

# Publication 544

## Sales and Other Dispositions of Assets

For use in preparing

**2024** Returns

Volume 3 of 5



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Publication 544 (Rev 2024) Catalog Number 39291D  
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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	<u>5,000</u>
Total received.....	\$31,000
Minus: Adjusted basis of property transferred .....	<u>(20,000)</u>
<b>Realized gain.....</b>	<b><u>\$11,000</u></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.

## **2.**

# **Ordinary or Capital Gain or Loss**

## **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.

## **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.

## **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 liquidating sale of its assets. Gain or loss is also generally recognized on a liquidating distribution of assets as if the corporation sold the assets to the distributee at 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.....	<u>(160,000)</u>
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**Section 1231 gain..... \$1,240,000**

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).

### **3.**

## **Ordinary or Capital Gain or Loss for Business Property**

### **Introduction**

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

## 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.