

## **IRC Provisions for Reading 8**

### **§121. §1031, §1033, §1041**

#### **§121 Exclusion of gain from sale of principal residence**

(a) Exclusion. Gross income shall not include gain from the sale or exchange of property if, during the 5-year period ending on the date of the sale or exchange, such property has been owned and used by the taxpayer as the taxpayer's principal residence for periods aggregating 2 years or more.

(b) Limitations.

(1) In general. The amount of gain excluded from gross income under subsection (a) with respect to any sale or exchange shall not exceed \$250,000.

(2) Special rules for joint returns. In the case of a husband and wife who make a joint return for the taxable year of the sale or exchange of the property—

(A) \$500,000 limitation for certain joint returns. Paragraph (1) shall be applied by substituting “\$500,000” for “\$250,000” if—

(i) either spouse meets the ownership requirements of subsection (a) with respect to such property;

(ii) both spouses meet the use requirements of subsection (a) with respect to such property; and

(iii) neither spouse is ineligible for the benefits of subsection (a) with respect to such property by reason of paragraph (3) .

(B) Other joint returns. If such spouses do not meet the requirements of subparagraph (A) , the limitation under paragraph (1) shall be the sum of the limitations under paragraph (1) to which each spouse would be entitled if such spouses had not been married. For purposes of the preceding sentence, each spouse shall be treated as owning the property during the period that either spouse owned the property.

(3) Application to only 1 sale or exchange every 2 years.

(A) In general. Subsection (a) shall not apply to any sale or exchange by the taxpayer if, during the 2-year period ending on the date of such sale or exchange, there was any other sale or exchange by the taxpayer to which subsection (a) applied.

(B) Pre-May 7, 1997, sales not taken into account. Subparagraph (A) shall be applied without regard to any sale or exchange before May 7, 1997.

(4) Special rule for certain sales by surviving spouses. In the case of a sale or exchange of property by an unmarried individual whose spouse is deceased on the date of such sale, paragraph (1) shall be applied by substituting “\$500,000” for “\$250,000” if such sale occurs not later than 2 years after the date of death of such spouse and the requirements of paragraph (2)(A) were met immediately before such date of death.

(5) Exclusion of gain allocated to nonqualified use.

(A) In general. Subsection (a) shall not apply to so much of the gain from the sale or exchange of property as is allocated to periods of nonqualified use.

(B) Gain allocated to periods of nonqualified use. For purposes of subparagraph (A) , gain shall be allocated to periods of nonqualified use based on the ratio which—

(i) the aggregate periods of nonqualified use during the period such property was owned by the taxpayer, bears to

(ii) the period such property was owned by the taxpayer.

(C) Period of nonqualified use. For purposes of this paragraph —

(i) In general. The term “period of nonqualified use” means any period (other than the portion of any period preceding January 1, 2009) during which the property is not used as the principal residence of the taxpayer or the taxpayer's spouse or former spouse.

(ii) Exceptions. The term “period of nonqualified use” does not include—

(I) any portion of the 5-year period described in subsection (a) which is after the last date that such property is used as the principal residence of the taxpayer or the taxpayer's spouse,

(II) any period (not to exceed an aggregate period of 10 years) during which the taxpayer or the taxpayer's spouse is serving on qualified official extended duty (as defined in subsection (d)(9)(C) ) described in clause (i) , (ii) , or (iii) of subsection (d)(9)(A) , and

(III) any other period of temporary absence (not to exceed an aggregate period of 2 years) due to change of employment, health conditions, or such other unforeseen circumstances as may be specified by the Secretary.

(D) Coordination with recognition of gain attributable to depreciation. For purposes of this paragraph —

(i) subparagraph (A) shall be applied after the application of subsection (d)(6) , and

(ii) subparagraph (B) shall be applied without regard to any gain to which subsection (d)(6) applies.

(c) Exclusion for taxpayers failing to meet certain requirements.

