

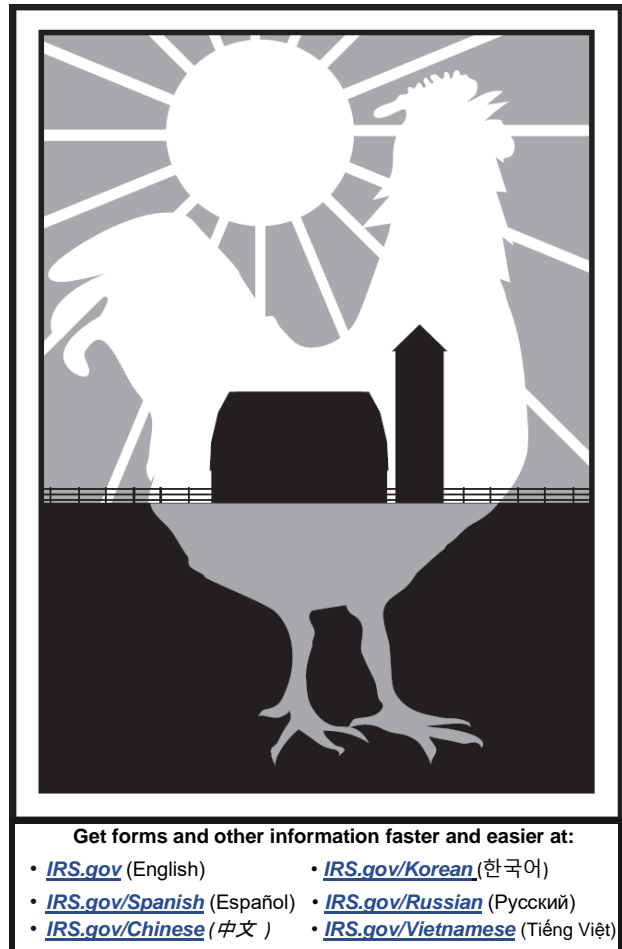
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Farmers Tax Guide

For use in preparing

2024 Returns

Volume 4 of 11



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The deductibility of not-for-profit losses applies to individuals, partnerships, estates, trusts, and S corporations. It doesn't apply to corporations other than S corporations.

In determining whether you are carrying on your farming activity for profit, all the facts are taken into account. No one factor alone is decisive. Among the factors to consider are whether:

- You operate your farm in a businesslike manner;
- The time and effort you spend on farming indicate you intend to make it profitable;
- You depend on income from farming for your livelihood;
- Your losses are due to circumstances beyond your control or are normal in the start-up phase of farming;
- You change your methods of operation in an attempt to improve profitability;

- You, or your advisors, have the knowledge needed to carry on the farming activity as a successful business;
- You were successful in making a profit in similar activities in the past;
- You make a profit from farming in some years and the amount of profit you make; and
- You can expect to make a future profit from the appreciation of the assets used in the farming activity.

Presumption of profit. Your farming or other activity is presumed carried on for profit if it produced a profit in at least 3 of the last 5 tax years, including the current year.

Activities that consist primarily of breeding, training, showing, or racing horses are presumed carried on for profit if they produced a profit in at least 2 of the last 7 tax years, including the current year. The activity must be substantially the same for each year

within this period. You have a profit when the gross income from an activity is more than the deductions for it.

If a taxpayer dies before the end of the 5-year (or 7-year) period, the period ends on the date of the taxpayer's death.

If your business or investment activity passes this 3- (or 2-) years-of-profit test, presume it is carried on for profit. This means the limits discussed here don't apply. You can take all your business deductions from the activity on Schedule F, even for the years that you have a loss. You can rely on this presumption in every case, unless the IRS shows it isn't valid.

If you fail the 3- (or 2-) years-of-profit test, you may still be considered to operate your farm for profit by considering the factors listed earlier.

Using the presumption later. If you are starting out in farming and don't have 3 (or 2) years showing a profit, you may want to take advantage of this presumption later, after you have had the 5 (or 7) years of experience allowed by the test.

You can choose to do this by filing Form 5213. Filing this form postpones any determination that your farming activity isn't carried on for profit until 5 (or 7) years have passed since you first started farming. You must file Form 5213 within 3 years after the due date of your return for the year in which you first carried on the activity, or, if earlier, within 60 days after receiving a written notice from the IRS proposing to disallow deductions attributable to the activity.

The benefit gained by making this choice is that the IRS won't immediately question whether your farming activity is engaged in for profit. Accordingly, it won't limit your deductions. Rather, you will gain time to earn

a profit in 3 (or 2) out of the first 5 (or 7) years you carry on the farming activity. If you show 3 (or 2) years of profit at the end of this period, your deductions aren't limited under these rules. If you don't have 3 (or 2) years of profit (and can't otherwise show that you operated your farm for profit), the limit applies retroactively to any year in the 5-year (or 7-year) period with a loss.

Filing Form 5213 automatically extends the period of limitations on any year in the 5-year (or 7-year) period to 2 years after the due date of the return for the last year of the period. The period is extended only for deductions of the activity and any related deductions that might be affected.

Limit on deductions and losses. If your activity isn't carried on for profit, take deductions only in the following order, and only to the extent stated in the three categories.

Category 1. Deductions you can take for personal as well as for business activities are allowed in full. For individuals, all nonbusiness deductions, such as those for home mortgage interest, taxes, and casualty losses (attributable to a federally declared disaster), belong in this category. See chapter 11 for more information. For the limits that apply to mortgage interest, see Pub. 936.

Category 2. Deductions that don't result in an adjustment to the basis of property are allowed next, but only to the extent your gross income from the activity is more than the deductions you take (or could take) under the first category. Most business deductions, such as those for fertilizer, feed, insurance premiums, utilities, wages, etc., belong in this category.

Category 3. Business deductions that decrease the basis of property are allowed last, but only to the extent the gross income from the activity is more than deductions you

take (or could take) under the first two categories. The deductions for depreciation, amortization, and the part of a casualty loss an individual could not deduct in category 1 belong in this category.

Where more than one asset is involved, divide depreciation and these other deductions proportionally among those assets.



The Tax Cuts and Jobs Acts (TCJA) suspended miscellaneous itemized deductions, so these deductions are not available for tax years beginning after December 31, 2017 and before January 1, 2026.

Partnerships and S corporations. If a partnership or S corporation carries on a not-for-profit activity, these limits apply at the partnership or S corporation level. They are reflected in the individual shareholder's or partner's distributive shares.

More information. For more information on not-for-profit activities, see *Not-for-Profit Activities* in chapter 9 of Pub. 334.

5.

Soil and Water Conservation Expenses

Introduction

If you are in the business of farming, you can choose to deduct certain expenses for:

- Soil or water conservation,
- Prevention of erosion of land used in farming, or
- Endangered species recovery.

Otherwise, these are capital expenses that must be added to the basis of the land. (See chapter 6 for information on determining basis.)

