

# Publication 544

## Sales and Other Dispositions of Assets

For use in preparing

**2024** Returns

Volume 4 of 5



Get forms and other information faster and easier at:

- [IRS.gov](https://www.irs.gov) (English)
- [IRS.gov/Korean](https://www.irs.gov/Korean) (한국어)
- [IRS.gov/Spanish](https://www.irs.gov/Spanish) (Español)
- [IRS.gov/Russian](https://www.irs.gov/Russian) (Русский)
- [IRS.gov/Chinese](https://www.irs.gov/Chinese) (中文)
- [IRS.gov/Vietnamese](https://www.irs.gov/Vietnamese) (Tiếng Việt)



Publication 544 (Rev 2024) Catalog Number 39291D  
Department of the Treasury **Internal Revenue Service** [www.irs.gov](https://www.irs.gov)



Visit the Accessibility  
Page on [IRS.gov](https://www.irs.gov)

This page is intentionally left blank

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

**Example.** You manufacture and sell steel cable, which you deliver on returnable reels that are depreciable property. Customers make deposits on the reels, which you refund if the reels are returned within a year. If they are not returned, you keep each deposit as the agreed-upon sales price. Most reels are returned within the 1-year period. You keep adequate records showing depreciation and other charges to the capitalized cost of the reels. Under these conditions, the reels are not property held for sale to customers in the ordinary course of your business.

Any gain or loss resulting from their not being returned may be capital or ordinary, depending on your section 1231 transactions.

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

**Property deducted under the de minimis safe harbor for tangible property.** If you deducted the costs of a property under the de minimis safe harbor for tangible property (currently \$2,500 or less or \$5,000 or less if you have an applicable financial statement),

then upon its sale or disposition, this property is not treated as property used in the trade or business under section 1231. Generally, any gain on the disposition of this property is treated as ordinary income and is reported in Part II of Form 4797.

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

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

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

***Nonrecaptured section 1231 losses.***

Your nonrecaptured section 1231 losses are your net section 1231 losses for the previous 5 years that have not been applied against a net section 1231 gain.

Therefore, if in any of your 5 preceding tax years you had section 1231 losses, a net gain for the current year from the sale of section 1231 assets is ordinary gain to the extent of your prior losses.

These losses are applied against your net section 1231 gain beginning with the earliest loss in the 5-year period.

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

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

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

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



# Depreciation Recapture

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



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

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

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

- Whether the adjusted basis was figured using depreciation or amortization another person claimed.

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

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

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

## **Section 1245 Property**

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

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

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

1. Personal property (either tangible or intangible).
2. Other tangible property (except buildings and their structural

components, discussed later) used as any of the following.

- a. An integral part of manufacturing, production, or extraction, or of furnishing transportation, communications, electricity, gas, water, or sewage disposal services.
  - b. A research facility in any of the activities in (a).
  - c. A facility in any of the activities in (a) for the bulk storage of fungible commodities (discussed later).
3. Where applicable, that part of real property (not included in (2)) with an adjusted basis reduced by (but not limited to) the following.
- a. Amortization of certified pollution control facilities.

- b. The section 179 expense deduction.
- c. Deduction for qualified clean-fuel vehicles and certain refueling property (as in effect before repeal by Public Law 113-295).
- d. Deduction for capital costs incurred in complying with Environmental Protection Agency sulfur regulations.
- e. Deduction for certain qualified refinery property if in effect before the repeal by the Tax Increase Prevention Act of 2014. (Repealed by Public Law 113-295, section 221(a)(34)(A), except with regard to deductions made prior to December 19, 2014.)

- f. Any applicable deduction for qualified energy efficient commercial building property. See section 179D of the Internal Revenue Code.
- g. Amortization of railroad grading and tunnel bores, if in effect before the repeal by the Revenue Reconciliation Act of 1990. (Repealed by Public Law 99-514, Tax Reform Act of 1986, section 242(a).)
- h. Certain expenditures for childcare facilities if in effect before repeal by the Omnibus Budget Reconciliation Act of 1990, Public Law 101-508, section 11801(a)(13) (except with regard to deductions made prior to November 5, 1990).