(1) In general. In the case of a sale or exchange to which this subsection applies, the ownership and use requirements of subsection (a) , and subsection (b)(3) , shall not apply; but the dollar limitation under paragraph (1) or (2) of subsection (b) , whichever is applicable, shall be equal to—

(A) the amount which bears the same ratio to such limitation (determined without regard to this paragraph ) as

(B)

(i) the shorter of—

(I) the aggregate periods, during the 5-year period ending on the date of such sale or exchange, such property has been owned and used by the taxpayer as the taxpayer's principal residence; or

(II) the period after the date of the most recent prior sale or exchange by the taxpayer to which subsection (a) applied and before the date of such sale or exchange, bears to

(ii) 2 years.

(2) Sales and exchanges to which subsection applies. This subsection shall apply to any sale or exchange if—

(A) subsection (a) would not (but for this subsection ) apply to such sale or exchange by reason of—

(i) a failure to meet the ownership and use requirements of subsection (a) ,  
or

(ii) subsection (b)(3) , and

(B) such sale or exchange is by reason of a change in place of employment, health, or, to the extent provided in regulations, unforeseen circumstances.

(d) Special rules.

(1) Joint returns. If a husband and wife make a joint return for the taxable year of the sale or exchange of the property, subsections (a) and (c) shall apply if either spouse meets the ownership and use requirements of subsection (a) with respect to such property.

(2) Property of deceased spouse. For purposes of this section , in the case of an unmarried individual whose spouse is deceased on the date of the sale or exchange of property, the period such unmarried individual owned and used such property shall include the period such deceased spouse owned and used such property before death.

(3) Property owned by spouse or former spouse. For purposes of this section —

(A) Property transferred to individual from spouse or former spouse. In the case of an individual holding property transferred to such individual in a transaction described in section 1041(a) , the period such individual owns such property shall include the period the transferor owned the property.

(B) Property used by former spouse pursuant to divorce decree, etc. Solely for purposes of this section , an individual shall be treated as using property as such individual's principal residence during any period of ownership while such individual's spouse or former spouse is granted use of the property under a divorce or separation instrument (as defined in section 71(b)(2) ).

(4) Tenant-stockholder in cooperative housing corporation. For purposes of this section, if the taxpayer holds stock as a tenant-stockholder (as defined in section 216) in a cooperative housing corporation (as defined in such section), then—

(A) the holding requirements of subsection (a) shall be applied to the holding of such stock, and

(B) the use requirements of subsection (a) shall be applied to the house or apartment which the taxpayer was entitled to occupy as such stockholder.

(5) Involuntary conversions.

(A) In general. For purposes of this section, the destruction, theft, seizure, requisition, or condemnation of property shall be treated as the sale of such property.

(B) Application of section 1033. In applying section 1033 (relating to involuntary conversions), the amount realized from the sale or exchange of property shall be treated as being the amount determined without regard to this section , reduced by the amount of gain not included in gross income pursuant to this section .

(C) Property acquired after involuntary conversion. If the basis of the property sold or exchanged is determined (in whole or in part) under section 1033(b) (relating to basis of property acquired through involuntary conversion), then the holding

and use by the taxpayer of the converted property shall be treated as holding and use by the taxpayer of the property sold or exchanged.

- (6) Recognition of gain attributable to depreciation. Subsection (a) shall not apply to so much of the gain from the sale of any property as does not exceed the portion of the depreciation adjustments (as defined in section 1250(b)(3) ) attributable to periods after May 6, 1997, in respect of such property.
- (7) Determination of use during periods of out-of-residence care. In the case of a taxpayer who—
  - (A) becomes physically or mentally incapable of self-care, and
  - (B) owns property and uses such property as the taxpayer's principal residence during the 5-year period described in subsection (a) for periods aggregating at least 1 year,

then the taxpayer shall be treated as using such property as the taxpayer's principal residence during any time during such 5- year period in which the taxpayer owns the property and resides in any facility (including a nursing home) licensed by a State or political subdivision to care for an individual in the taxpayer's condition.