Generally, once a farmer has adopted this method of treating soil and water conservation expenditures, the farmer must deduct all such expenditures (up to the 25%

limitation) for the current and later tax years. See Change of method, later.

The deduction for conservation expenses cannot be more than 25% of your gross income from farming. See 25% Limit on Deduction, later.



Conservation expenses for land in a foreign country do not qualify for this special treatment.

Although some expenses are not deductible as soil and water conservation expenses, they may be deductible as ordinary and necessary farm expenses. These include interest and taxes, the cost of periodically clearing brush from productive land, the regular removal of sediment from a drainage ditch, and expenses paid or incurred primarily to produce an agricultural crop that may also conserve soil.

You must include in income most government payments for approved conservation practices. However, you can exclude some

payments you receive under certain cost-sharing conservation programs. For more information, see *Agricultural Program Payments* in chapter 3.



To get the full deduction to which you are entitled, you should maintain your records to clearly distinguish between your ordinary and necessary farm business expenses and your soil and water conservation expenses. **Topics.** This chapter discusses the following.

- Business of farming,
- Plan certification,
- Conservation expenses,
- Assessment by conservation district,
- 25% limit on deduction,
- When to deduct or capitalize, and
- Sale of a farm.

Business of Farming

For purposes of soil and water conservation expenses, you are in the business of farming if you cultivate, operate, or manage a farm for profit, either as an owner or a tenant. You are not in the business of farming if you cultivate or operate a farm for recreation or pleasure, rather than for profit. You are not farming if you are engaged only in forestry or the growing of timber.

Farm defined. A farm includes livestock, dairy, poultry, fish, fruit, and truck farms. It also includes plantations, ranches, ranges, and orchards. A fish farm is an area where fish and other marine animals are grown or raised and artificially fed, protected, etc. It doesn't include an area where they are merely caught or harvested. A plant nursery is a farm for purposes of deducting soil and water conservation expenses.

Farm rental. If you own a farm and receive farm rental payments based on farm production, either in cash or crop shares, you are in the business of farming.

If you receive a fixed rental payment that is not based on farm production, you are in the business of farming only if you materially participate in operating or managing the farm.

Example. You own a farm in Iowa. You rent out the farm for \$250 in cash per acre and don't materially participate in producing or managing production of the crops grown on the farm. You can't deduct your soil conservation expenses for this farm. You must capitalize the expenses and add them to the basis of the land.



If you receive cash rent for a farm you own that is not used in farm production, you can't deduct soil and water conservation expenses for that farm.

For more information, see Material participation for landlords under Landlord Participation in Farming in chapter 12.

Plan Certification

You can deduct soil and water conservation expenses only if they are consistent with a plan approved by the Natural Resources Conservation Service (NRCS) of the Department of Agriculture. If no such plan exists, the expenses must be consistent with a soil conservation plan of a comparable state agency. Keep a copy of the plan with your books and records to support your deductions.

Conservation plan. A conservation plan includes the farming conservation practices approved for the area where your farmland is located. There are three types of approved plans.

- NRCS individual site plans. These plans are issued individually to farmers who

request assistance from NRCS to develop a conservation plan designed specifically for their farmland.

- NRCS county plans. These plans include a listing of farm conservation practices approved for the county where the farmland is located. You can deduct expenses for conservation practices not included on the NRCS county plans only if the practice is a part of an individual site plan.
- Comparable state agency plans. These plans are approved by state agencies and can be approved individual site plans or county plans.

A list of NRCS conservation programs is available at

[NRCS.USDA.gov/programs/initiatives.](https://www.nrcs.usda.gov/programs/initiatives)

Individual site plans can be obtained from NRCS offices and the comparable state agencies.

Conservation Expenses

You can deduct conservation expenses only for land you or your tenant are using, or have used in the past, for farming. These expenses include, but are not limited to, the following.

1. The treatment or movement of earth, such as:
 - a. Leveling,
 - b. Conditioning,
 - c. Grading,
 - d. Terracing,
 - e. Contour furrowing, and
 - f. Restoration of soil fertility.
2. The construction, control, and protection of:
 - a. Diversion channels;
 - b. Drainage ditches;
 - c. Irrigation ditches;

- d. Earthen dams; and
 - e. Watercourses, outlets, and ponds.
- 3. The eradication of brush.
 - 4. The planting of windbreaks.

You can't deduct expenses to drain or fill wetlands, or to prepare land for center pivot irrigation systems, as soil and water conservation expenses. These expenses are added to the basis of the land.



If you choose to deduct soil and water conservation expenses, you must include as gross income any cost-sharing payments you receive for those expenses. See chapter 3 for information about payments eligible for the cost-sharing exclusion.

New farm or farmland. If you acquire a new farm or new farmland from someone who was using it in farming immediately before

you acquired the land, soil and water conservation expenses you incur on it will be treated as made on land used in farming at the time the expenses were paid or incurred. You can deduct soil and water conservation expenses for this land if your use of it is substantially a continuation of its use in farming. The new farming activity doesn't have to be the same as the old farming activity. For example, if you buy land that was used for grazing cattle and then prepare it for use as an apple orchard, you can deduct your conservation expenses.

Land not used for farming. If your conservation expenses benefit both land that doesn't qualify as land used for farming and land that does qualify, you must allocate the expenses between the two types of land. Land that doesn't qualify as land used for farming would include uncultivated land, which would need to be developed for farming. Because the land is not used in

farming during the time that developmental expenditures are made, no deduction for soil and water conservation expenses is available under section 175. For example, if the expenses benefit 200 acres of your land, but only 120 acres of this land are used for farming, then you can deduct 60% ($120 \div 200$) of the expenses. You can use another method to allocate these expenses if you can clearly show that your method is more reasonable.

Table 5-1. Limits on Deducting an Assessment by a Conservation District for Depreciable Property

Total Limit on Deduction for Assessment for	Yearly Limit on Deduction for Assessment for	Yearly Limit for All Conservation Expenses
------------------------------------------------------------------------	-------------------------------------------------------------------------	---------------------------------------------------------------

Depreciable Property	Depreciable Property	
10% of:	\$500 + 10% of:	25% of:
Total assessment against all members of the district for the property.	Your deductible share of the cost to the district for the property.	Your gross income from farming.
<ul style="list-style-type: none"> • No one taxpayer can deduct more than 10% of the total assessment. • Any amount over 10% is a capital 	<ul style="list-style-type: none"> • If the amount you pay or incur for any year is more than the limit, you can deduct for that year only 10% of 	<ul style="list-style-type: none"> • Limit for all conservation expenses, including assessments for depreciable property. • Amounts greater than

<p>expense and is added to the basis of your land.</p> <ul style="list-style-type: none"> • If an assessment is paid in installments, each payment must be prorated between the conservation expense and the capital expense. 	<p>your deductible share of the cost.</p> <ul style="list-style-type: none"> • You can deduct the remainder in equal amounts over the next 9 tax years. 	<p>25% can be carried to the following year and added to that year's expenses. The total is then subject to the 25% of gross income from farming limit in that year.</p>
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Depreciable conservation assets. You generally can't deduct your expenses for depreciable conservation assets. However, you can deduct certain amounts you pay or incur for an assessment for depreciable

property that a soil and water conservation or drainage district levies against your farm. See *Assessment for Depreciable Property*, later.

