

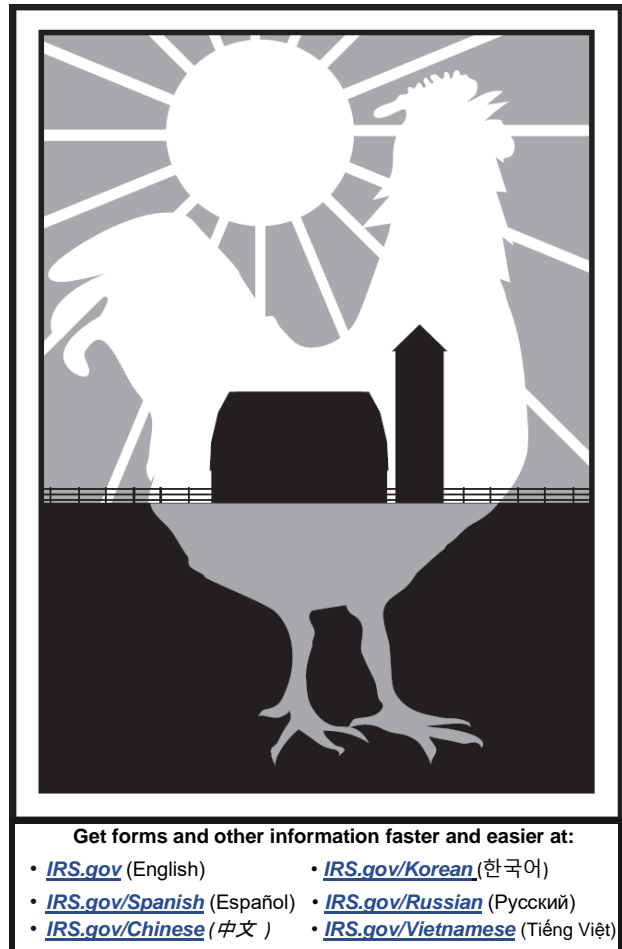
Publication 225

Farmers Tax Guide

For use in preparing

2024 Returns

Volume 8 of 11



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Example — **New Gross Profit**
Worksheet 10-2. **Percentage — Selling Price Reduced**
Keep for Your Records



1.	Enter the reduced selling price for the property	<u>85,000</u>
2.	Enter your adjusted basis for the property	<u>40,000</u>
3.	Enter your selling expenses	<u>-0-</u>
4.	Enter any depreciation recapture	<u>-0-</u>
5.	Add lines 2, 3, and 4	<u>40,000</u>
6.	Subtract line 5 from line 1. This is your adjusted gross profit	<u>45,000</u>
7.	Enter any installment sale income reported in prior year(s)	<u>22,605</u>
8.	Subtract line 7 from line 6	<u>22,395</u>
9.	Future installments	<u>47,325</u>
10.	Divide line 8 by line 9. This is your new gross profit percentage*	<u>47.32%</u>

* Apply this percentage to all future payments to determine how much of each of those payments is installment sale income.

You will report installment sale income of \$6,878 (47.32% of \$14,535) in 2024, \$7,449 (47.32% of \$15,742) in 2025, and \$8,067 (47.32% of \$17,048) in 2026.

Form 6252. Use Form 6252 to report an installment sale in the year it takes place and to report payments received, or considered received because of related party resales, in later years. Attach it to your tax return for each year.

Disposition of Installment Obligation

A disposition generally includes a sale, exchange, cancellation, bequest, distribution, or transmission of an installment obligation. An installment obligation is the buyer's note, deed of trust, or other evidence that the buyer will make future payments to you.

If you're using the installment method and you dispose of the installment obligation, you will generally have a gain or loss to report. It's considered gain or loss on the sale of the

property for which you received the installment obligation.

Cancellation. If an installment obligation is canceled or otherwise becomes unenforceable, it's treated as a disposition other than a sale or exchange. Your gain or loss is the difference between your basis in the obligation and its FMV at the time you cancel it. If the parties are related, the FMV of the obligation is considered to be no less than its full face value.

Transfer due to death. The transfer of an installment obligation (other than to a buyer) as a result of the death of the seller isn't a disposition. Any unreported gain from the installment obligation isn't treated as gross income to the decedent. No income is reported on the decedent's return due to the transfer. It is income in respect of a decedent. Whoever receives the installment obligation as a result of the seller's death is taxed on the installment payments the same

as the seller would've been had the seller lived to receive the payments.

However, if the installment obligation is canceled, becomes unenforceable, or is transferred to the buyer because of the death of the holder of the obligation, it's a disposition. The estate must figure its gain or loss on the disposition. If the holder and the buyer were related, the FMV of the installment obligation is considered to be no less than its full face value.

More information. For more information, see *Disposition of an Installment Obligation* in Pub. 537.

Sale of depreciable property. You generally can't report gain from the sale of depreciable property to a related person on the installment method. However, see *Related parties* under *Installment Sale of a Farm*, earlier.

You generally can't use the installment method to report any depreciation recapture income. However, you can report any gain greater than the recapture income on the installment method.

The recapture income reported in the year of sale is included in your installment sale basis to determine your gross profit on the installment sale.

Figure your depreciation recapture income (including the section 179 deduction and the section 179A deduction recapture) in Part III of Form 4797. As instructed on the form, transfer the depreciation recapture income to Part II of Form 4797 as ordinary income in the year of sale.



If you sell depreciable business property, prepare Form 4797 first in order to figure the amount to enter on Form 6252, Part I, line 12. See the Form 6252 instructions for details.

For more information on the section 179 deduction, see Section 179 Expense Deduction in chapter 7. For more information on depreciation recapture, see Depreciation Recapture in chapter 9.

Payments Received or Considered Received

You must figure your gain each year on the payments you receive, or are treated as receiving, from an installment sale.

In certain situations, you're considered to have received a payment, even though the buyer doesn't pay you directly. These situations occur when the buyer assumes or pays any of your debts, such as a loan, or pays any of your expenses, such as a sales commission. However, as discussed later, the buyer's assumption of your debt is treated as a recovery of basis, rather than as a payment, in many cases.

Buyer pays seller's expenses. If the buyer pays any of your expenses related to the sale of your property, it's considered a payment to you in the year of sale. Include these expenses in the selling and contract prices when figuring the gross profit percentage.

Buyer assumes mortgage. If the buyer assumes or pays off your mortgage, or otherwise takes the property subject to the mortgage, the following rules apply.

Mortgage less than basis. If the buyer assumes a mortgage that isn't more than your installment sale basis in the property, it isn't considered a payment to you. It's considered a recovery of your basis. The contract price is the selling price minus the mortgage.

Example. You sell property with an adjusted basis of \$19,000. You have selling expenses of \$1,000. The buyer assumes your existing mortgage of \$15,000 and agrees to pay you \$10,000 (a cash down payment of \$2,000

and \$2,000 (plus 8% interest) in each of the next 4 years).