- i. Expenditures to remove architectural and transportation barriers to the handicapped and elderly.
  - j. Deduction for qualified tertiary injectant expenses.
  - k. Certain reforestation expenditures.
  - l. Deduction for election to expense qualified advanced mine safety equipment property.
  - m. Any deduction for qualified film, television, or live theatrical productions allowed under section 181 of the Internal Revenue Code.
4. Single purpose agricultural (livestock) or horticultural structures.

5. Storage facilities (except buildings and their structural components) used in distributing petroleum or any primary product of petroleum.
6. Any railroad grading or tunnel bore.

***Buildings and structural components.***

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

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



the structure can be expected to be replaced when the property it initially houses is replaced.

The fact that the structure is specially designed to withstand the stress and other demands of the property and cannot be used economically for other purposes indicates it is closely related to the use of the property it houses. Structures such as oil and gas storage tanks, grain storage bins, silos, fractionating towers, blast furnaces, basic oxygen furnaces, coke ovens, brick kilns, and coal tipples are not treated as buildings but as section 1245 property.

***Facility for bulk storage of fungible commodities.*** This term includes oil or gas storage tanks and grain storage bins. Bulk storage means the storage of a commodity in a large mass before it is used. For example, if a facility is used to store oranges that have been sorted and boxed, it is not used for bulk storage.

To be fungible, a commodity must be such that each of its parts is essentially interchangeable and each of its parts is indistinguishable from another part.

Stored materials that vary in composition, size, and weight are not fungible. Materials are not fungible if one part cannot be used in place of another part and the materials cannot be estimated and replaced by simple reference to weight, measure, and number. For example, the storage of different grades and forms of aluminum scrap is not storage of fungible commodities.

### **Gain Treated as Ordinary Income**

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

1. The depreciation and amortization allowed or allowable on the property.

2. The gain realized on the disposition (the amount realized from the disposition minus the adjusted basis of the property).

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

For any other disposition of section 1245 property, ordinary income is the lesser of (1), earlier, or the amount by which its FMV is more than its adjusted basis. See *Gifts* and *Transfers at Death*, later.

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

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

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

### **Depreciation and amortization.**

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

1. Ordinary depreciation deductions.
2. Any special depreciation allowance you claimed.
3. Amortization deductions for any of the following costs.
  - a. Acquiring a lease.

- b. Lessee improvements.
  - c. Certified pollution control facilities.
  - d. Certain reforestation expenses.
  - e. Section 197 intangibles.
4. The section 179 deduction.
5. Deductions for all of the following costs.
- a. Removing barriers to the disabled and the elderly.
  - b. Tertiary injectant expenses.
  - c. Qualified depreciable clean-fuel vehicles and refueling property (minus the amount of any recaptured deduction).
  - d. Environmental cleanup costs.
  - e. Certain reforestation expenses.
  - f. Qualified disaster expenses.

6. Any basis reduction for the investment credit (minus any basis increase for credit recapture).
7. Any basis reduction for the qualified electric vehicle credit (minus any basis increase for credit recapture).

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

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

### **Depreciation on other tangible property.**

You must take into account depreciation during periods when the property was not used as an integral part of an activity or did

not constitute a research or storage facility, as described earlier under Section 1245 Property.

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

**Depreciation allowed or allowable.** The greater of the depreciation allowed or allowable is generally the amount to use in figuring the part of gain to report as ordinary income. However, if, in prior years, you have consistently taken proper deductions under one method, the amount allowed for your prior years will not be increased even though a greater amount would have been allowed under another proper method.



If you did not take any deduction at all for depreciation, your adjustments to basis for depreciation allowable are figured by using the straight-line method.