You must capitalize expenses to buy, build, install, or improve depreciable structures or facilities. These expenses include those for materials, tile (including drainage tile), pipe, pumps (and other equipment), supplies, wages, fuel, hauling, and moving dirt when making or installing structures such as tanks, reservoirs, culverts, canals, dams, drainage systems, waste management systems or wells composed of masonry, concrete, tile (including drainage tile), metal, or wood. You recover your capital investment through annual allowances for depreciation.

You can deduct soil and water conservation expenses for nondepreciable earthen items. Nondepreciable earthen items include certain dams, ponds, and terraces described under *Property Having a Determinable Useful Life* in chapter 7.

Water well. You can't deduct the cost of drilling a water well for irrigation and other agricultural purposes as a soil and water conservation expense. It is a capital expense. You recover your cost through depreciation. You must also capitalize your cost for drilling a test hole. If the test hole produces no water and you continue drilling, the cost of the test hole is added to the cost of the producing well. You can recover the total cost through depreciation deductions.

If a test hole, dry hole, or dried-up well (resulting from prolonged lack of rain, for instance) is abandoned, you can deduct your unrecovered cost in the year of abandonment. Abandonment means that all economic benefits from the well are terminated. For example, filling or sealing a well excavation or casing so that all economic benefits from the well are terminated constitutes an abandonment.

Endangered species recovery expenses.

If you are in the business of farming and meet other specific requirements, you can choose to deduct the conservation expenses discussed earlier as endangered species recovery expenses. Otherwise, these are capital expenses that must be added to the basis of the land.

The expenses must be paid or incurred for the purpose of achieving site-specific management actions recommended in a recovery plan approved under section 4(f) of the Endangered Species Act of 1973. See section 175 for more information.

Assessment by Conservation District

In some localities, a soil or water conservation or drainage district incurs expenses for soil or water conservation and levies an assessment against the farmers who benefit from the expenses. You can deduct as a conservation expense amounts you pay or incur for the part of an assessment that:

- Covers expenses you could deduct if you had paid them directly, or
- Covers expenses for depreciable property used in the district's business.

A water or drainage district assessment for repairs or maintenance of district property or for interest paid by the district for a loan to buy property may qualify as a business deduction. See Regulations section 1.164-4(b)(1).

Assessment for Depreciable Property

You can generally deduct as a conservation expense amounts you pay or incur for the part of a conservation or drainage district assessment that covers expenses for depreciable property.

This includes items such as pumps, locks, concrete structures (including dams and weir gates), draglines, and similar equipment. The depreciable property must be used in the district's soil and water conservation

activities. However, the following limits apply to these assessments.

- The total assessment limit.
- The yearly assessment limit.

After you apply these limits, the amount you can deduct is added to your other conservation expenses for the year. The total for these expenses is then subject to the 25% of gross income from farming limit on the deduction, discussed later. See Table 5-1 for a brief summary of these limits.



To ensure your deduction is within the deduction limits, keep records to show the following.

- The total assessment against all members of the district for the depreciable property.
- Your deductible share of the cost to the district for the depreciable property.
- Your gross income from farming.

Total assessment limit. You can't deduct more than 10% of the total amount assessed to all members of the conservation or drainage district for the depreciable property. This applies whether you pay the assessment in one payment or in installments. If your assessment is more than 10% of the total amount assessed, both the following rules apply.

- The amount over 10% is a capital expense and is added to the basis of your land.
- If the assessment is paid in installments, each payment must be prorated between the conservation expense and the capital expense.

Yearly assessment limit. The maximum amount you can deduct in any 1 year is the total of 10% of your deductible share of the cost as explained earlier, plus \$500. If the amount you pay or incur is equal to or less than the maximum amount, you can deduct it in the year it is paid or incurred. If the

amount you pay or incur is more, you can deduct in that year only 10% of your deductible share of the cost. You can deduct the remainder in equal amounts over the next 9 tax years. Your total conservation expense deduction for each year is also subject to the 25% of gross income from farming limit on the deduction, discussed later.

Example 1. This year, the soil conservation district levies, and you pay, an assessment of \$2,400 against your farm. Of the assessment, \$1,500 is for digging drainage ditches. You can deduct this part as a soil or conservation expense as if you had paid it directly. The remaining \$900 is for depreciable equipment to be used in the district's irrigation activities. The total amount assessed by the district against all its members for the depreciable equipment is \$7,000.

The total amount you can deduct for the depreciable equipment is limited to 10% of the total amount assessed by the district

against all its members for depreciable equipment, or \$700. The \$200 excess (\$900 – \$700) is a capital expense you must add to the basis of your farm.

To figure the maximum amount you can deduct for the depreciable equipment this year, multiply your deductible share of the total assessment (\$700) by 10% (0.10). Add \$500 to the result for a total of \$570. Your deductible share, \$700, is greater than the maximum amount deductible in 1 year, so you can deduct only \$70 of the amount you paid or incurred for depreciable property this year (10% of \$700). You can deduct the balance at the rate of \$70 a year over the next 9 years.

You add \$70 to the \$1,500 portion of the assessment for drainage ditches. You can deduct \$1,570 of the \$2,400 assessment as a soil and water conservation expense this year, subject to the 25% of gross income

from farming limit on the deduction, discussed later.

Example 2. Assume the same facts as in *Example 1* except that \$1,850 of the \$2,400 assessment is for digging drainage ditches and \$550 is for depreciable equipment. The total amount assessed by the district against all its members for depreciable equipment is \$5,500. The total amount you can deduct for the depreciable equipment is limited to 10% of this amount, or \$550.

The maximum amount you can deduct this year for the depreciable equipment is \$555 (10% of your deductible share of the total assessment, \$55, plus \$500). Since your deductible share is less than the maximum amount deductible in 1 year, you can deduct the entire \$550 this year. You can deduct the entire assessment, \$2,400, as a soil and water conservation expense this year, subject to the 25% of gross income from farming limit on the deduction, discussed below.

Sale or other disposal of land during 9-year period. If you dispose of the land during the 9-year period for deducting conservation expenses subject to the yearly limit, any amounts you have not yet deducted because of this limit are added to the basis of the property.

Death of farmer during 9-year period. If a farmer dies during the 9-year period, any remaining amounts not yet deducted are deducted in the year of death.

25% Limit on Deduction

The total deduction for conservation expenses in any tax year is limited to 25% of your gross income from farming for that year. For farming partnerships and S corporations, this is applied to each partner or shareholder.

Gross income from farming. Gross income from farming is the income you derive in the business of farming from the production of crops, fish, fruits, other agricultural products,

or livestock. Gains from sales of draft, breeding, or dairy livestock are included. Gains from sales of assets such as farm machinery, or from the disposition of land, are not included.

