics people ask about most. If you still need help, TACs provide tax help when a tax issue can't be handled online or by phone. All TACs now provide service by appointment, so you'll know in advance that you can get the service you need without long wait times. Before you visit, go to [IRS.gov/TACLocator](https://www.irs.gov/TACLocator) to find the nearest TAC and to check hours, available services, and appointment options. Or, on the IRS2Go app, under the Stay Connected tab, choose the Contact Us option and click on "Local Offices."

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Below is a message to you from the Taxpayer Advocate Service, an independent organization established by Congress.

## The Taxpayer Advocate Service (TAS) Is Here To Help You

### What Is the Taxpayer Advocate Service?

The Taxpayer Advocate Service (TAS) is an independent organization within the Internal Revenue Service (IRS). TAS helps taxpayers resolve problems with the IRS, makes administrative and legislative recommendations to prevent or correct the problems, and protects taxpayer rights. We work to ensure that every taxpayer is treated fairly and that you know and understand your rights under the Taxpayer Bill of Rights. We are Your Voice at the IRS.

### How Can TAS Help Me?

TAS can help you resolve problems that you haven't been able to resolve with the IRS on your own. Always try to resolve your problem with the IRS first, but if you can't, then come to TAS. Our services are free.

- TAS helps all taxpayers (and their representatives), including individuals, businesses, and exempt organizations. You may be eligible for TAS help if your IRS problem is causing financial difficulty, if you've tried and been unable to resolve your issue with the IRS, or if you believe an IRS system, process, or procedure just isn't working as it should.
- To get help any time with general tax topics, visit [www.TaxpayerAdvocate.IRS.gov](https://www.TaxpayerAdvocate.IRS.gov). The site can help

you with common tax issues and situations, such as what to do if you make a mistake on your return or if you get a notice from the IRS.

- TAS works to resolve large-scale (systemic) problems that affect many taxpayers. You can report systemic issues at [www.IRS.gov/SAMS](http://www.IRS.gov/SAMS). (Be sure not to include any personal identifiable information.)

## How Do I Contact TAS?

TAS has offices in every state, the District of Columbia, and Puerto Rico. To find your local advocate's number:

- Go to [www.TaxpayerAdvocate.IRS.gov/Contact-Us](http://www.TaxpayerAdvocate.IRS.gov/Contact-Us),

- Check your local directory, or
- Call TAS toll free at 877-777-4778.

## What Are My Rights as a Taxpayer?

The Taxpayer Bill of Rights describes ten basic rights that all taxpayers have when dealing with the IRS. Go to [www.TaxpayerAdvocate.IRS.gov/Taxpayer-Rights](http://www.TaxpayerAdvocate.IRS.gov/Taxpayer-Rights) for more information about the rights, what they mean to you, and how they apply to specific situations you may encounter with the IRS. TAS strives to protect taxpayer rights and ensure the IRS is administering the tax law in a fair and equitable way.

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To help us develop a more useful index, please let us know if you have ideas for index entries. See "Comments and Suggestions" in the "Introduction" for the ways you can reach us.

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# Tax Publications for Business Taxpayers

See [How To Get Tax Help](#) for a variety of ways to get publications, including by computer, phone, and mail.

Keep for Your Records 

## General Guides

- 1 Your Rights as a Taxpayer
- 17 Your Federal Income Tax (For Individuals)
- 334 Tax Guide for Small Business (For Individuals Who Use Schedule C)
- 509 Tax Calendars

## Employer's Guides

- 15 (Circular E), Employer's Tax Guide
- 15-A Employer's Supplemental Tax Guide
- 15-B Employer's Tax Guide to Fringe Benefits
- 15-T Federal Income Tax Withholding Methods
- 926 Household Employer's Tax Guide