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

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

**Example.** In one transaction, you sold 50 machines, 25 trucks, and certain other property that is not section 1245 property. All of the depreciation was recorded in a single depreciation account.

After dividing the total received among the various assets sold, you figured that each unit of section 1245 property was sold at a gain. You can figure the ordinary income from depreciation as if the 50 machines and 25 trucks were one item.

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

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

## **Section 1250 Property**

Gain on the disposition of section 1250 property is treated as ordinary income to the extent of additional depreciation allowed or

allowable on the property. To determine the additional depreciation on section 1250 property, see Additional Depreciation, later.

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

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

## **Additional Depreciation**

If you hold section 1250 property longer than 1 year, the additional depreciation is the actual depreciation adjustments that are more than the depreciation figured using the straight-line method.

For a list of items treated as depreciation adjustments, see Depreciation and amortization under *Gain Treated as Ordinary Income*, earlier. For the treatment of unrecaptured section 1250 gain, see Capital Gains Tax Rates, later.

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

- You figured depreciation for the property using the straight-line method or any other method that does not result in depreciation that is more than the amount figured by the straight-line method; you held the property longer than 1 year; and, if the property was qualified property, you made a timely election not to claim any special depreciation allowance. In addition, if the property was in a renewal community,

you must not have elected to claim a commercial revitalization deduction for property placed in service before January 1, 2010.

- The property was residential low-income rental property you held for 16<sup>2</sup>/<sub>3</sub> years or longer. For low-income rental housing on which the special 60-month depreciation for rehabilitation expenses was allowed, the 16<sup>2</sup>/<sub>3</sub> years start when the rehabilitated property is placed in service.
- You chose the alternate ACRS method for the property, which was a type of 15-, 18-, or 19-year real property covered by the section 1250 rules.
- The property was residential rental property or nonresidential real property placed in service after 1986 (or after July 31, 1986, if the choice to use MACRS was made); you held it longer than 1 year; and, if the property was qualified property, you made a timely election not

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

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

**Example.** You give your child section 1250 property on which you took \$2,000 in depreciation deductions, of which \$500 is additional depreciation. Immediately after the gift, your child's adjusted basis in the property is the same as yours and reflects the \$500 additional depreciation.

On January 1 of the next year, after taking depreciation deductions of \$1,000 on the property, of which \$200 is additional depreciation, your child sells the property. At the time of sale, the additional depreciation is \$700 (\$500 allowed to you plus \$200 allowed to your child).

**Depreciation allowed or allowable.**

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

**Retired or demolished property.** The adjustments reflected in adjusted basis generally do not include deductions for

depreciation on retired or demolished parts of section 1250 property unless these deductions are reflected in the basis of replacement property that is section 1250 property.

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

**Figuring straight-line depreciation.** The useful life and salvage value you would have used to figure straight-line depreciation are the same as those used under the depreciation method you actually used. If you did not use a useful life under the depreciation method actually used (such as with the units-of-production method)



or if you did not take salvage value into account (such as with the declining balance method), the useful life or salvage value for figuring what would have been the straight-line depreciation is the useful life and salvage value you would have used under the straight-line method.

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

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

***Property held by lessee.*** If a lessee makes a leasehold improvement, the lease period for figuring what would have been the straight-line depreciation adjustments includes all renewal periods. This inclusion of the renewal periods cannot extend the lease period taken into account to a period that is longer than the remaining useful life of the improvement.

The same rule applies to the cost of acquiring a lease.

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

### **Applicable Percentage**

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

#### **Nonresidential real property.**

For real property that is not residential rental property,

the applicable percentage for periods after 1969 is 100%. For periods before 1970, the percentage is zero and no ordinary income because of additional depreciation before 1970 will result from its disposition.

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

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

- Federally assisted housing projects if the mortgage is insured under section 221(d)(3) or 236 of the National Housing Act, or housing financed or assisted by

direct loan or tax abatement under similar provisions of state or local laws.