The selling price is \$25,000 (\$15,000 + \$10,000). Your gross profit is \$5,000 (\$25,000 – \$20,000 installment sale basis). The contract price is \$10,000 (\$25,000 – \$15,000 mortgage). Your gross profit percentage is 50% (\$5,000 ÷ \$10,000). You report half of each \$2,000 payment received as gain from the sale. You also report all interest you receive as ordinary income.

Mortgage more than basis. If the buyer assumes a mortgage that is more than your installment sale basis in the property, you recover your entire basis. The part of the mortgage greater than your basis is treated as a payment received in the year of sale.

To figure the contract price, subtract the mortgage from the selling price. This is the total amount (other than interest) you will receive directly from the buyer. Add to this amount the payment you're considered to

have received (the difference between the mortgage and your installment sale basis). The contract price is then the same as your gross profit from the sale.



If the mortgage the buyer assumes is equal to or more than your installment sale basis, the gross profit percentage will always be 100%.

Example. The selling price for your property is \$90,000. The buyer will pay you \$10,000 annually (plus 8% interest) over the next 3 years and assume an existing mortgage of \$60,000. Your adjusted basis in the property is \$44,000. You have selling expenses of \$6,000, for a total installment sale basis of \$50,000. The part of the mortgage that is more than your installment sale basis is \$10,000 (\$60,000 – \$50,000). This amount is included in the contract price and treated as a payment received in the year of sale. The contract price is \$40,000:

Selling price Minus:	\$90,000
Mortgage	<u>(60,000)</u>

Amount actually received	<u>\$30,000</u>
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Add difference:

Mortgage	\$60,000
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Minus: Installment sale basis	<u>(50,000)</u>	<u>\$10,000</u>
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Contract price	<u>\$40,000</u>
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Your gross profit on the sale is also \$40,000

Selling price	\$90,000
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Minus: Installment sale basis	<u>(50,000)</u>
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Gross profit	<u>\$40,000</u>
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Your gross profit percentage is 100%. Report 100% of each payment (less interest) as gain from the sale. Treat the \$10,000 excess of the mortgage over your installment sale basis as a payment and report 100% of it as gain in the year of sale.

Buyer assumes other debts. If the buyer assumes any other debts, such as a loan or back taxes, it may be considered a payment to you in the year of sale.

If the buyer assumes the debt instead of paying it off, only part of it may have to be treated as a payment. Compare the debt to your installment sale basis in the property being sold. If the debt is less than your installment sale basis, none of it is treated as a payment. If it's more, only the difference is treated as a payment. If the buyer assumes more than one debt, any part of the total that is more than your installment sale basis is considered a payment. These rules are the same as the rules discussed earlier under

Buyer assumes mortgage. However, they apply only to the following types of debt the buyer assumes.

- Those acquired from ownership of the property you're selling, such as a mortgage, a lien, overdue interest, or back taxes.
- Those acquired in the ordinary course of your business, such as a balance due for inventory you purchased.

If the buyer assumes any other type of debt, such as a personal loan or your legal fees relating to the sale, it's treated as if the buyer had paid off the debt at the time of the sale. The value of the assumed debt is then considered a payment to you in the year of sale.

Property used as a payment. If you receive property rather than money from the buyer, it's still considered a payment in the year received. However, see Trading property for

like-kind property, later. Generally, the amount of the payment is the property's FMV on the date you receive it.

Exception. If the property the buyer gives you is payable on demand or readily tradable (see examples later), the amount you should consider as payment in the year received is:

- The FMV of the property on the date you receive it if you use the cash method of accounting;
- The face amount of the obligation on the date you receive it if you use an accrual method of accounting; or
- The stated redemption price at maturity less any OID or, if there is no OID, the stated redemption price at maturity appropriately discounted to reflect total unstated interest. See Unstated interest, later.

Examples. If you receive a note from the buyer as payment, and the note stipulates that you can demand payment from the buyer at any time, the note is **payable on demand**. If you receive marketable securities from the buyer as payment, and you can sell the securities on an established securities market (such as the New York Stock Exchange) at any time, the securities are **readily tradable**. In these examples, use the above rules to determine the amount you should consider as payment in the year received.

Debt not payable on demand. Any evidence of debt you receive from the buyer that isn't payable on demand isn't considered a payment. This is true even if the debt is guaranteed by a third party, including a government agency.

Fair market value (FMV). This is the price at which property would change hands between a willing buyer and a willing seller,

neither being under any compulsion to buy or sell and both having a reasonable knowledge of all the necessary facts.

Third-party note. If the property the buyer gives you is a third-party note (or other obligation of a third party), you're considered to have received a payment equal to the note's FMV. Because the FMV of the note is itself a payment on your installment sale, any payments you later receive from the third party aren't considered payments on the sale. The excess of the note's face value over its FMV is interest. Exclude this interest in determining the selling price of the property. However, see *Exception* under *Property used as a payment*, earlier.

Example. You sold real estate in an installment sale. As part of the down payment, the buyer assigned to you a \$50,000, 8% third-party note. The FMV of the third-party note at the time of the sale was

\$30,000. This amount, not \$50,000, is a payment to you in the year of sale.

The third-party note had an FMV equal to 60% of its face value ($\$30,000 \div \$50,000$), so 60% of each principal payment you receive on this note is a nontaxable return of capital. The remaining 40% is interest taxed as ordinary income.

Bond. A bond or other evidence of debt you receive from the buyer that is payable on demand or readily tradable in an established securities market is treated as a payment in the year you receive it. For more information on the amount you should treat as a payment, see *Exception* under *Property used as a payment*, earlier.

If you receive a government or corporate bond for a sale before October 22, 2004, and the bond has interest coupons attached or can be readily traded in an established securities market, you're considered to have received payment equal to the bond's FMV.

However, see Exception under *Property used as a payment*, earlier.

Buyer's note. The buyer's note (unless payable on demand) isn't considered payment on the sale. However, its full face value is included when figuring the selling price and the contract price. Payments you receive on the note are used to figure your gain in the year received.

Sale to a related person. If you sell depreciable property to a related person and the sale is an installment sale, you may not be able to report the sale using the installment method. For information on these rules, see the Instructions for Form 6252 and Related parties under *Installment Sale of a Farm*, earlier.

Trading property for like-kind property. If you trade business or investment real property solely for other business or investment real property of a like kind, you can postpone reporting the gain from the

trade. These trades are known as like-kind exchanges. The property you receive in a like-kind exchange is treated as if it were a continuation of the property you gave up. A trade isn't a like-kind exchange if the property you trade or the property you receive is property you hold primarily for sale to customers. See *Like-Kind Exchanges* in chapter 8 for a discussion of like-kind property.

If, in addition to like-kind property, you receive an installment obligation in the exchange, the following rules apply to determine installment sale income each year.

- The contract price is reduced by the FMV of the like-kind property received in the trade.
- The gross profit is reduced by any gain on the trade that can be postponed.

- Like-kind property received in the trade isn't considered payment on the installment obligation.

Unstated interest. An installment sale contract may provide that each deferred payment on the sale will include interest or that there will be an interest payment in addition to the principal payment. Interest provided in the contract is called stated interest.