Example. In 2024, you report gross income from farming for your single-member LLC (SMLLC) on Schedule F (Form 1040) of \$85,000. Additionally, your gain from sales of cull raised breeding animals reported on Form 4797, line 2(g), is \$15,000. Therefore, your gross income from farming is \$100,000 (\$85,000 + \$15,000). Thus, the applicable 25% limitation ($\$100,000 \times 25\% (0.25)$) is \$25,000 for soil and water expenses in 2024.



The calculation of farm income for soil and water conservation expenses differs from the calculations for income averaging and estimated tax payments. For more information, see Income Averaging for Farmers in chapter 3 and Gross Income in chapter 15.

Carryover of deduction. If your deductible conservation expenses in any year are more than 25% of your gross income from farming for that year, you can carry the unused deduction over to later years. However, the deduction in any later year is limited to 25% of the gross income from farming for that year as well.

Example. In 2024, you have gross income of \$32,000. During the year, you incurred \$10,000 of deductible soil and water conservation expenses. However, your deduction is limited to 25% of \$32,000, or \$8,000. The \$2,000 excess (\$10,000 – \$8,000) is carried over to 2025 and added to deductible soil and water conservation expenses made in that year. The total of the 2024 carryover plus 2025 expenses is deductible in 2025, subject to the limit of 25% of your gross income from farming in 2025. Any expenses over the limit in that year are carried to 2026 and later years.

Net operating loss (NOL). The deduction for soil and water conservation expenses, after applying the 25% limit, is included when figuring an NOL for the year. If the NOL is carried to another year, the soil and water conservation deduction included in the NOL is not subject to the 25% limit in the year to which it is carried.

When To Deduct or Capitalize

If you choose to deduct soil and water conservation expenses, you must deduct the total allowable amount on your tax return for the first year you pay or incur these expenses. If you choose not to deduct the expenses, you must capitalize them.

Change of method. If you want to change your method for the treatment of soil and water conservation expenses, or you want to treat the expenses for a particular project or a single farm in a different manner, you must get the approval of the IRS. To get this

approval, submit a written request by the due date of your return for the first tax year you want the new method to apply. You or your authorized representative must sign the request. **Do not** use Form 3115 for this request. Use the procedure outlined below.

Your request must include the following information.

- Your name and address.
- The first tax year the method or change of method is to apply.
- Whether the method or change of method applies to all your soil and water conservation expenses or only to those for a particular project or farm. If the method or change of method doesn't apply to all your expenses, identify the project or farm to which the expenses apply.
- The total expenses you paid or incurred in the first tax year the method or change of method is to apply.

- A statement that you will account separately in your books for the expenses to which this method or change of method relates.



Send your request to the following address.

Department of the Treasury
Internal Revenue Service Center
Cincinnati, OH 45999

For more information, see *Change in Accounting Method* in chapter 2.

Sale of a Farm

If you sell your farm, you can't adjust the basis of the land at the time of the sale for any unused carryover of soil and water conservation expenses (except for deductions of assessments for depreciable property, discussed earlier). However, if you acquire another farm and return to the business of

farming, you can start taking deductions again for the unused carryovers.

Gain on sale of farmland. If you held the land 5 years or less before you sold it, gain on the sale of the land is treated as ordinary income up to the amount you previously deducted for soil and water conservation expenses. If you held

the land less than 10 but more than 5 years, the gain is treated as ordinary income up to a specified percentage of the previous deductions. See Section 1252 property under Other Gains in chapter 9.

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6.

Basis of Assets

Introduction

Your basis is the amount of your investment in property for tax purposes. Use basis to figure the gain or loss on the sale, exchange, or other disposition of property. Also use basis to figure depreciation, amortization, depletion, and casualty losses. You may have property that you use for both business or the production of income purposes and for personal purposes. You must allocate the basis of this property based on its use. Only the basis allocated to the business or the production of business income use of the property can be depreciated.

Your original basis in property is adjusted (increased or decreased) by certain events. For example, if you make improvements to the property, increase your basis. If you take

deductions for depreciation, or casualty losses, or claim certain credits, reduce your basis.



Keep accurate records of all items that affect the basis of your assets. For information on keeping records, see chapter 1.

Topics

This chapter discusses:

- Cost basis
- Adjusted basis
- Basis other than cost

Useful Items

You may want to see:

Publication

- ☐ **544** Sales and Other Dispositions of Assets
- ☐ **551** Basis of Assets

□ **946** How To Depreciate Property

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

Cost Basis

The basis of property you buy is usually its cost. Cost is the amount you pay in cash, debt obligations, other property, or services. Your cost includes amounts you pay for sales tax, freight, installation, and testing. The basis of real estate and business assets will include other items, discussed later. Basis generally does not include interest payments.

You may also have to capitalize (add to basis) certain other costs related to buying or producing property. Under the uniform capitalization rules, discussed later, you may have to capitalize direct costs and certain indirect costs of producing property.

Loans with low or no interest. If you buy property on a time-payment plan that charges little or no interest, the basis of your

property is your stated purchase price minus the amount considered to be unstated interest. You generally have unstated interest if your interest rate is less than the applicable federal rate. See the discussion of unstated interest in Pub. 537, *Installment Sales*.

Real Property

Real property, also called real estate, is land and generally anything built on, growing on, or attached to land.

If you buy real property, certain fees and other expenses related to the purchase of the property are part of your cost basis in the property. Some of these expenses are discussed next.

Lump-sum purchase. If you buy improvements, such as buildings, and the land on which they stand for a lump sum, allocate your cost basis between the land and improvements. See *Allocating the Basis*, later.

Real estate taxes. If you pay the real estate taxes the seller owed on real property you bought, and the seller did not reimburse you, treat those taxes as part of your basis. If the seller reimburses you for the portion of real estate taxes from the time they owned the property, reduce your deductible real estate tax expense by the amount of the reimbursement.

If you reimburse the seller for taxes the seller paid for you, you can generally deduct that amount as a tax expense in the year of purchase. If you do not reimburse the seller for real estate taxes, you cannot deduct the amount paid on your behalf as a tax expense. In either case, do not include that amount in the basis of your property.

Settlement costs. Your basis includes the settlement fees and closing costs for buying the property. See Pub. 551 for a detailed list of items you can and cannot include in basis.

Do not include fees and costs for getting a loan on the property. Also, do not include amounts placed in escrow for the future payment of items such as taxes and insurance.

Points. If you pay points to get a loan (including a mortgage, second mortgage, home equity loan, or line of credit), do not add the points to the basis of the related property. You may be able to deduct the points currently or over the term of the loan.

Assumption of a mortgage. If you buy property and assume (or buy the property subject to) an existing mortgage, your basis includes the amount you pay for the property plus the amount of the mortgage that you assumed.

Example. If you buy a farm for \$100,000 cash and assume a mortgage of \$400,000, your basis is \$500,000.

Constructing assets. If you build property or have assets built for you, your expenses for this construction are part of your basis. Some of these expenses include the following costs.