- Low-income rental housing for which a depreciation deduction for rehabilitation expenses was allowed.
- Low-income rental housing held for occupancy by families or individuals eligible to receive subsidies under section 8 of the United States Housing Act of 1937, as amended, or under provisions of state or local laws that authorize similar subsidies for low-income families.
- Housing financed or assisted by direct loan or insured under Title V of the Housing Act of 1949.

The applicable percentage for low-income housing is 100% minus 1% for each full month the property was held over 100 full months.

If you have held low-income housing for at least 16 years and 8 months, the percentage is zero and no ordinary income will result from its disposition.

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

***Example.*** On June 1, 2024, you acquired low-income housing property. On April 3, 2023 (130 months after the property was acquired), foreclosure proceedings were started on the property, and on December 3, 2023 (150 months after the property was acquired), the property was disposed of as a result of the foreclosure proceedings. The property qualifies for a reduced applicable percentage because it was held more than 100 full months.

The applicable percentage reduction is 30% (130 months minus 100 months) rather than 50% (150 months minus 100 months) because it does not apply after April 3, 2023, the starting date of the foreclosure proceedings. Therefore, 70% of the additional depreciation is treated as ordinary income.

***Holding period.*** The holding period used to figure the applicable percentage for low-income housing generally starts on the day after you acquired it. For example, if you bought low-income housing on January 1, 2008, the holding period starts on January 2, 2008. If you sold it on January 2, 2024, the holding period is exactly 192 full months. The applicable percentage for additional depreciation is 8%, or 100% minus 1% for each full month the property was held over 100 full months.

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

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

If the adjusted basis of the property in your hands just after acquiring it is more than its adjusted basis to the transferor just before transferring it, the holding period of the

difference is figured as if it were a separate improvement. See *Low-Income Housing With Two or More Elements* next.

## **Low-Income Housing With Two or More Elements**

If you dispose of low-income housing property that has two or more separate elements, the applicable percentage used to figure ordinary income because of additional depreciation may be different for each element. The gain to be reported as ordinary income is the sum of the ordinary income figured for each element.

The following are the types of separate elements.

- A separate improvement (defined below).
- The basic section 1250 property plus improvements not qualifying as separate improvements.



- The units placed in service at different times before all of the section 1250 property is finished. For example, this happens when a taxpayer builds an apartment building of 100 units and places 30 units in service (available for renting) on January 4, 2021; 50 on July 18, 2021; and the remaining 20 on January 18, 2022.

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

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

1. 25% of the adjusted basis of the property at the start of the first day of the 36-month period, or the first day

of the holding period of the property, whichever is later.

2. 10% of the unadjusted basis (adjusted basis plus depreciation and amortization adjustments) of the property at the start of the period determined in (1).
3. \$5,000.

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

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

**Addition to the capital account.** Any addition to the capital account made after the initial acquisition or completion of the property by you or any person who held the property during a period included in your

holding period is to be considered when figuring the total amount of separate improvements.

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

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

the entire section 1250 property is treated as consisting of two distinct properties.

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

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

- The holding period of a separate element placed in service before the entire section 1250 property is finished starts on the first day of the month that the separate element is placed in service.
- The holding period for each separate improvement qualifying as a separate element starts on the day after the improvement is acquired or, for

improvements constructed, reconstructed, or erected, the first day of the month that the improvement is placed in service.

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

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

**Figuring ordinary income attributable to each separate element.** Figure ordinary income attributable to each separate element as follows.

Step 1. Divide the element's additional depreciation after 1975 by the sum of all the elements' additional depreciation after 1975 to determine the percentage used in Step 2.

Step 2. Multiply the percentage figured in Step 1 by the lesser of the additional depreciation after 1975 for the entire property or the gain from disposition of the entire property (the difference between the FMV or amount realized and the adjusted basis).

Step 3. Multiply the result in Step 2 by the applicable percentage for the element.