- (8) Sales of remainder interests. For purposes of this section —
  - (A) In general. At the election of the taxpayer, this section shall not fail to apply to the sale or exchange of an interest in a principal residence by reason of such interest being a remainder interest in such residence, but this section shall not apply to any other interest in such residence which is sold or exchanged separately.
  - (B) Exception for sales to related parties. Subparagraph (A) shall not apply to any sale to, or exchange with, any person who bears a relationship to the taxpayer which is described in section 267(b) or 707(b) .
- (9) Uniformed services, foreign service, and intelligence community.
  - (A) In general. At the election of an individual with respect to a property, the running of the 5-year period described in subsections (a) and (c)(1)(B) and paragraph (7) of this subsection with respect to such property shall be suspended during any period that such individual or such individual's spouse is serving on qualified official extended duty—
    - (i) as a member of the uniformed services,
    - (ii) as a member of the Foreign Service of the United States, or
    - (iii) as an employee of the intelligence community.
  - (B) Maximum period of suspension. The 5-year period described in subsection (a) shall not be extended more than 10 years by reason of subparagraph (A).
  - (C) Qualified official extended duty. For purposes of this paragraph —
    - (i) In general. The term “qualified official extended duty” means any extended duty while serving at a duty station which is at least 50 miles from such property or while residing under Government orders in Government quarters.
    - (ii) Uniformed services. The term “uniformed services” has the meaning given such term by section 101(a)(5) of title 10, United States Code, as in effect on the date of the enactment of this paragraph .

- (iii) Foreign Service of the United States. The term “member of the Foreign Service of the United States” has the meaning given the term “member of the Service” by paragraph (1), (2), (3), (4), or (5) of section 103 of the Foreign Service Act of 1980, as in effect on the date of the enactment of this paragraph .
- (iv) Employee of intelligence community. The term “employee of the intelligence community” means an employee (as defined by section 2105 of title 5, United States Code) of—
  - (I) the Office of the Director of National Intelligence,
  - (II) the Central Intelligence Agency,
  - (III) the National Security Agency,
  - (IV) the Defense Intelligence Agency,
  - (V) the National Geospatial-Intelligence Agency,
  - (VI) the National Reconnaissance Office,
  - (VII) any other office within the Department of Defense for the collection of specialized national intelligence through reconnaissance programs,
  - (VIII) any of the intelligence elements of the Army, the Navy, the Air Force, the Marine Corps, the Federal Bureau of Investigation, the Department of Treasury, the Department of Energy, and the Coast Guard,
  - (IX) the Bureau of Intelligence and Research of the Department of State, or
  - (X) any of the elements of the Department of Homeland Security concerned with the analyses of foreign intelligence information.
- (v) Extended duty. The term “extended duty” means any period of active duty pursuant to a call or order to such duty for a period in excess of 90 days or for an indefinite period.
- (vi) Repealed.

(D) Special rules relating to election.

- (i) Election limited to 1 property at a time. An election under subparagraph (A) with respect to any property may not be made if such an election is in effect with respect to any other property.
  - (ii) Revocation of election. An election under subparagraph (A) may be revoked at any time.
- (10) Property acquired in like-kind exchange. If a taxpayer acquires property in an exchange with respect to which gain is not recognized (in whole or in part) to the taxpayer under subsection (a) or (b) of section 1031 , subsection (a) shall not apply to the sale or exchange of such property by such taxpayer (or by any person whose basis in such property is determined, in whole or in part, by reference to the basis in the hands of such taxpayer) during the 5-year period beginning with the date of such acquisition.
- (11) Property acquired from a decedent. [check effective date]  
The exclusion under this section shall apply to property sold by—
- (A) the estate of a decedent,

(B) any individual who acquired such property from the decedent (within the meaning of section 1022 ), and

(C) a trust which, immediately before the death of the decedent, was a qualified revocable trust (as defined in section 645(b)(1) ) established by the decedent,

determined by taking into account the ownership and use by the decedent.

(12) Peace corps.

(A) In general. At the election of an individual with respect to a property, the running of the 5-year period described in subsections (a) and (c)(1)(B) and paragraph (7) of this subsection with respect to such property shall be suspended during any period that such individual or such individual's spouse is serving outside the United States—

(i) on qualified official extended duty (as defined in paragraph (9)(C)) as an employee of the Peace Corps, or

(ii) as an enrolled volunteer or volunteer leader under section 5 or 6 (as the case may be) of the Peace Corps Act (22 U.S.C. 2504, 2505).

(B) Applicable rules. For purposes of subparagraph (A) , rules similar to the rules of subparagraphs (B) and (D) shall apply.