- Land.
- Labor and materials.
- Architect's fees.
- Building permit charges.
- Payments to contractors.
- Payments for rental equipment.
- Inspection fees.

In addition, if you use your own employees, farm materials, and equipment to build an asset, do not deduct the following expenses.

- Employee wages paid for the construction work, reduced by any employment credits allowed.

- Depreciation on equipment you own while it is used in the construction.
- Operating and maintenance costs for equipment used in the construction.
- The cost of business supplies and materials used in construction.

You must capitalize these expenses by including them in the asset's basis.



Do not include the value of your own labor, or any other labor you did not pay for, in the basis of any property you construct.

Allocating the Basis

In some instances, the rules for determining basis apply to a group of assets acquired in the same transaction or to property that consists of separate items. To determine the basis of these assets or separate items, there must be an allocation of basis.

Land and buildings. Allocate the cost basis according to the respective fair market values (FMVs) of the land and improvements at the time of purchase. Figure the basis of each asset by multiplying the lump sum by a fraction. The numerator is the FMV of that asset, and the denominator is the FMV of the whole property at the time of purchase.

Fair market value (FMV). FMV is the price at which property would change hands between a willing buyer and a willing seller, neither having to buy or sell, and both having reasonable knowledge of all necessary facts. Sales of similar property on or about the same date may help in figuring the FMV of the property.

Group of assets acquired. If you buy multiple assets for a lump sum, allocate the amount you pay among the assets. Use this allocation to figure your basis for depreciation and gain or loss on a later disposition of any of these assets. You and the seller may agree

in the sales contract to a specific allocation of the purchase price among the assets. If this allocation is based on the value of each asset and you and the seller have adverse tax interests, the allocation will generally be accepted.

Farming business acquired. If you buy a group of assets that make up a farming business, there are special rules you must use to allocate the purchase price among the assets. Generally, reduce the purchase price by any cash received. Allocate the remaining purchase price to the other business assets received in proportion to (but not more than) their FMVs and in a certain order. See *Trade or Business Acquired* under *Allocating the Basis* in Pub. 551 for more information. Also, see the examples under *Sale of a Farm* in chapter 8.

Transplanted embryo. If you buy a cow that is pregnant with a transplanted embryo, allocate to the basis of the cow the part of the

purchase price equal to the FMV of the cow without the implant. Allocate the rest of the purchase price to the basis of the calf. Neither the cost allocated to the cow nor the cost allocated to the calf is deductible as a current business expense, however, you may be able to take a deduction for depreciation for the cow. The tax treatment for the basis of the cost allocated to the calf will depend on producer's intent.

Example. You buy 10 embryo transplanted cows that are 5 months pregnant for \$40,000.

FMV of 10 cows without implanted embryos is \$12,000. Therefore, the 10 calves that were born from the embryo implanted cows would have a basis of \$28,000 (\$40,000 - \$12,000) which is their basis at birth.

If you placed these calves in service in the breeding herd, their basis for depreciation is \$28,000. If you decide to sell the calves instead of putting them in the breeding herd,

you deduct their \$28,000 basis from the sales proceeds.

Uniform Capitalization Rules

Under the uniform capitalization rules, you must include certain direct and indirect costs in the basis of property you produce or in your inventory costs, rather than claim them as a current year deduction. You recover these costs through depreciation, amortization, or cost of goods sold when you use, sell, or otherwise dispose of the property.



Any farming business that has average annual gross receipts of \$30 million or less for the 3 preceding tax years and is not a tax shelter is not subject to the uniform capitalization rules.

Generally, you are subject to the uniform capitalization rules if you do either of the following.

1. Produce real property or tangible personal property.
2. Acquire property for resale.

You produce property if you construct, build, install, manufacture, develop, improve, or create the property.



You are not subject to the uniform capitalization rules if the property is produced for personal use.

In a farming business, you produce property if you raise or grow any agricultural or horticultural commodity, including plants and animals.

Plants. A plant produced in a farming business includes the following items.

- A fruit, nut, or other crop-bearing tree.
- An ornamental tree.
- A vine.
- A bush.

- Sod.
- The crop or yield of a plant that will have more than one crop or yield.

Animals. An animal produced in a farming business includes any stock, poultry or other bird, and fish or other sea life.

The direct and indirect costs of producing plants or animals include preparatory costs and preproductive period costs. Preparatory costs include the acquisition costs of the seed, seedling, plant, or animal. For plants, preproductive period costs include the costs of items such as irrigation, pruning, frost protection, spraying, and harvesting. For animals, preproductive period costs include the costs of items such as feed, maintaining pasture or pen areas, breeding, veterinary services, and bedding.

Table 6-1. **Plants With a Preproductive Period of More Than 2 Years**

Plants producing the following crops or yields have a nationwide weighted average preproductive period of more than 2 years.			
• Almonds	• Dates	• Macadamia nuts	• Pistachio nuts
• Apples	• Figs	• Mangoes	• Plums
• Apricots	• Grapefruit	• Nectarines	• Pomegranates
• Avocados	• Grapes	• Olives	• Prunes
• Blueberries	• Guavas	• Oranges	• Tangelos
• Cherries	• Kiwifruit	• Peaches	• Tangerines
• Chestnuts	• Kumquats	• Pears	• Tangors
• Coffee beans	• Lemons	• Pecans	• Walnuts
• Currants	• Limes	• Persimmons	

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Exceptions. In a farming business, the uniform capitalization rules do not apply to:

1. Any animal,
2. Any plant with a preproductive period of 2 years or less, or
3. Any costs of replanting certain plants lost or damaged due to casualty.

Exceptions (1) and (2) do not apply to a corporation, partnership, or tax shelter required to use an accrual method of accounting. See Accrual Method Required under Accounting Methods in chapter 2.

In addition, you can elect not to use the uniform capitalization rules for plants with a preproductive period of more than 2 years. This election cannot be made by a corporation, partnership, or tax shelter required to use an accrual method of accounting. This election also does not apply to any costs incurred for the planting, cultivation, maintenance, or development of

any citrus or almond grove (or any part thereof) within the first 4 years the trees were planted.



If you elect not to use the uniform capitalization rules, you must use the alter-native depreciation system for all property used in any of your farming businesses and placed in service in any tax year during which the election is in effect. See chapter 7 for additional information on depreciation.

Example. You grow trees that have a preproductive period of more than 2 years. The trees produce an annual crop. You are an individual and the uniform capitalization rules apply to your farming business. You must capitalize the direct costs and an allocable part of indirect costs incurred due to the production of the trees. You are not required to capitalize the costs of producing the annual crop because its preproductive period is 2 years or less.

Preproductive period of more than 2 years. The preproductive period of plants grown in commercial quantities in the United States is based on their nationwide weighted average preproductive period. Plants producing the crops or yields shown in Table 6-1 have a nationwide weighted average preproductive period of more than 2 years. Other plants (not shown in Table 6-1) may also have a nationwide weighted average preproductive period of more than 2 years.