**Example.** You sold at a gain of \$25,000 low-income housing property subject to the ordinary income rules of section 1250. The property consisted of four elements (W, X, Y, and Z).

Step 1. The additional depreciation for each element is W—\$12,000; X—None; Y—\$6,000; and Z—\$6,000. The sum of the additional depreciation for all the elements is \$24,000.

Step 2. The depreciation deducted on element X was \$4,000 less than it would have been under the straight-line method. Additional depreciation on the property as a whole is \$20,000 (\$24,000 – \$4,000). \$20,000 is lower than the \$25,000 gain on the sale, so \$20,000 is used in Step 2.

Step 3. The applicable percentages to be used in Step 3 for the elements are W—68%; X—85%; Y—92%; and Z—100%.

From these facts, the sum of the ordinary income for each element is figured as follows.



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

To find what part of the gain from the disposition of section 1250 property is treated as ordinary income, follow these steps.

1. In a sale, exchange, or involuntary conversion of the property, figure the amount realized that is more than the adjusted basis of the property. In any other disposition of the property, figure the FMV that is more than the adjusted basis.

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

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

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

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

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

## **Installment Sales**

If you report the sale of property under the installment method, any depreciation recapture under section 1245 or 1250 is taxable as ordinary income in the year of sale.

This applies even if no payments are received in that year. If the gain is more than the depreciation recapture income, report the rest of the gain using the rules of the installment method. For this purpose, include the recapture income in your installment sale basis to determine your gross profit on the installment sale.

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

For a detailed discussion of installment sales, see Pub. 537.

## Gifts

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

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

**Part gift and part sale or exchange.** If you transfer depreciable personal property or real property for less than its FMV in a transaction considered to be partly a gift and partly a sale or exchange and you have a gain because the amount realized is more than your adjusted

basis, you must report ordinary income (up to the amount of gain) to recapture depreciation. If the depreciation (additional depreciation, if section 1250 property) is more than the gain, the balance is carried over to the transferee to be taken into account on any later disposition of the property. However, see Bargain sale to charity, later.

**Example.** You transferred depreciable personal property to your son for \$20,000. When transferred, the property had an adjusted basis to you of \$10,000 and an FMV of \$40,000. You took depreciation of \$30,000. You are considered to have made a gift of \$20,000, the difference between the \$40,000 FMV and the \$20,000 sale price to your son. You have a taxable gain on the transfer of \$10,000 (\$20,000 sale price minus \$10,000 adjusted basis) that must be reported as ordinary income from depreciation.

You report \$10,000 of your \$30,000 depreciation as ordinary income on the transfer of the property, so the remaining \$20,000 depreciation is carried over to your son for him to take into account on any later disposition of the property.

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

You may also have to reduce the FMV of the contributed property by the long-term capital gain (including any section 1231 gain)

that would have resulted had the property been sold. For more information, see *Giving Property That Has Increased in Value* in Pub. 526.

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



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

## **Transfers at Death**

When a taxpayer dies, no gain is reported on depreciable personal property or real property transferred to his or her estate or beneficiary. For information on the tax liability of a decedent, see Pub. 559.

However, if the decedent disposed of the property while alive and, because of his or her method of accounting or for any other reason, the gain from the disposition is reportable by the estate or beneficiary,

it must be reported in the same way the decedent would have had to report it if he or she were still alive.

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

**Example 1.** You owned depreciable property that, upon your death, was inherited by your child. No ordinary income from depreciation is reportable on the transfer, even though the value used for estate tax purposes is more than the adjusted basis of the property to you when you died. However, if you sold the property before your death and realized a gain and if, because of your method of accounting, the proceeds from the sale are income in respect of a decedent reportable by your child, your child must report ordinary income from depreciation.

**Example 2.** The trustee of a trust created by a will transfers depreciable property to a beneficiary in satisfaction of a specific bequest of \$10,000. If the property had a value of \$9,000 at the date used for estate tax valuation purposes, the \$1,000 increase in value to the date of distribution is a gain realized by the trust. Ordinary income from depreciation must be reported by the trust on the transfer.