If an installment sale contract doesn't provide for adequate stated interest, section 483 provides that part of the stated principal amount of the contract may be recharacterized as interest. This interest is called unstated interest.

If section 1274 applies to the contract, this interest is called original issue discount (OID).

Generally, if a buyer gives a debt in consideration for personal-use property, the unstated interest rules don't apply to the

buyer. Therefore, the buyer can't deduct the unstated interest. The seller must report the unstated interest as income. Personal-use property is any property in which substantially all of its use by the buyer isn't in connection with a trade or business or an investment activity.

If the debt is subject to section 483 rules and is also subject to the below-market loan rules, such as a gift loan, compensation-related loan, or corporation-shareholder loan, then both parties are subject to the below-market loan rules rather than the unstated interest rules.

Unstated interest reduces the stated selling price of the property and the buyer's basis in the property. It increases the seller's interest income and the buyer's interest expense.

In general, an installment sale contract provides for adequate stated interest if the stated interest rate (based on an appropriate

compounding period) is at least equal to the applicable federal rate (AFR).



The AFRs are published monthly in the Internal Revenue Bulletin (IRB).

You can access the IRBs at [IRS.gov/Guidance](https://www.irs.gov/guidance).

More information. For more information, see *Unstated Interest and Original Issue Discount (OID)* in Pub. 537.

Example

On January 3, 2024, you sold your farm, including the home, farmland, and buildings. You received \$50,000 down and the buyer's note for \$200,000. In addition, the buyer assumed an outstanding \$50,000 mortgage on the farmland. The total selling price was \$300,000. The note payments of \$25,000 each, plus adequate interest, are due every July 1 and January 1, beginning in July 2024. Your selling expenses were \$15,000.

Adjusted basis and depreciation. The adjusted basis and depreciation claimed on each asset sold are as follows:

	Seller's Basis	Depreciation Claimed	Adjusted Basis
Home	\$33,743	\$0	\$33,743
Farmland	73,610	0	73,610
Buildings	66,630	31,500	35,130

*Owned and used as main home for at least 2 of the 5 years prior to the sale.

Adjusted basis for installment sale purposes. To determine the adjusted basis for installment sale purposes, prorate the selling expense based on the relative FMV of each asset and add it to the adjusted basis (see above).

	Selling Expense	Adjusted Basis	Adjusted Basis for Installment Sale
Home*	\$3,000	\$33,743	\$36,743
Farmland	8,250	73,610	81,860
Buildings	3,750	35,130	38,880
	\$15,000	\$142,483	\$157,483

*Owned and used as main home for at least 2 of the 5 years prior to the sale.

Depreciation recapture. The buildings are section 1250 property. There may be specific rules for depreciation recapture of buildings (1250 property) using the straight-line method. See chapter 9 for more information on depreciation recapture.

Special rules may apply when you sell section 1250 assets depreciated under the straight-line method. See the Unrecaptured Section 1250 Gain Worksheet in the Instructions for

Schedule D (Form 1040). As payments are received on the installment sale, unrecognized 1250 gain must be recognized before any section 1231 gain is recognized. See chapter 3 of Pub. 544 for more information on section 1250 assets.

Gross profit. The following table shows each asset reported on the installment method, its selling price, adjusted basis for installment sale, gain, and gross profit.

	<u>Selling Price</u>	<u>Adjusted Basis</u>	<u>Gain</u>	<u>Gross Profit</u>
Home	\$60,000	\$36,743	\$23,257	\$0
Farmland	165,000	81,860	83,140	83,140
Buildings	75,000	38,880	36,120	36,120
	<u>\$300,000</u>	<u>\$157,483</u>	<u>\$142,517</u>	<u>\$119,260</u>

Home. The gain on the home (\$23,257) is excluded from your income because it qualifies for the exclusion of gain from the sale of a principal residence. Therefore, don't include that gain when you figure your gross profit percentage.

Section 1231 gains. The gain on the farmland and buildings is reported as section 1231 gains.

See Section 1231 Gains and Losses in chapter 9.

Contract price and gross profit percentage. The contract price is \$250,000. This is calculated by subtracting the \$50,000 mortgage assumed from the \$300,000 selling price.

Gross profit percentage for the sale is 47.704% ($\$119,260$ gross profit \div $\$250,000$ contract price). The gross profit percentage for each asset is figured as follows:

	Percent
Home	0
Farmland ($\$83,140 \div \$250,000$)	33.256
Buildings ($\$36,120 \div \$250,000$)	14.448
Total	47.704

Figuring the gain to report on the installment method. One hundred percent (100%) of each payment is reported on the installment method. The total amount received on the sale in 2024 is \$75,000 (\$50,000 down payment + \$25,000 payment on July 1). The installment sale part of the total payments received in 2024 is also \$75,000. Figure the gain to report for each asset by multiplying its gross profit percentage times \$75,000.

	Income
Home	\$0
Farmland ($33.256\% \times \$75,000$)	24,942
Buildings ($14.448\% \times \$75,000$)	<u>10,836</u>
Total installment income for 2024	<u>\$35,778</u>

Reporting the sale. Report the installment sale on three separate Forms 6252. One form should be filed for each component of the sale. Then, report the amounts from Form 6252 on Form 4797 and Schedule D (Form 1040). Attach a separate page to each Form 6252 that shows the computations in the example.



If you sell depreciable business property, prepare Form 4797 first in order to figure the amount to enter on Form 6252.

Section 1231 gains. The gains on the farmland and buildings are section 1231 gains. They are combined with any other section 1231 gains and losses. A net section 1231 gain is capital gain and a net section 1231 loss is an ordinary loss.

Installment income for years after 2024. You figure installment income for the years after 2024 by applying the same gross profit percentages to the payments you receive

each year. If you receive \$50,000 during the year, the entire \$50,000 is considered received on the installment sale ($100\% \times \$50,000$). You realize income as follows:

	Income
Home	\$0
Farmland ($33.256\% \times \$50,000$)	16,628
Buildings ($14.448\% \times \$50,000$)	<u>7,224</u>
Total installment income	<u>\$23,852</u>

In this example, no gain is ever recognized from the sale of your home. You will combine your section 1231 gains from this sale with section 1231 gains and losses from other sales in each of the later years to determine whether to report them as ordinary or capital gains. The interest received with each payment will be included in full as ordinary income.

Note. Refer to Pub. 523 to determine whether or not the sale of the personal residence will result in a taxable event.

Summary. The installment income (rounded to the nearest dollar) from the sale of the farm is reported as follows:

Selling price	\$300,000
Minus: Adjusted basis for installment reporting	(157,483)
Minus: Excluded gain from home	<u>(23,257)</u>
Gross profit	<u>\$119,260</u>

Gain reported in 2024 (year of sale) Gain reported in 2025:	\$35,778
\$50,000 × 47.704% Gain reported in 2026:	23,852
\$50,000 × 47.704% Gain reported in 2027:	23,852

\$50,000 × 47.704% Gain reported in 2028:	23,852
\$25,000 × 47.704%	<u>11,926</u>
Total gain reported	<u>\$119,260</u>

11.

Casualties, Thefts, and Condemnations

Reminder

Special rules for qualified disaster losses.