## Specialized Publications

- 225 Farmer's Tax Guide
- 463 Travel, Gift, and Car Expenses
- 505 Tax Withholding and Estimated Tax
- 510 Excise Taxes (Including Fuel Tax Credits and Refunds)
- 515 Withholding of Tax on Nonresident Aliens and Foreign Entities
- 517 Social Security and Other Information for Members of the Clergy and Religious Workers
- 527 Residential Rental Property (Including Rental of Vacation Homes)
- 534 Depreciating Property Placed in Service Before 1987
- 537 Installment Sales
- 538 Accounting Periods and Methods
- 541 Partnerships
- 542 Corporations
- 544 Sales and Other Dispositions of Assets
- 551 Basis of Assets
- 556 Examination of Returns, Appeal Rights, and Claims for Refund
- 560 Retirement Plans for Small Business (SEP, SIMPLE, and Qualified Plans)
- 561 Determining the Value of Donated Property
- 583 Starting a Business and Keeping Records
- 587 Business Use of Your Home (Including Use by Daycare Providers)
- 594 The IRS Collection Process
- 595 Capital Construction Fund for Commercial Fishers
- 597 Information on the United States-Canada Income Tax Treaty
- 598 Tax on Unrelated Business Income of Exempt Organizations
- 901 U.S. Tax Treaties
- 908 Bankruptcy Tax Guide
- 925 Passive Activity and At-Risk Rules
- 946 How To Depreciate Property
- 947 Practice Before the IRS and Power of Attorney
- 1544 Reporting Cash Payments of Over \$10,000 (Received in a Trade or Business)
- 1546 Taxpayer Advocate Service — Your Voice at the IRS

## Spanish Language Publications

- 1SP Derechos del Contribuyente
- 15SP Guía Tributaria para Empleadores
- 17SP El Impuesto Federal sobre los Ingresos Para Personas Físicas
- 179 (Circular PR), Guía Contributiva Federal para Patronos Puertorriqueños
- 334SP Guía Tributaria para Pequeños Negocios (Para Individuos que Usan el Anexo C)
- 594SP El Proceso de Cobro del IRS
- 850 English-Spanish Glossary of Tax 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)

**Commonly Used Tax Forms** See [How To Get Tax Help](#) for a variety of ways to get forms, including by computer, phone, and mail.

*Keep for Your Records*



**Form Number and Form Title**

<b>W-2</b>	Wage and Tax Statement
<b>W-4</b>	Employee's Withholding Certificate
<b>940</b>	Employer's Annual Federal Unemployment (FUTA) Tax Return
<b>941</b>	Employer's QUARTERLY Federal Tax Return
<b>944</b>	Employer's ANNUAL Federal Tax Return
<b>1040</b>	U.S. Individual Income Tax Return
<b>Sch. A</b>	Itemized Deductions
<b>Sch. B</b>	Interest and Ordinary Dividends
<b>Sch. C</b>	Profit or Loss From Business (Sole Proprietorship)
<b>Sch. D</b>	Capital Gains and Losses
<b>Sch. E</b>	Supplemental Income and Loss
<b>Sch. F</b>	Profit or Loss From Farming
<b>Sch. H</b>	Household Employment Taxes
<b>Sch. J</b>	Individuals With Income from Farming or Fishing
<b>Sch. R</b>	Credit for the Elderly or the Disabled
<b>Sch. SE</b>	Self-Employment Tax
<b>1040-ES</b>	Estimated Tax for Individuals
<b>1040-X</b>	Amended U.S. Individual Income Tax Return
<b>1065</b>	U.S. Return of Partnership Income
<b>Sch. D</b>	Capital Gains and Losses
<b>Sch. K-1</b>	Partner's Share of Income, Deductions, Credits, etc.
<b>1120</b>	U.S. Corporation Income Tax Return
<b>Sch. D</b>	Capital Gains and Losses
<b>1120-S</b>	U.S. Income Tax Return for an S Corporation
<b>Sch. D</b>	Capital Gains and Losses and Built-In Gains
<b>Sch. K-1</b>	Shareholder's Share of Income, Deductions, Credits, etc.
<b>2106</b>	Employee Business Expenses
<b>2210</b>	Underpayment of Estimated Tax by Individuals, Estates, and Trusts
<b>2441</b>	Child and Dependent Care Expenses
<b>2848</b>	Power of Attorney and Declaration of Representative
<b>3800</b>	General Business Credit
<b>3903</b>	Moving Expenses
<b>4562</b>	Depreciation and Amortization (Including Information on Listed Property)
<b>4797</b>	Sales of Business Property
<b>4868</b>	Application for Automatic Extension of Time To File U.S. Individual Income Tax Return
<b>5329</b>	Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts
<b>6252</b>	Installment Sale Income
<b>7004</b>	Application for Automatic Extension of Time To File Certain Business Income Tax, Information, and Other Returns
<b>8283</b>	Noncash Charitable Contributions
<b>8300</b>	Report of Cash Payments Over \$10,000 Received in a Trade or Business
<b>8582</b>	Passive Activity Loss Limitations
<b>8606</b>	Nondeductible IRAs
<b>8822</b>	Change of Address
<b>8829</b>	Expenses for Business Use of Your Home
<b>8949</b>	Sales and Other Dispositions of Capital Assets