## **Like-Kind Exchanges and Involuntary Conversions**

A like-kind exchange of your depreciable property or an involuntary conversion of the property into similar or related property will generally not result in your having to report ordinary income from depreciation unless money or property other than like-kind, similar, or related property is also received in the transaction.

However, section 1245 recapture may occur when property that is not section 1245 property is received as part of a like-kind exchange or involuntary conversion even if no gain would otherwise be recognized. See the examples below for more information.



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

## **Ordinary Income Recapture in Like-Kind Exchanges**

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

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

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

**Example.** You exchange real property with an FMV of \$100,000 and basis of \$50,000 for real property with an FMV of \$60,000 and \$40,000 cash. The gain realized on the exchange is \$50,000. The gain recognized on the like-kind exchange is \$40,000 (the cash received). The property you dispose of consists of section 1245 and section 1250 property.

The section 1245 property has a basis of \$10,000 and an adjusted basis of \$0. The property received consists of \$45,000 of section 1250 property and \$15,000 of section 1245 property. The section 1245 ordinary income recapture is computed as follows.

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

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

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

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

See Regulations sections 1.1252-2(d) and 1.1254-2(d), and Temporary Regulations section 16A.1255-2(c) for details on these types of property.

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

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

**Example.** You exchange real property with an FMV of \$200,000 and adjusted basis of \$120,000 for real property with an FMV of \$160,000 and \$40,000 cash. The gain recognized on the exchange is \$40,000 (the amount of cash received).



The property you dispose of consists of section 1250 qualified improvement property (QIP) that has a basis of \$15,000 and adjusted basis of \$0 due to the additional first-year depreciation deduction taken. Assume you compute the section 1250 recapture amount on the QIP to be \$10,000. The property you receive is solely section 1250 property. The ordinary income recapture limit is computed as the greater of the following.

Gain recognized on the like-kind exchange.....	\$40,000
--	----------

or

Section 1250 Recapture.....	\$10,000
-----------------------------	----------

Less: FMV section 1250 property received.....	<u>(160,000)</u>
---	------------------

Section 1250(d)(4)(A) limit.....	<u><b>\$0</b></u>
----------------------------------	-------------------

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

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

Gain recognized on the like-kind exchange.....	\$0
--	-----

or

Section 1250(a)(1)(A) Recapture.....	\$10,000
---	----------

Less: FMV section 1250 property  
received..... (200,000)

Section 1250(d)(4)(A) limit..... **\$0**

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

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

- The gain that must be included in income under the rules for involuntary conversions.

- The FMV of the replacement property other than depreciable personal property acquired in the transaction.

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

**Example 2.** A fire destroyed office machinery you bought for \$116,000. The depreciation deductions were \$91,640 and the machinery had an adjusted basis of \$24,360.

You received a \$117,000 insurance payment, realizing a gain of \$92,640.

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

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

1) Gain realized on the transaction (\$92,640) limited to depreciation (\$91,640)	\$91,640
---	----------

2) Gain includible in income (amount not spent).....	3,000
--	-------

Plus: FMV of property other than depreciable personal property (the stock)	<u>9,000</u>	<u>12,000</u>
--	--------------	---------------

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

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

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

- The gain that must be reported under the rules for like-kind exchanges or involuntary conversions plus the FMV of stock bought as replacement property in acquiring control of a corporation.
- The gain you would have had to report as ordinary income from additional depreciation had the transaction been a cash sale minus the cost (or FMV in an exchange) of the depreciable real property acquired.

The ordinary income not reported for the year of the disposition is carried over to the depreciable real property acquired in the like-

kind exchange or involuntary conversion as additional depreciation from the property disposed of. Further, to figure the applicable percentage of additional depreciation to be treated as ordinary income, the holding period starts over for the new property.