Special rules apply to federally declared disaster area losses. A federally declared disaster is a disaster that occurred in an area declared by the President to be eligible for federal assistance under the Robert T. Stafford Disaster Relief and Emergency Assistance Act.

See *Disaster Area Losses*, later, and Pub. 547, *Casualties, Disasters, and Thefts*, for more information on the special relief. Also, see [IRS.gov/DisasterTaxRelief](https://www.irs.gov/DisasterTaxRelief) for more information.

Introduction

This chapter explains the tax treatment of casualties, thefts, and condemnations. A casualty occurs when property is damaged, destroyed, or lost due to a sudden, unexpected, or unusual event. A theft occurs when property is stolen. A condemnation occurs when private property is legally taken for public use without the owner's consent. A casualty, theft, or condemnation may result in a deductible loss or taxable gain on your federal income tax return. You may have a deductible loss or a taxable gain even if only a portion of your property was affected by a casualty, theft, or condemnation.

An involuntary conversion occurs when you receive money or other property as reimbursement for a casualty, theft, condemnation, disposition of property under threat of condemnation, or certain other events discussed in this chapter.

If an involuntary conversion results in a gain and you buy qualified replacement property within the specified replacement period, you can postpone reporting the gain on your income tax return. For more information, see *Postponing Gain*, later.

Topics

This chapter discusses:

- Casualties and thefts
- How to figure a loss or gain
- Other involuntary conversions
- Postponing gain
- Disaster area losses
- Reporting gains and losses
- Drought involving property connected with a trade or business or a transaction entered into for profit

Useful Items

You may want to see:

Publication

- ☐ **523** Selling Your Home
- ☐ **525** Taxable and Nontaxable Income
- ☐ **536** Net Operating Losses (NOLs) for Individuals, Estates, and Trusts
- ☐ **542** Corporations
- ☐ **544** Sales and Other Dispositions of Assets
- ☐ **547** Casualties, Disasters, and Thefts
- ☐ **584** Casualty, Disaster, and Theft Loss Workbook (Personal-Use Property)
- ☐ **584-B** Business Casualty, Disaster, and Theft Loss Workbook
- ☐ **976** Disaster Relief

Form (and Instructions)

☐ **Sch A (Form 1040)** Itemized Deductions

☐ **Sch D (Form 1040)** Capital Gains and
Losses

☐ **Sch F (Form 1040)** Profit or Loss From
Farming

☐ **4684** Casualties and Thefts

☐ **4797** Sales of Business Property

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

Casualties and Thefts



For tax years 2018 through 2025, personal casualty and theft losses of an individual are deductible only to the extent they're attributable to a federally declared disaster. An exception to the rule limiting the deduction for personal casualty and theft losses to federal disaster losses applies where you have personal casualty

gains to the extent the losses don't exceed your gains.

If your property is destroyed, damaged, or stolen, you may have a deductible loss. If the insurance or other reimbursement is more than the adjusted basis of the destroyed, damaged, or stolen property, you may have a taxable gain.

Casualty. A casualty is the damage, destruction, or loss of property resulting from an identifiable event that is sudden, unexpected, or unusual.

- A sudden event is one that is swift, not gradual or progressive.
- An unexpected event is one that is ordinarily unanticipated and unintended.
- An unusual event is one that isn't a day-to-day occurrence and that isn't typical of the activity in which you were engaged.

Deductible losses. Deductible casualty losses can result from a number of different causes, including the following.

- Airplane crashes.
- Car, truck, or farm equipment accidents not resulting from your willful act or willful negligence.
- Earthquakes.
- Fires (but see *Nondeductible losses* next for exceptions).
- Floods.
- Freezing.
- Government-ordered demolition or relocation of a home that is unsafe to use because of a disaster, as discussed under *Disaster Area Losses* in Pub. 547.
- Lightning.
- Storms, including hurricanes and tornadoes.

- Terrorist attacks.
- Vandalism.
- Volcanic eruptions.

Note. For tax years 2018 through 2025, if you are an individual and you have a loss of personal-use property caused by one the events listed above, or other casualties or thefts, this loss is deductible only if it is attributable to a federally declared disaster. See Pub. 547 for more information.

Example. The event causing you to suffer a personal casualty loss occurred before January 1, 2018, but the casualty loss was not sustained until January 1, 2018, or later. If this loss was not attributed to a federally declared disaster, it is not deductible.

Nondeductible losses. A casualty loss isn't deductible if the damage or destruction is caused by the following.

- Accidentally breaking articles such as glassware or china under normal conditions.
- A family pet (explained below).
- A fire if you willfully set it, or pay someone else to set it.
- A car, truck, or farm equipment accident if your willful negligence or willful act caused it. The same is true if the willful act or willful negligence of someone acting for you caused the accident.
- Progressive deterioration (explained below).

Family pet. Loss of property due to damage by a family pet isn't deductible as a casualty loss unless the requirements discussed above under Casualty are met.

Example. You keep your horse in your yard. The ornamental fruit trees in your yard were damaged when your horse stripped the bark

from them. Some of the trees were completely girdled and died. Because the damage wasn't unexpected or unusual, the loss isn't deductible.

Progressive deterioration. Loss of property due to progressive deterioration isn't deductible as a casualty loss. This is because the damage results from a steadily operating cause or a normal process, rather than from a sudden event. Examples of damage due to progressive deterioration include damage from rust, corrosion, or termites. However, weather-related conditions or disease may cause another type of involuntary conversion. See *Other Involuntary Conversions*, later.

Theft. A theft is the taking and removing of money or property with the intent to deprive the owner of it. The taking of property must be illegal under the law of the state where it occurred and it must have been done with criminal intent. You don't need to show a conviction for theft.

Theft includes the taking of money or property by the following means.

- Blackmail.
- Burglary.
- Embezzlement.
- Extortion.
- Kidnapping for ransom.
- Larceny.
- Robbery.
- Threats.
- Timber trespass.

The taking of money or property through fraud or misrepresentation is theft if it is illegal under state or local law.

Decline in market value of stock. You can't deduct as a theft loss the decline in market value of stock acquired on the open market for investment if the decline is caused by

disclosure of accounting fraud or other illegal misconduct by the officers or directors of the corporation that issued the stock. However, you may be able to deduct it as a capital loss on Schedule D (Form 1040) if the stock is sold or exchanged or becomes completely worthless. You report a capital loss on Schedule D (Form 1040). For more information about stock sales, worthless stock, and capital losses, see chapter 4 of Pub. 550.

Mislaid or lost property. The simple disappearance of money or property isn't a theft. However, an accidental loss or disappearance of property can qualify as a casualty if it results from an identifiable event that is sudden, unexpected, or unusual.

Example. A car door is accidentally slammed on your hand, breaking the setting of your diamond ring. The diamond falls from the ring and is never found. The loss of the diamond is a casualty.

Farm Property Losses

You can deduct certain casualty or theft losses that occur in the business of farming. The following is a discussion of some losses you can deduct and some you can't deduct.

Livestock or produce bought for resale.