(e) Denial of exclusion for expatriates. This section shall not apply to any sale or exchange by an individual if the treatment provided by section 877(a)(1) applies to such individual.

(f) Election to have section not apply. This section shall not apply to any sale or exchange with respect to which the taxpayer elects not to have this section apply.

(g) Residences acquired in rollovers under section 1034. For purposes of this section , in the case of property the acquisition of which by the taxpayer resulted under section 1034 (as in effect on the day before the date of the enactment of this section) in the nonrecognition of any part of the gain realized on the sale or exchange of another residence, in determining the period for which the taxpayer has owned and used such property as the taxpayer's principal residence, there shall be included the aggregate periods for which such other residence (and each prior residence taken into account under section 1223(6) in determining the holding period of such property) had been so owned and used.

## §1031 Exchange of property held for productive use or investment

(a) Nonrecognition of gain or loss from exchanges solely in kind.

(1) In general. No gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property of like kind which is to be held either for productive use in a trade or business or for investment.

(2) Exception. This subsection shall not apply to any exchange of—

- (A) stock in trade or other property held primarily for sale,
- (B) stocks, bonds, or notes,
- (C) other securities or evidences of indebtedness or interest,
- (D) interests in a partnership,
- (E) certificates of trust or beneficial interests, or
- (F) choses in action.

For purposes of this section , an interest in a partnership which has in effect a valid election under section 761(a) to be excluded from the application of all of subchapter K shall be treated as an interest in each of the assets of such partnership and not as an interest in a partnership.

(3) Requirement that property be identified and that exchange be completed not more than 180 days after transfer of exchanged property. For purposes of this subsection, any property received by the taxpayer shall be treated as property which is not like-kind property if—

- (A) such property is not identified as property to be received in the exchange on or before the day which is 45 days after the date on which the taxpayer transfers the property relinquished in the exchange, or
- (B) such property is received after the earlier of—
  - (i) the day which is 180 days after the date on which the taxpayer transfers the property relinquished in the exchange, or
  - (ii) the due date (determined with regard to extension) for the transferor's return of the tax imposed by this chapter for the taxable year in which the transfer of the relinquished property occurs.

(b) Gain from exchanges not solely in kind. If an exchange would be within the provisions of subsection (a), of section 1035(a) , of section 1036(a) , or of section 1037(a) , if it were not for the fact that the property received in exchange consists not only of property permitted by such provisions to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(c) Loss from exchanges not solely in kind. If an exchange would be within the provisions of subsection (a), of section 1035(a), of section 1036(a), or of section 1037(a), if it were not for the fact that the property received in exchange consists not only of property permitted by such provisions to be received without the recognition of gain or loss, but also of other property or money, then no loss from the exchange shall be recognized.

(d) Basis. If property was acquired on an exchange described in this section , section 1035(a), section 1036(a), or section 1037(a), then the basis shall be the same as that of the property

exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized on such exchange. If the property so acquired consisted in part of the type of property permitted by this section, section 1035(a), section 1036(a), or section 1037(a), to be received without the recognition of gain or loss, and in part of other property, the basis provided in this subsection shall be allocated between the properties (other than money) received, and for the purpose of the allocation there shall be assigned to such other property an amount equivalent to its fair market value at the date of the exchange. For purposes of this section, section 1035(a), and section 1036(a), where as part of the consideration to the taxpayer another party to the exchange assumed (as determined under section 357(d)) a liability of the taxpayer, such assumption shall be considered as money received by the taxpayer on the exchange.

(e) Exchanges of livestock of different sexes. For purposes of this section, livestock of different sexes are not property of a like kind.

(f) Special rules for exchanges between related persons.

(1) In general. If—

(A) a taxpayer exchanges property with a related person,

(B) there is nonrecognition of gain or loss to the taxpayer under this section with respect to the exchange of such property (determined without regard to this subsection), and

(C) before the date 2 years after the date of the last transfer which was part of such exchange—

(i) the related person disposes of such property, or

(ii) the taxpayer disposes of the property received in the exchange from the related person which was of like kind to the property transferred by the taxpayer,

there shall be no nonrecognition of gain or loss under this section to the taxpayer with respect to such exchange; except that any gain or loss recognized by the taxpayer by reason of this subsection shall be taken into account as of the date on which the disposition referred to in subparagraph (C) occurs.