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

The ordinary income to be reported is \$6,000, which is the greater of the following amounts.



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

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

***Basis of property acquired.*** If the ordinary income you have to report because of additional depreciation is limited, the total basis of the property you acquired is its FMV

(its cost, if bought to replace property involuntarily converted into money) minus the gain postponed.

If you acquired more than one item of property, allocate the total basis among the properties in proportion to their FMV (their cost, in an involuntary conversion into money). However, if you acquired both depreciable real property and other property, allocate the total basis as follows.

1. Subtract the ordinary income because of additional depreciation that you do not have to report from the FMV (or cost) of the depreciable real property acquired.
2. Add the FMV (or cost) of the other property acquired to the result in (1).
3. Divide the result in (1) by the result in (2).

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

***Example 1.*** In 1999, low-income housing property that you acquired and placed in service in 1994 was destroyed by fire and you received a \$90,000 insurance payment. The property's adjusted basis was \$38,400, with additional depreciation of \$14,932.

On December 1, 1999, you used the insurance payment to acquire and place in service replacement low-income housing property.

Your realized gain from the involuntary conversion was \$51,600 (\$90,000 – \$38,400). You chose to postpone reporting the gain under the involuntary conversion rules. Under the rules for depreciation recapture on real property, the ordinary gain was \$14,932, but you did not have to report any of it because of the limit for involuntary conversions.

The basis of the replacement low-income housing property was its \$90,000 cost minus the \$51,600 gain you postponed, or \$38,400. The \$14,932 ordinary gain you did not report is treated as additional depreciation on the replacement property. If you sold the property in 2024, your holding period for figuring the applicable percentage of

additional depreciation to report as ordinary income would have begun December 2, 1999, the day after you acquired the property.

**Example 2.** You received a \$90,000 fire insurance payment for depreciable real property (office building) with an adjusted basis of \$30,000. You use the whole payment to buy property similar in use, spending \$42,000 for depreciable real property and \$48,000 for land. You choose to postpone reporting the \$60,000 gain realized on the involuntary conversion. Of this gain, \$10,000 is ordinary income from additional depreciation but is not reported because of the limit for involuntary conversions of depreciable real property. The basis of the property bought is \$30,000 (\$90,000 – \$60,000), allocated as follows.

1. The \$42,000 cost of depreciable real property minus \$10,000 ordinary income not reported is \$32,000.

2. The \$48,000 cost of other property (land) plus the \$32,000 figured in (1) is \$80,000.
3. The \$32,000 figured in (1) divided by the \$80,000 figured in (2) is 0.4.
4. The basis of the depreciable real property is \$12,000. This is the \$30,000 total basis multiplied by the 0.4 figured in (3).
5. The basis of the other property (land) is \$18,000. This is the \$30,000 total basis minus the \$12,000 figured in (4).

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

## **Multiple Properties**

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

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

In the absence of an agreement, the allocation should be made by taking into account the appropriate facts and circumstances.

These include, but are not limited to, a comparison between the depreciable property and all the other property being disposed of in the transaction. The comparison should take into account all of the following facts and circumstances.

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

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



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

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

The amount allocated to the other property disposed of is treated as consisting of the FMV of all property acquired that has not already been taken into account.

If you dispose of and acquire depreciable real property and other property in a like-kind exchange or involuntary conversion, the amount realized is allocated in the following way.

The amount allocated to each of the three types of property (depreciable real property, depreciable personal property,

or other property) disposed of is treated as consisting of:

1. The FMV of that type of property acquired; and
2. To the extent of any remaining balance, the excess FMV of the other types of property acquired. If the excess FMV is more than the remaining balance of the amount realized and is from both of the other two types of property, you can apply the unallocated amount in any manner you choose.