Casualty or theft losses of livestock or produce bought for resale are deductible on Schedule F (Form 1040) if you report your income on the cash method. If you report your income on an accrual method, take casualty and theft losses on property bought for resale by omitting the item from the closing inventory for the year of the loss. You can't take a separate deduction.

Livestock, plants, produce, and crops raised for sale. Losses of livestock, plants, produce, and crops raised for sale are generally not deductible if you report your income on the cash method. You have already deducted the cost of raising these items as farm expenses, so their basis is equal to zero.

For plants with a preproductive period of more than 2 years, you may have a deductible loss if you have a tax basis in the plants. You usually have a tax basis if you capitalized the expenses associated with these plants under the uniform capitalization rules. The uniform capitalization rules are discussed in chapter 6.

If you report your income on an accrual method, casualty or theft losses are deductible only if you included the items in your inventory at the beginning of your tax year. You get the deduction by omitting the item from your inventory at the close of your tax year. You can't take a separate casualty or theft deduction.

Income loss. A loss of future income isn't deductible.

Example. A severe flood destroyed your crops. Because you are a cash method taxpayer and already deducted the cost of raising the crops as farm expenses, this loss

isn't deductible, as explained above under *Livestock, plants, produce, and crops raised for sale*. You estimate that the crop loss will reduce your farm income by \$25,000. This loss of future income is also not deductible.

Loss of timber. If you sell timber downed as a result of a casualty, you may have a reportable gain. If you use the proceeds to buy qualified replacement property, you can postpone reporting the gain. See *Timber loss* in the section *Postponing Gain*, later.

Property used in farming. Casualty and theft losses of property used in your farm business usually result in deductible losses. If a fire or storm destroyed your barn, or you lose by casualty or theft farm equipment or an animal you bought for draft, breeding, dairy, or sport, you may have a deductible loss. See *How To Figure a Loss*, later.

Raised draft, breeding, dairy, or sporting animals. Generally, losses of raised draft, breeding, dairy, or sporting animals don't

result in deductible casualty or theft losses because you have no basis in the animals. However, you may have a basis in the animal and therefore may be able to claim a deduction, if you report your income using the accrual method, use inventories to determine your income, and included the animals in your inventory.

When you include livestock in inventory, its last inventory value is its basis. When you lose an inventoried animal held for draft, breeding, dairy, or sport by casualty or theft during the year, decrease ending inventory by the amount you included in inventory for the animal. You can't take a separate deduction.

How To Figure a Loss

How you figure a deductible casualty or theft loss depends on whether the loss was to farm or personal-use property and whether the property was stolen or partly or completely destroyed.

Farm property. Farm property is the property you use in your farming business. If your farm property was completely destroyed or stolen, your loss is figured as follows:

Your adjusted basis in the property

MINUS

Any salvage value

MINUS

Any insurance or other reimbursement you receive or expect to receive



You can use the schedules in Pub. 584-B to list your stolen, damaged, or destroyed business property and to figure your loss.

If your farm property was partially damaged, use the following steps to figure your casualty loss.

- 1.** Determine your adjusted basis in the property before the casualty or theft.

2. Determine the decrease in fair market value of the property as a result of the casualty or theft.
3. From the smaller of the amounts you determined in (1) and (2), subtract any insurance or other reimbursement you receive or expect to receive.

Personal-use property. For tax years 2018 through 2025, personal casualty and theft losses of an individual are deductible only to the extent they're attributable to a federally declared disaster. An exception to the rule limiting the deduction for personal casualty and theft losses to federal disaster losses applies where you have personal casualty gains to the extent the losses don't exceed your gains.

Personal-use property is property used by you or your family members for personal purposes and not used in your farm business or for income-producing purposes. The following items are examples of personal-use property.

- Your main home.
- Furniture and electronics used in your main home and not used in a home office or for business purposes.
- Clothing and jewelry.
- An automobile used for nonbusiness purposes.

You figure the casualty or theft loss on this property by taking the following steps.

1. Determine your adjusted basis in the property before the casualty or theft.
2. Determine the decrease in fair market value of the property as a result of the casualty or theft.
3. From the smaller of the amounts you determined in (1) and (2), subtract any insurance or other reimbursement you receive or expect to receive.

You must apply the deduction limits, discussed later, to determine your deductible loss.



You can use Pub. 584 to list your stolen or damaged personal-use property and figure your loss. It includes schedules to help you figure the loss on your home, its contents, and your motor vehicles.

Adjusted basis. Adjusted basis is your basis (usually cost) increased or decreased by various events, such as improvements and casualty losses. For more information about adjusted basis, see chapter 6.

Decrease in fair market value (FMV). The decrease in FMV is the difference between the property's value immediately before the casualty or theft and its value immediately afterward. FMV is defined in chapter 10 under *Payments Received or Considered Received*.

Appraisal. To figure the decrease in FMV because of a casualty or theft, you generally need a competent appraisal. But other measures, such as the cost of cleaning up or making repairs and certain safe harbor methods, can be used to establish decreases in FMV.

An appraisal to determine the difference between the FMV of the property immediately before a casualty or theft and immediately afterward should be made by a competent appraiser. The appraiser must recognize the effects of any general market decline that may occur along with the casualty. This information is needed to limit any deduction to the actual loss resulting from damage to the property.

Note. Several factors are important in evaluating the accuracy of an appraisal. See Pub. 547 for additional details regarding appraisals.

Cost of cleaning up or making repairs.

The cost of cleaning up after a casualty isn't part of a casualty loss. Neither is the cost of repairing damaged property after a casualty. But you can use the cost of cleaning up or making repairs after a casualty as a measure of the decrease in FMV if you meet all the following conditions.

- The repairs are actually made.
- The repairs are necessary to bring the property back to its condition before the casualty.
- The amount spent for repairs isn't excessive.
- The repairs fix the damage only.
- The value of the property after the repairs is not, due to the repairs, more than the value of the property before the casualty.

Landscaping. The cost of restoring landscaping to its original condition after a casualty may indicate the decrease in FMV. You may be able to measure your loss by what you spend on the following.

- Removing destroyed or damaged trees and shrubs, minus any salvage you receive.
- Pruning and other measures taken to preserve damaged trees and shrubs.
- Replanting necessary to restore the property to its approximate value before the casualty.

Safe harbor methods for individual taxpayers to determine casualty and theft losses. Revenue Procedure 2018-08, 2018-2 I.R.B. 286, available at [IRS.gov/IRB/2018-02_IRB#RP-2018-08](https://www.irs.gov/irb/2018-02_IRB#RP-2018-08), provides safe harbor methods that you may use to figure the amount of your casualty and theft losses of your personal-use residential real property

and personal belongings. If you qualify for and use a safe harbor method described in Revenue Procedure 2018-08, the IRS won't challenge your determination. The use of a safe harbor method described in Revenue Procedure 2018-08 isn't mandatory. For more information about this safe harbor method, see Pub. 547.

Related expenses. The incidental expenses due to a casualty or theft, such as expenses for the treatment of personal injuries, temporary housing, or a rental car, aren't part of your casualty or theft loss. However, they may be deductible as farm business expenses if the damaged or stolen property is farm property.