More information. For more information on the uniform capitalization rules that apply to property produced in a farming business, see Regulations section 1.263A-4. **Adjusted Basis**

Before figuring gain or loss on a sale, exchange, or other disposition of property or figuring allowable depreciation, depletion, or amortization, you must usually make certain adjustments to the cost basis or basis other than cost (discussed later) of the property.

The adjustments to the original basis are increases or decreases to the cost basis or other basis which result in the adjusted basis of the property.

Increases to Basis

Increase the basis of any property by all items properly added to a capital account. These include the cost of any improvements having a useful life of more than 1 year.

The following costs increase the basis of property.

- The cost of extending utility service lines to property
- Legal fees, such as the cost of defending and perfecting title.
- Legal fees for seeking a decrease in an assessment levied against property to pay for local improvements.
- Assessments for items such as paving roads and building ditches that increase

the value of the property assessed. Do not deduct these expenses as taxes. However, you can deduct as taxes amounts assessed for maintenance or repairs, or for meeting interest charges related to the improvements.

If you make additions or improvements to business property, depreciate the basis of each addition or improvement as separate depreciable property using the rules that would apply to the original property if you had placed it in service at the same time you placed the addition or improvement in service. See chapter 7 for more information.

Deducting vs. capitalizing costs. Do not add to your basis costs that you can deduct as current expenses. For example, amounts paid for incidental repairs or maintenance are deductible as business expenses and are not added to basis. However, you can elect either to deduct or to capitalize certain other costs.

See Deducting vs. Capitalizing Costs under Increase to Basis in Pub. 551.

Note. Generally, you can deduct amounts paid for repairs and maintenance to your tangible property if the amounts paid are not otherwise required to be capitalized.

However, you may elect to capitalize amounts paid for repair and maintenance consistent with the treatment on your books and records. If you make this election, it applies to all amounts paid for repair and maintenance to tangible property that you treat as capital expenditures on your books and records for the tax year. To make the election to treat repairs and maintenance as capital expenditures, attach a statement titled "Section 1.263(a)-3(n) Election" to your timely filed return (excluding extensions). For more information on what to include in the statement, see Regulations section 1.263(a)-3(n). If you timely filed your return for the year without making the election, you can still

make the election by filing an amended return within 6 months of the due date of the return (excluding extensions). Attach the statement to the amended return and enter "Filed pursuant to section 301.9100-2" on the statement. File the amended return at the same address you filed the original return.

Decreases to Basis

The following are some items that reduce the basis of property.

- Section 179 deduction.
- Deductions previously allowed or allowable for amortization, depreciation, and depletion.
- Residential energy efficient property credits. See Form 5695.
- Investment credit (part or all) taken.
- Casualty and theft losses and insurance reimbursements.

- Payments you receive for granting an easement.
- Exclusion from income of subsidies for energy conservation measures.
- Certain canceled debt excluded from income.
- Rebates from a manufacturer or seller.
- Patronage dividends received from a cooperative association as a result of a purchase of property. See Patronage Dividends in chapter 3.
- Gas-guzzler tax. See Form 6197.

Some of these items are discussed next. For a more detailed list of items that decrease basis, see section 1016 of the Internal Revenue Code and Pub. 551.

Depreciation and section 179 deduction.

The adjustments you must make to the basis of the property if you take the section 179 deduction or depreciate the property are

explained next. For more information on these deductions, see chapter 7.

Section 179 deduction. If you take the section 179 expense deduction for all or part of the cost of qualifying business property, decrease the basis of the property by the deduction.

Depreciation. Decrease the basis of property by the depreciation you deducted or could have deducted on your tax returns under the method of depreciation you chose. If you took less depreciation than you could have under the method chosen, decrease the basis by the amount you could have taken under that method. If you did not take a depreciation deduction, reduce the basis by the full amount of the depreciation you could have taken.

If you deducted more depreciation than you should have, decrease your basis by the amount you should have deducted plus the part of the excess depreciation you deducted

that actually reduced your tax liability for any year.

See chapter 7 for information on figuring the depreciation you should have claimed.

In decreasing your basis for depreciation, take into account the amount deducted on your tax returns as depreciation and any depreciation you must capitalize under the uniform capitalization rules.

Casualty and theft losses. If you have a casualty or theft loss, decrease the basis in your property by any insurance or other reimbursement and by any deductible loss not covered by insurance. See chapter 11 for information about figuring your casualty or theft loss.

You must increase your basis in the property by the amount you spend on clean-up costs (such as debris removal) and repairs that substantially prolong the life of the property, increase its value, or adapt it to a different

use. To make this determination, compare the repaired property to the property before the casualty. For more information on casualty and theft losses, see Pub. 547.

Easements. The amount you receive for granting an easement is usually considered to be proceeds from the sale of an interest in the real property. It reduces the basis of the affected part of the property. If the amount received is more than the basis of the part of the property affected by the easement, reduce your basis in that part to zero and treat the excess as a recognized gain. See *Easements and rights-of-way* in chapter 3.

Exclusion from income of subsidies for energy conservation measures. You can exclude from gross income any subsidy you received from a public utility company for the purchase or installation of an energy conservation measure for a dwelling unit. Reduce the basis of the property by the excluded amount.

Canceled debt excluded from income. If a debt you owe is canceled or forgiven, other than as a gift or bequest, you must generally include the canceled amount in your gross income for tax purposes. A debt includes any indebtedness for which you are liable or which attaches to property you hold.

You can exclude your canceled debt from income if the debt is any of the following.

1. Debt canceled in a bankruptcy case or when you are insolvent.
2. Qualified farm debt.
3. Qualified real property business debt (provided you are not a C corporation).

If you exclude canceled debt from income as described in (1) or (2), you may have to reduce the basis of your depreciable and nondepreciable property. If you exclude canceled debt described in (3), you must only

reduce the basis of your depreciable property by the excluded amount.

For more information about canceled debt in a bankruptcy case, see Pub. 908, Bankruptcy Tax Guide. For more information about insolvency and canceled debt that is qualified farm debt, see chapter 3. For more information about qualified real property business debt, see Pub. 334, Tax Guide for Small Business.

Basis Other Than Cost

There are times when you cannot use cost as basis. In these situations, the FMV or the adjusted basis of property may be used. Examples are discussed next.

Property changed from personal to business or rental use. When you hold property for personal use and then change it to business use or use it to produce rent, you must figure its basis for depreciation. An example of changing property from personal

to business use would be changing the use of your pickup truck that you originally purchased for your personal use to use in your farming business. The basis for depreciation is the lesser of:

- The FMV of the property on the date of the change, or
- Your adjusted basis on the date of the change.

If you later sell or dispose of this property, the basis you use will depend on whether you are figuring a gain or loss. The basis for figuring a gain is your adjusted basis in the property when you sell the property. Figure the basis for a loss starting with the smaller of your adjusted basis or the FMV of the property at the time of the change to business or rental use. Then make adjustments (increases and decreases) for the period after the change in the property's use, as discussed earlier under Adjusted Basis.