**Example.** A fire destroyed your property with a total FMV of \$50,000. It consisted of machinery worth \$30,000 and nondepreciable property worth \$20,000. You received an insurance payment of \$40,000 and immediately used it with \$10,000 of your own funds (for a total of \$50,000) to buy machinery with an FMV of \$15,000 and nondepreciable property with an FMV of

\$35,000. The adjusted basis of the destroyed machinery was \$5,000 and your depreciation on it was \$35,000. You choose to postpone reporting your gain from the involuntary conversion. You must report \$9,000 as ordinary income from depreciation arising from this transaction, figured as follows.

1. The \$40,000 insurance payment must be allocated between the machinery and the other property destroyed in proportion to the FMV of each. The amount allocated to the machinery is  $\$30,000/\$50,000 \times \$40,000$ , or \$24,000. The amount allocated to the other property is  $\$20,000/\$50,000 \times \$40,000$ , or \$16,000. Your gain on the involuntary conversion of the machinery is \$24,000 minus the \$5,000 adjusted basis, or \$19,000.
2. The \$24,000 allocated to the machinery disposed of is treated as consisting of the \$15,000 FMV of the

replacement machinery bought and \$9,000 of the FMV of other property bought in the transaction. All \$16,000 allocated to the other property disposed of is treated as consisting of the FMV of the other property that was bought.

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

# **4.**

## **Reporting Gains and Losses**

### **Introduction**

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

Although this discussion generally refers to Schedule D (Form 1040) and Form 8949, many of the rules discussed here also apply to taxpayers other than individuals. However, the rules for property held for personal use will usually not apply to taxpayers other than individuals.

### **Topics**

This chapter discusses:

- Information returns
- Schedule D (Form 1040)

- Form 4797
- Form 8949

## Useful Items

You may want to see:

### Publication

- ☐ **550** Investment Income and Expenses
- ☐ **537** Installment Sales

### Form (and Instructions)

- ☐ **Schedule D (Form 1040)** Capital Gains and Losses
- ☐ **1099-B** Proceeds From Broker and Barter Exchange Transactions
- ☐ **1099-S** Proceeds From Real Estate Transactions
- ☐ **4684** Casualties and Thefts
- ☐ **4797** Sales of Business Property
- ☐ **6252** Installment Sale Income

- ❑ **6781** Gains and Losses From Section 1256 Contracts and Straddles
- ❑ **8824** Like-Kind Exchanges
- ❑ **8949** Sales and Other Dispositions of Capital Assets

See *How To Get Tax Help* at the end of this publication for information about getting publications and forms.

## **Information Returns**

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

**Form 1099-B.** If you sold property, such as stocks, bonds, or certain commodities, through a broker, you should receive Form 1099-B (or a substitute statement) from the broker. Use the Form 1099-B or substitute statement to complete Form 8949 and/or Schedule D.

Whether or not you receive Form 1099-B, you must report all taxable sales of stock, bonds, commodities, etc., on Form 8949 and/or Schedule D, as applicable. For more information on figuring gains and losses from these transactions, see chapter 4 of Pub. 550. For information on reporting the gains and losses, see the Instructions for Form 8949 and the Instructions for Schedule D (Form 1040), or the instructions for the applicable Schedule D.

**Form 1099-S.** An information return must be provided on certain real estate transactions. Generally, the person responsible for closing the transaction must report on Form 1099-S sales or exchanges of the following types of property.

- Land (improved or unimproved), including air space.
- An inherently permanent structure, including any residential, commercial, or industrial building.



- A condominium unit and its related fixtures and common elements (including land).
- Stock in a cooperative housing corporation.
- Any noncontingent interest in standing timber.

If you sold or exchanged any of the above types of property, the person responsible for closing the transaction must give you a copy of Form 1099-S, or a substitute statement containing the same information as Form 1099-S. Your Form 1099-S will show the gross proceeds from the sale or exchange in box 2. See the Instructions for Form 8949 and the Instructions for Schedule D (Form 1040) for how to report these transactions. Also see chapter 2 of Pub. 550.

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

# **Schedule D and Form 8949**

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

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