Separate computations for more than one item of property. Generally, if a single casualty or theft involves more than one item of property, you must figure your loss separately for each item of property. Then,

combine the losses to determine your total loss.

Example. A fire on your farm damaged a tractor and the barn in which it was stored. The tractor had an adjusted basis of \$3,300. Its FMV was \$28,000 just before the fire and \$10,000 immediately afterward. The barn had an adjusted basis of \$28,000. Its FMV was \$55,000 just before the fire and \$25,000 immediately afterward. You received insurance reimbursements of \$2,100 on the tractor and \$26,000 on the barn. Figure your deductible casualty loss separately for the two items of property.

	Tractor	Barn
1. Adjusted basis	\$3,300	\$28,000
2. FMV before fire	\$28,000	\$55,000
3. FMV after fire	10,000	25,000
4. Decrease in FMV (line 2 – line 3)	\$18,000	\$30,000

5. Loss (lesser of line 1 or line 4)	\$3,300	\$28,000
6. Minus: Insurance	2,100	26,000
7. Deductible casualty loss	\$1,200	\$2,000
8. Total deductible casualty loss		\$3,200

You spent \$10,800 restoring the tractor to its pre-casualty condition and \$30,000 restoring the barn to its pre-casualty condition. Your adjusted basis in the tractor after the casualty is \$10,800 ($\$3,300 - \$2,100 - \$1,200 + \$10,800$). Your adjusted basis in the barn after the casualty is \$30,000 ($\$28,000 - \$26,000 - \$2,000 + \$30,000$).

Exception for personal-use real property.

In figuring a casualty loss on personal-use real property, the entire property (including any improvements, such as buildings, trees,

and shrubs) is treated as one item. Figure the loss using the smaller of the following.

- The decrease in FMV of the entire property.
- The adjusted basis of the entire property.

Example. You bought a farm in 2010 for \$300,000. The adjusted basis of the residential part is now \$64,000. In 2024, a tornado, which was a federally declared disaster, blew down shade trees and three ornamental trees planted at a cost of \$3,750 on the residential part. The adjusted basis of the residential part includes the \$3,750. The FMV of the residential part immediately before the tornado was \$120,000, and \$112,500 immediately after the tornado. The trees weren't covered by insurance. Your adjusted gross income (AGI) for 2024 is \$55,000.

9. Adjusted basis	<u>\$64,000</u>
10. FMV before tornado	\$120,000
11. FMV after tornado	<u>112,500</u>
12. Decrease in FMV (line 2 – line 3)	<u>\$7,500</u>
13. Loss (lesser of line 1 or line 4)	\$7,500
14. Minus: Insurance	<u>-0-</u>
15. Loss before applying limits	<u>\$7,500</u>

As explained later under Deduction Limits on Losses of Personal-Use Property, you have to reduce the \$7,500 amount by the applicable limit or limits. As this loss is not a **qualified disaster loss**, the applicable limits would be \$100 and 10% of your AGI. Because this loss

is not attributed to a qualified disaster, your deductible loss would be figured as follows.

16.	Subtract \$100	<u>100</u>
17.	Loss after \$100 rule	<u>\$7,400</u>
18.	Subtract 10% of \$55,000 AGI	<u>5,500</u>
19.	Casualty loss deduction	<u>\$1,900</u>

You never replaced the trees. Your adjusted basis in the residential part of your property after the casualty is \$62,100 (\$64,000 - \$1,900).

Insurance and other reimbursements. If you receive an insurance or other type of reimbursement, you must subtract the reimbursement when you figure your business or personal loss. You don't have a casualty or theft loss to the extent you are reimbursed.

If you expect to be reimbursed for part or all of your loss, you must subtract the expected reimbursement when you figure your loss. You must reduce your loss even if you don't receive payment until a later tax year.



Don't subtract from your loss any insurance payments you receive for living expenses if you lose the use of your main home or are denied access to it because of a casualty. You may have to include a portion of these payments in your income. See Insurance payments for living expenses in Pub. 547 for details.

Reimbursement received after deducting loss. If you figure your casualty or theft loss using your expected reimbursement, you may have to adjust your tax return for the tax year in which you get your actual reimbursement.

Actual reimbursement less than expected. If you later receive less reimbursement than you expected, include

that difference as a loss with your other losses (if any) on your return for the year in which you can reasonably expect no more reimbursement.

Actual reimbursement more than expected.

If you later receive more reimbursement than you expected after you have claimed a deduction for the loss, you may have to include the extra reimbursement in your income for the year you receive it. However, if any part of your original deduction didn't reduce your tax for the earlier year, don't include that part of the reimbursement in your income. Don't refigure your tax for the year you claimed the deduction. See *Recoveries* in Pub. 525 to find out how much extra reimbursement to include in income.



If the total of all the reimbursements you receive is more than your adjusted basis in the destroyed or stolen property, you will have a gain on the casualty

or theft. See Figuring a Gain in Pub. 547 for information on how to treat a gain from the reimbursement you receive because of a casualty or theft.

Actual reimbursement same as expected.

If you later receive exactly the reimbursement you expected to receive, you don't have to include any of the reimbursement in your income and you can't deduct any additional loss.

Lump-sum reimbursement. If you have a casualty or theft loss of several assets at the same time without an allocation of reimbursement to specific assets, divide the lump-sum reimbursement among the assets according to the FMV of each asset at the time of the loss. Figure the gain or loss separately for each asset that has a separate basis.

Disaster assistance. Food, medical supplies, and other forms of assistance you receive don't reduce your casualty loss, unless they

are replacements for lost or destroyed property. Excludable cash gifts you receive also do not reduce your casualty loss if there are no restrictions on how you can use the money.

Generally, disaster relief grants received under the Robert T. Stafford Disaster Relief and Emergency Assistance Act aren't included in your income. See Federal disaster relief grants, later, under Disaster Area Losses.

Qualified disaster relief payments for expenses you incurred as a result of a federally declared disaster aren't taxable income to you. See Qualified disaster relief payments, later, under Disaster Area Losses.

Adjustments to basis. If you have a casualty or theft loss, you must decrease your basis in the property by any insurance or other reimbursement you receive and by any deductible loss. The result is your adjusted basis in the property. If you make either of the basis adjustments described above,

amounts you spend on repairs to restore your property to its pre-casualty condition increase your adjusted basis. See Adjusted Basis in chapter 6 for more information.

Example. You built a new grain storage facility for \$50,000. This is the basis in your grain storage facility because that is the total cost you incurred to build it. During the year, a tornado damaged your grain storage facility and your allowable casualty loss deduction was \$2,000. In addition, your insurance company reimbursed you \$8,000 for the damage and you spent \$12,000 to restore the grain storage facility to its pre-casualty condition. Your adjusted basis in the grain storage facility after the casualty is \$52,000 ($\$50,000 - \$2,000 - \$8,000 + \$12,000$).