Property received for services. If you receive property for services, include the property's FMV in income. The amount you include in income becomes your basis. If the services were performed for a price agreed on beforehand, it will be accepted as the FMV of the property if there is no evidence to the contrary.

Example. Rocco Stowsa is an accountant and also operates a farming business. Rocco agreed to do some accounting work for his neighbor in exchange for a dairy cow. The accounting work and the cow are each worth \$1,500. Rocco must include \$1,500 in income for his accounting services. Rocco's basis in the cow is \$1,500.

Taxable Exchanges

A taxable exchange is one in which the gain is taxable, or the loss is deductible. A taxable gain or deductible loss is also known as a recognized gain or loss. A taxable exchange occurs when you receive cash or get property

that is not similar or related in use to the property exchanged. If you receive property in exchange for other property in a taxable exchange, the basis of the property you receive is usually its FMV at the time of the exchange.

Example. You trade a tract of farmland with an adjusted basis of \$20,000 for a tractor that has an FMV of \$60,000. You must report a taxable gain of \$40,000 for the land. The tractor has a basis of \$60,000.

Nontaxable Exchanges

A nontaxable exchange is an exchange in which you are not taxed on any gain and you cannot deduct any loss. A nontaxable gain or loss is also known as an unrecognized gain or loss. If you receive property in a nontaxable exchange, its basis is usually the same as the basis of the property you transferred.

Involuntary Conversions

If you receive property as a result of an involuntary conversion, such as a casualty, theft, or condemnation, figure the basis of the replacement property you receive using the basis of the converted property.

Similar or related property. If the replacement property is similar or related in service or use to the converted property, the replacement property's basis is the same as the old property's basis on the date of the conversion. However, make the following adjustments.

1. Decrease the basis by the following amounts.
 - a. Any loss you recognize on the involuntary conversion.
 - b. Any money you receive that you do not spend on similar property.

2. Increase the basis by the following amounts.
 - a. Any gain you recognize on the involuntary conversion.
 - b. Any cost of acquiring the replacement property.

Money or property not similar or related.

If you receive money or property not similar or related in service or use to the converted property and you buy replacement property similar or related in service or use to the converted property, the basis of the replacement property is its cost decreased by the gain not recognized on the involuntary conversion.

Allocating the basis. If you buy more than one piece of replacement property, allocate your basis among the properties based on their respective costs.

Basis for depreciation. Special rules apply in determining and depreciating the basis of MACRS property acquired in an involuntary conversion. For more information, see *Figuring the Deduction for Property Acquired in a Nontaxable Exchange* under *Figuring Depreciation Under MACRS* in chapter 7.

For more information about involuntary conversions, see chapter 11.

Like-Kind Exchanges

Generally, if you exchange real property you use in your business or hold for investment solely for other business or investment real property of a like kind, you do not recognize the gain or loss from the exchange. If you also receive non-like-kind property or money as part of the exchange, you do recognize gain, but only to the extent of the value of the other property or money you received in the exchange, and you do not recognize any loss.

For an exchange to qualify as a like-kind exchange, you must hold for business or investment purposes both the property you transfer and the property you receive. There must also be an exchange of like-kind property. For more information, see *Like-Kind Exchanges* in chapter 8.

The basis of the property you receive is generally the same as the adjusted basis of the property you gave up.

Example. You trade farmland for another larger tract of farmland. Your adjusted basis in your farmland is \$110,000. The FMV of the new tract of farmland is \$150,000. Because this is a nontaxable exchange, you do not recognize any gain and your basis in the farmland you receive is \$110,000, the same as the adjusted basis in the farmland you exchanged.

Note. An exchange of personal property, such as machinery or equipment, does not qualify as a like-kind exchange.

Exchange expenses. Exchange expenses are generally the closing costs that you pay. They include such items as brokerage commissions, attorney fees, and deed preparation fees. Add them to the basis of the like-kind property you receive.

Property plus cash. If you trade property in a like-kind exchange and also pay money, the basis of the property you receive is increased by the money you paid.

Example. Assume the same facts from the previous example except you pay an additional \$20,000 in cash. Your adjusted basis in the newly acquired farming real estate is \$130,000 (\$110,000 adjusted basis of your old farmland plus the \$20,000 cash you paid).

Special rules for related persons. If a like-kind exchange takes place directly or indirectly between related persons and either party disposes of the property within 2 years after the exchange, the exchange no longer

qualifies for like-kind exchange treatment. Each person must report any gain or loss not recognized on the original exchange unless the loss is not deductible under the related-party rules. Each person reports it on the tax return filed for the year in which the later disposition occurred. If this rule applies, the basis of the property received in the original exchange will be its FMV. For more information, see chapter 8.

Basis for depreciation. Special rules apply in determining and depreciating the basis of MACRS property acquired in a like-kind transaction. For more information, see *Figuring the Deduction for Property Acquired in a Nontaxable Exchange* under *Figuring Depreciation Under MACRS* in chapter 7.

Partially Nontaxable Exchanges

A partially nontaxable exchange is an exchange in which you receive property that is not a like-kind property or money in addition to a like-kind property. The basis of

the property you receive is the same as the adjusted basis of the property you gave up with the following adjustments.

1. Decrease the basis by the following amounts.
 - a. Any money you receive.
 - b. Any loss you recognize on the exchange.
2. Increase the basis by the following amounts.
 - a. Any additional costs you incur.
 - b. Any gain you recognize on the exchange.

If the other party to the exchange assumes your liabilities, treat the debt assumption as money you received in the exchange.

Example. You trade farmland (basis of \$100,000) for another tract of farmland (FMV of \$110,000) and \$30,000 cash. You realize a

gain of \$40,000. This is the FMV of the land received plus the cash minus the basis of the land you traded (\$110,000 + \$30,000 – \$100,000). Include your gain in income (recognize gain) only to the extent of the cash received. Your basis in the land you received is figured as follows.

Basis of land traded	\$100,000
Minus: Cash received (adjustment 1a) .	<u>-30,000</u>
	\$70,000
Plus: Gain recognized (adjustment 2b)	<u>+ 30,000</u>
Basis of land received	<u>\$100,000</u>

Allocation of basis. If you receive like-kind and unlike properties in the exchange, allocate the basis first to the unlike property, other than money, up to its FMV on the date of the exchange. The rest is the basis of the like-kind property.

Example. You trade a tract of farmland with an adjusted basis of \$100,000 for another tract of farmland that has an FMV of \$92,500. You also receive \$4,000 in cash and a pickup truck with an FMV of \$11,000. Since only real property qualifies for like-kind exchange treatment, your receipt of the truck and cash means you must recognize gain on the exchange. You realize a gain of \$7,500. This is the sum of the FMV of the tract of farmland you receive, the FMV of the truck you receive, and the cash you receive, minus the adjusted basis of the farmland you traded ($\$92,500 + \$11,000 + \$4,000 - \$100,000$). You include in income (recognize) all \$7,500 of the gain because it is the lesser of the realized gain (\$7,500) and the sum of the FMV of the unlike property and the cash received (\$15,000). Your basis in the properties you received is figured as follows.