Deduction Limits on Losses of Personal-Use Property

Casualty and theft losses of personal-use property may be deducted using Form 4684. For more information see the Instructions for

Form 4684. This deduction will be entered on Schedule A (Form 1040) as an itemized deduction but you can increase your standard deduction by qualified disaster losses if you elect not to itemize your deductions. See *Increased standard deduction reporting*, later.

For tax years 2018 through 2025, casualty and theft losses of personal-use property are deductible only to the extent they're attributable to a federally declared disaster.

An exception to the rule above (limiting the personal casualty and theft loss deduction to losses attributable to a federally declared disaster) applies if you have personal casualty gains for the tax year. In this case, you may reduce your personal casualty gains by any casualty losses not attributable to a federally declared disaster. Any excess gain is used to reduce losses from a federally declared disaster.

There are two limits on the deduction for casualty or theft loss of personal-use property. You figure these limits on Form 4684.

\$100 rule. You must reduce each casualty or theft loss on personal-use property by \$100. This rule applies after you have subtracted any reimbursement.

10% rule. You must further reduce the total of all your casualty or theft losses on personal-use property by 10% of your AGI. Apply this rule after you reduce each loss by \$100. AGI is reported on line 11 of Form 1040 or 1040-SR.

Example. In June, you discovered that your house had been burglarized. Your loss after insurance reimbursement was \$2,000. Your AGI for the year you discovered the burglary is \$57,000. Figure your theft loss deduction as follows:

1. Loss after insurance	\$2,000
2. Subtract \$100	100
3. Loss after \$100 rule	\$1,900
4. Subtract 10% (0.10) × \$57,000 AGI	\$5,700
5. Theft loss deduction	-0-

You don't have a theft loss deduction because your loss (\$1,900) is less than 10% of your AGI (\$5,700).



Please note this theft loss was not attributed to a major disaster declared by the President under section 401 of the Stafford Act and therefore would not be a deductible loss.



If you have personal casualty losses that were attributable to a major disaster declared by the President under section 401 of the Stafford Act, your net casualty loss from this qualified disaster

doesn't have to exceed 10% of your AGI to qualify for the deduction. However, this disaster must meet the following requirements:

- It must have been declared by the President during the period between January 1, 2020, and February 25, 2021.
- It must have an incident period that began on or after December 28, 2019, or on or before December 27, 2020, and ended no later than January 25, 2021.

Also, the \$100 limit per casualty is increased to \$500. For more information, see the Instructions for Form 4684.



If you have a casualty or theft gain in addition to a loss, you will have to make a special computation before you figure your 10% limit. See 10% Rule in Pub. 547.

When Loss Is Deductible

Generally, you can deduct casualty losses that aren't reimbursable only in the tax year in which they occur. You can generally deduct theft losses that aren't reimbursable only in the year you discover your property was stolen.

Example. In November 2023, engine parts were stolen from Frank's stored tractor. Frank didn't know that the theft occurred until March 2024, when he attempted to start the tractor. Any theft loss to which Frank is entitled as a deduction will be deductible in the 2024 tax year.

Losses in federally declared disaster areas are subject to different rules. See *Disaster Area Losses*, later, for an exception.

If you aren't sure whether part of your casualty or theft loss will be reimbursed, don't deduct that part until the tax year when you

become reasonably certain that it won't be reimbursed.

Leased property. If you lease property from someone else, you can deduct a loss on the property in the year your liability for the loss is determined. This is true even if the loss occurred or the liability was paid in a different year. You aren't entitled to a deduction until your liability under the lease can be determined with reasonable accuracy. Your liability can be determined when a claim for recovery is settled, adjudicated, or abandoned.

Example. Robert leased a tractor from First Implement, Inc., for use in his farm business.

The tractor was destroyed by a tornado in June 2023. The loss wasn't insured. First Implement billed Robert for the FMV of the tractor on the date of the loss. Robert disagreed with the bill and refused to pay it. First Implement later filed suit in court against Robert. In 2024, Robert and First

Implement agreed to settle the suit for \$20,000, and the court entered a judgment in favor of First Implement. Robert paid \$20,000 in June 2024. He can claim the \$20,000 as a loss on his 2024 tax return.

Net operating loss (NOL). If your deductions, including casualty or theft loss deductions, are more than your income for the year, you may have an NOL. See Pub. 536 for more information.



Generally, an NOL arising in a tax year beginning in 2018 or later may not be carried back and instead must be carried forward indefinitely. However, farming losses resulting in an NOL, arising in tax years beginning in 2018 or later, may be carried back two years and carried forward indefinitely.

Proof of Loss

To deduct a casualty or theft loss, you must be able to prove that there was a casualty or

theft. You must have records to support the amount you claim for the loss.

Casualty loss proof. For a casualty loss, your records should show all the following information.

- That you were the owner of the property or, if you leased the property from someone else, that you were contractually liable to the owner for the damage.
- The type of casualty (car accident, fire, storm, etc.) and when it occurred.
- That the loss was a direct result of the casualty.
- Whether a claim for reimbursement exists for which there is a reasonable expectation of recovery.

Theft loss proof. For a theft loss, your records should show all the following information.

- That you were the owner of the property.
- That your property was stolen.
- When you discovered your property was missing.
- Whether a claim for reimbursement exists for which there is a reasonable expectation of recovery.

Figuring a Gain

A casualty or theft may result in a taxable gain. If you receive an insurance payment or other reimbursement that is more than your adjusted basis in the destroyed, damaged, or stolen property, you have a gain from the casualty or theft. You generally report your gain as income in the year you receive the reimbursement. However, depending on the type of property you receive, you may not

have to report your gain. See *Postponing Gain*, later. Your gain is figured as follows:

- The amount you receive, minus
- Your adjusted basis in the property at the time of the casualty or theft.

Even if the decrease in FMV of your property is smaller than the adjusted basis of your property, use your adjusted basis to figure the gain.

Amount you receive. The amount you receive includes any money plus the value of any property you receive, minus any expenses you have in obtaining reimbursement. It also includes any reimbursement used to pay off a mortgage or other lien on the damaged, destroyed, or stolen property.

Example. A tornado severely damaged your barn. The adjusted basis of the barn was \$25,000. Your insurance company reimbursed you \$40,000 for the damaged barn. However,

you had legal expenses of \$2,000 to collect that insurance. Your insurance minus your expenses to collect the insurance is more than your adjusted basis in the barn, so you have a gain.

1. Insurance reimbursement	\$40,000
2. Legal expenses	<u>2,000</u>
3. Amount received (line 1 – line 2)	\$38,000
4. Adjusted basis	<u>25,000</u>
5. Gain on casualty (line 3 – line 4).	<u>\$13,000</u>

The adjusted basis of the barn after the casualty is \$0 (\$25,000 + \$13,000 – \$38,000) if you recognized gain and did not repair the barn.

Other Involuntary Conversions

In addition to casualties and thefts, other events cause involuntary conversions of property. Some of these are discussed in the following paragraphs.

Gain or loss from an involuntary conversion of your property is usually recognized for tax purposes. You report the gain or deduct the loss on your tax return for the year you realize it. However, depending on the type of property you receive, you may not have to report your gain on the involuntary conversion. See *Postponing Gain*, later.

Condemnation

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 property. The owner receives a

condemnation award (money or property) in exchange for the property taken. A condemnation is a forced sale, the owner being the seller and the condemning authority being the buyer.

Threat of condemnation. Treat the sale of your property under threat of condemnation as a condemnation, provided you have reasonable grounds to believe that your property will be condemned.

Main home condemned. If you have a gain because your main home is condemned, you generally can exclude the gain from your income as if you had sold or exchanged your home. For information on this exclusion, see Pub. 523. If your gain is more than the amount you can exclude, but you buy replacement property, you may be able to postpone reporting the excess gain. See Postponing Gain, later. (You can't deduct a loss from the condemnation of your main home.)

More information. For information on how to figure the gain or loss on condemned property, see chapter 1 in Pub. 544. Also, see *Postponing Gain*, later, to find out if you can postpone reporting the gain.

Irrigation Project

The sale or other disposition of property located within an irrigation project to conform to the acreage limits of federal reclamation laws is an involuntary conversion.

Livestock Losses

Diseased livestock. If your livestock die from disease, or are destroyed, sold, or exchanged because of disease, even though the disease isn't of epidemic proportions, treat these occurrences as involuntary conversions. If the livestock were raised or purchased for resale, follow the rules for livestock discussed earlier

under Farm Property Losses. Otherwise, figure the gain or loss from these conversions using the rules discussed under Determining Gain or Loss in chapter 8. If you replace the livestock, you may be able to postpone reporting the gain. See Postponing Gain below.

Reporting dispositions of diseased livestock. If you choose to postpone reporting gain on the disposition of diseased livestock, you must attach a statement to your return explaining that the livestock were disposed of because of disease. You must also include other information on this statement. See How To Postpone Gain, later, under Postponing Gain.

Weather-related sales of livestock. If you sell or exchange livestock (other than poultry) held for draft, breeding, or dairy purposes solely because of drought, flood, or other weather-related conditions, treat the sale or exchange as an involuntary conversion. Only

livestock sold in excess of the number you normally would sell under usual business practice, in the absence of weather-related conditions, are considered involuntary conversions. Figure the gain or loss using the rules discussed under Determining Gain or Loss in chapter 8. If you replace the livestock, you may be able to postpone reporting the gain. See Postponing Gain below.

Example. It is your usual business practice to sell five of your dairy animals during the year. This year, you sold 20 dairy animals because of drought. The sale of 15 animals is treated as an involuntary conversion.



If you don't replace the livestock, you may be able to report the gain in the following year's income. This rule also applies to other livestock (including poultry). See Sales Caused by Weather-Related Conditions in chapter 3.

Tree Seedlings

If, because of an abnormal drought, the failure of planted tree seedlings is greater than normally anticipated, you may have a deductible loss. Treat the loss as a loss from an involuntary conversion. The loss equals the previously capitalized reforestation costs you had to duplicate on replanting. You deduct the loss on the return for the year the seedlings died.

Postponing Gain

Don't report a gain if you receive reimbursement in the form of property similar or related in service or use to the destroyed, stolen, or other involuntarily converted property. Your basis in the new property is generally the same as your adjusted basis in the property it replaces.

You must generally report the gain on your stolen, destroyed, or other involuntarily converted property if you receive money or

unlike property as reimbursement. However, you can choose to postpone reporting the gain if you purchase replacement property similar or related in service or use to your destroyed, stolen, or other involuntarily converted property within a specific replacement period.

If you have a gain on damaged property, you can postpone reporting the gain if you spend an amount at least equal to the reimbursement to restore the property.

To postpone reporting all the gain, the cost of your replacement property must be at least as much as the reimbursement you receive. If the cost of the replacement property is less than the reimbursement, you must include the gain in your income up to the amount of the unspent reimbursement. For more information about postponing gain on the replacement of damaged property, see Code section 1033.

Example 1. In 2005, you constructed a barn to store farm equipment at a cost of \$70,000. In 2010, you added a grain bin to the barn at a cost of \$30,000. In May of this year, the property was worth \$140,000. In June, the barn and grain storage facility were destroyed by a tornado. At the time of the tornado, you had an adjusted basis of \$0 in the property. You received \$140,000 from the insurance company. You had a gain of \$140,000 (\$140,000 – \$0).

You spent \$130,000 to rebuild the barn and grain bin. Since this is less than the insurance proceeds received, you must include \$10,000 (\$140,000 – \$130,000) in your income. You choose to postpone the remaining \$130,000 gain.

Example 2. In 2013, you bought a cabin in the mountains for your personal use at a cost of \$70,000. You made no further improvements or additions to it. When a storm destroyed the cabin this January, the

cabin was worth \$250,000. You received \$146,000 from the insurance company in March. You had a gain of \$76,000 (\$146,000 – \$70,000).

You spent \$144,000 to rebuild the cabin. Since this is less than the insurance proceeds received, you must include \$2,000 (\$146,000 – \$144,000) in your income. You choose to postpone reporting the remaining \$74,000 gain.

Buying replacement property from a related person. You can't postpone reporting a gain from a casualty, theft, or other involuntary conversion if you buy the replacement property from a related person (discussed later), and any of 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. Individuals, partnerships (other than those in (2) above), and S corporations if the total realized gain for the tax year on all involuntarily converted properties on which there are realized gains is more than \$100,000.

For involuntary conversions described in (3) above, gains can't be offset by 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 doesn't apply if the related person acquired the property from an unrelated person within the period of time allowed for replacing the involuntarily converted property.

Related persons. Under this rule, related persons include, for example, a parent and child, a brother and sister, a corporation and an individual who owns more than 50% of its outstanding stock, and two partnerships in which the same C corporations own more than 50% of the capital or profits interests.

For more information on related persons, see *Nondeductible Loss under Sales and Exchanges Between Related Persons* in chapter 2 of Pub. 544.

Death of a taxpayer. If a taxpayer dies after realizing a gain, but before buying replacement property, the gain must be reported for the year in which the decedent realized the gain. The executor of the estate or the person succeeding to the funds from the involuntary conversion can't postpone reporting the gain by buying replacement property.

Replacement Property

You must buy replacement property for the specific purpose of replacing your property. Your replacement property must be similar or related in service or use to the property it replaces. You don't have to use the same funds you receive as reimbursement for your old property to acquire the replacement property. If you spend the money you receive for other purposes, and borrow money to buy replacement property, you can still choose to postpone reporting the gain if you meet the other requirements. Property you acquire by gift or inheritance doesn't qualify as replacement property.

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. Examples of property that functions in the same way as the property it replaces are a home that replaces another home, a dairy

cow that replaces another dairy cow, and farm land that replaces other farm land. A grinding mill that replaces a tractor doesn't qualify. Neither does a draft animal that replaces a breeding or dairy cow.

Soil or other environmental contamination. If, because of soil or other environmental contamination, it isn't feasible for you to reinvest your insurance money or other proceeds from destroyed or damaged livestock in property similar or related in service or use to the livestock, you can treat other property (including real property) used for farming purposes as property similar or related in service or use to the destroyed or damaged livestock.