Adjusted basis old farmland	\$100,000
Minus: Cash received (adjustment 1a)	– 4,000
	\$96,000
Plus: Gain recognized (adjustment 2b)	+ 7,500
Total basis of properties received	\$103,500

Allocate the basis of \$103,500 first to the unlike property, the truck (\$11,000). This is the truck's FMV. The rest (\$92,500) is the basis in the farmland.

Sale and Purchase

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

Example. You own farmland with a barn. The properties have a combined adjusted basis of \$70,000, and an FMV of \$150,000. You are interested in another tract of farmland with a larger barn owned by your neighbor who is interested in exchanging the property with you. The total FMV of your neighbor's farmland and barn is \$200,000. You want the new barn to have a larger basis for depreciation, so you arrange to sell your old farmland and barn to your neighbor for \$150,000. Your neighbor then sells his farmland and barn to you for \$200,000. However, you are treated as having exchanged the old property for the new property because the sale and purchase are reciprocal and mutually dependent. Your basis in the new property is \$120,000 (\$50,000 cash paid plus \$70,000 adjusted basis in your old property), which must be allocated between the farmland and the barn.

Property Received as a Gift

To figure the basis of property you receive as a gift, you must know the donor's adjusted basis (defined earlier) just before it was given to you. You must also know its FMV at the time it was given to you and any gift tax paid on it.

FMV equal to or greater than donor's adjusted basis. If the FMV of the property is equal to or greater than the donor's adjusted basis, your basis is the donor's adjusted basis when you received the gift. Increase your basis by all or part of any gift tax paid, depending on the date of the gift.

Also, for figuring gain or loss from a sale or other disposition of the property, or for figuring depreciation, depletion, or amortization deductions on business property, you must increase or decrease your basis (the donor's adjusted basis) by any required adjustments to basis while you held the property. See Adjusted Basis, earlier.

If you received a gift during the tax year, increase your basis in the gift (the donor's adjusted basis) by the part of the gift tax paid on it due to the net increase in value of the gift. Figure the increase by multiplying the gift tax paid by the following fraction.

$$\frac{\text{Net increase in value of the gift}}{\text{Amount of the gift}}$$

The net increase in value of the gift is the FMV of the gift minus the donor's adjusted basis. The amount of the gift is its value for gift tax purposes after reduction by any annual exclusion and marital or charitable deduction that applies to the gift.

Example. In 2024, you received a gift of property from your mother that had an FMV of \$50,000. Her adjusted basis was \$20,000. The amount of the gift for gift tax purposes was \$32,000 (\$50,000 minus the \$18,000 annual exclusion). She paid a gift tax of

\$6,440. Your basis, \$26,054, is figured as follows.

Fair market value	\$50,000
Minus: Adjusted basis .	– 20,000
Net increase in value	\$30,000
Gift tax paid	\$6,440
Multiplied by ($\$30,000 \div \$32,000$)	$\times 0.94$
Gift tax due to net increase in value	\$6,054
Adjusted basis of property to your mother	+ 20,000
Your basis in the property	\$26,054

Note. If you received a gift before 1977, your basis in the gift (the donor's adjusted basis) includes any gift tax paid on it. However, your basis cannot exceed the FMV of the gift when it was given to you.

FMV less than donor's adjusted basis. If the FMV of the property at the time of the gift is less than the donor's adjusted basis, your basis depends on whether you have a gain or a loss when you dispose of the property. Your basis for figuring gain is the donor's adjusted basis plus or minus any required adjustments to basis while you held the property. Your basis for figuring loss is its FMV when you received the gift plus or minus any required adjustments to basis while you held the property. (See *Adjusted Basis*, earlier.)

If you use the donor's adjusted basis for figuring a gain and get a loss, and then use the FMV for figuring a loss and get a gain, you have neither gain nor loss on the sale or other disposition of the property.

Example. You received farmland as a gift from your parents when they retired from farming. At the time of the gift, the land had an FMV of \$80,000. Your parents' adjusted basis was \$100,000. After you received the

land, no events occurred that would increase or decrease your basis.

If you sell the land for \$120,000, you will have a \$20,000 gain because you must use the donor's adjusted basis at the time of the gift (\$100,000) as your basis to figure a gain. If you sell the land for \$70,000, you will have a \$10,000 loss because you must use the FMV at the time of the gift (\$80,000) as your basis to figure a loss.

If the sales price is between \$80,000 and \$100,000, you have neither gain nor loss. For instance, if the sales price was \$90,000 and you tried to figure a gain using the donor's adjusted basis (\$100,000), you would get a \$10,000 loss. If you then tried to figure a loss using the FMV (\$80,000), you would get a \$10,000 gain.

Business property. If you hold the gift as business property, your basis for figuring any depreciation, depletion, or amortization deductions is the same as the donor's

adjusted basis plus or minus any required adjustments to basis while you hold the property. For more information on depreciation, depletion or amortization, see chapter 7.

Property Transferred From a Spouse

The basis of property transferred to you or transferred in trust for your benefit by your spouse is the same as your spouse's adjusted basis. The same rule applies to a transfer by your former spouse if the transfer is incident to divorce. However, for property transferred in trust, adjust your basis for any gain recognized by your spouse or former spouse if the liabilities assumed plus the liabilities to which the property is subject are more than the adjusted basis of the property transferred.

The transferor must give you the records needed to determine the adjusted basis and holding period of the property as of the date of the transfer.

For more information, see *Property Settlements* in Pub. 504, *Divorced or Separated Individuals*.

Inherited Property

Your basis in property you inherited from a decedent is generally one of the following.

- The FMV of the property at the date of the decedent's death. If Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, you can use its appraised value.
- The FMV on the alternate valuation date if the personal representative for the estate elects to use alternate valuation. For information on the alternate valuation, see the Instructions for Form 706.

- The decedent's adjusted basis in land to the extent of the value that is excluded from the decedent's taxable estate as a qualified conservation easement.

If a federal estate tax return does not have to be filed, your basis in the inherited property is its appraised value at the date of death for state inheritance or transmission taxes.

Special-use valuation method. Under certain conditions, when a person dies, the executor or personal representative of that person's estate may elect to value qualified real property at other than its FMV. If so, the executor or personal representative values the qualified real property based on its use as a farm or other closely held business. If the executor or personal representative elects this method of valuation for estate tax purposes, this value is the basis of the property for the qualified heirs.

The qualified heirs should be able to get the necessary value from the executor or personal representative of the estate.

If you are a qualified heir who received special-use valuation property, increase your basis by any gain recognized by the estate or trust because of post-death appreciation.

Post-death appreciation is the property's FMV on the date of distribution minus the property's FMV either on the date of the individual's death or on the alternate valuation date. Figure all FMVs without regard to the special-use valuation.

You may be liable for an additional estate tax if, within 10 years after the death of the decedent, you transfer the property or the property stops being used as a farm. This tax does not apply if you dispose of the property in a like-kind exchange or in an involuntary conversion in which all of the proceeds are reinvested in qualified replacement property.