(2) Certain dispositions not taken into account. For purposes of paragraph (1)(C), there shall not be taken into account any disposition—

(A) after the earlier of the death of the taxpayer or the death of the related person,

(B) in a compulsory or involuntary conversion (within the meaning of section 1033) if the exchange occurred before the threat or imminence of such conversion, or

(C) with respect to which it is established to the satisfaction of the Secretary that neither the exchange nor such disposition had as one of its principal purposes the avoidance of Federal income tax.

(3) Related person. For purposes of this subsection, the term “related person” means any person bearing a relationship to the taxpayer described in section 267(b) or 707(b)(1).

(4) Treatment of certain transactions. This section shall not apply to any exchange which is part of a transaction (or series of transactions) structured to avoid the purposes of this subsection.

(g) Special rule where substantial diminution of risk.

- (1) In general. If paragraph (2) applies to any property for any period, the running of the period set forth in subsection (f)(1)(C) with respect to such property shall be suspended during such period.
  - (2) Property to which subsection applies. This paragraph shall apply to any property for any period during which the holder's risk of loss with respect to the property is substantially diminished by—
    - (A) the holding of a put with respect to such property,
    - (B) the holding by another person of a right to acquire such property, or
    - (C) a short sale or any other transaction.
- (h) Special rules for foreign real and personal property. For purposes of this section —
- (1) Real property. Real property located in the United States and real property located outside the United States are not property of a like kind.
  - (2) Personal property.
    - (A) In general. Personal property used predominantly within the United States and personal property used predominantly outside the United States are not property of a like kind.
    - (B) Predominant use. Except as provided in subparagraphs (C) and (D), the predominant use of any property shall be determined based on—
      - (i) in the case of the property relinquished in the exchange, the 2-year period ending on the date of such relinquishment, and
      - (ii) in the case of the property acquired in the exchange, the 2-year period beginning on the date of such acquisition.
    - (C) Property held for less than 2 years. Except in the case of an exchange which is part of a transaction (or series of transactions) structured to avoid the purposes of this subsection —
      - (i) only the periods the property was held by the person relinquishing the property (or any related person) shall be taken into account under subparagraph (B)(i) , and
      - (ii) only the periods the property was held by the person acquiring the property (or any related person) shall be taken into account under subparagraph (B)(ii) .
    - (D) Special rule for certain property. Property described in any subparagraph of section 168(g)(4) shall be treated as used predominantly in the United States.
- (i) Special rules for mutual ditch, reservoir, or irrigation company stock. For purposes of subsection (a)(2)(B) , the term “stocks” shall not include shares in a mutual ditch, reservoir, or irrigation company if at the time of the exchange—
- (1) the mutual ditch, reservoir, or irrigation company is an organization described in section 501(c)(12)(A) (determined without regard to the percentage of its income that is collected from its members for the purpose of meeting losses and expenses), and
  - (2) the shares in such company have been recognized by the highest court of the State in which such company was organized or by applicable State statute as constituting or representing real property or an interest in real property.

### §1033 Involuntary conversions [excerpt]

(a) General rule. If property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted—

(1) Conversion into similar property. Into property similar or related in service or use to the property so converted, no gain shall be recognized.

(2) Conversion into money. Into money or into property not similar or related in service or use to the converted property, the gain (if any) shall be recognized except to the extent hereinafter provided in this paragraph:

(A) Nonrecognition of gain. If the taxpayer during the period specified in subparagraph (B) , for the purpose of replacing the property so converted, purchases other property similar or related in service or use to the property so converted, or purchases stock in the acquisition of control of a corporation owning such other property, at the election of the taxpayer the gain shall be recognized only to the extent that the amount realized upon such conversion (regardless of whether such amount is received in one or more taxable years) exceeds the cost of such other property or such stock. Such election shall be made at such time and in such manner as the Secretary may by regulations prescribe. For purposes of this paragraph —

(i) no property or stock acquired before the disposition of the converted property shall be considered to have been acquired for the purpose of replacing such converted property unless held by the taxpayer on the date of such disposition; and

(ii) the taxpayer shall be considered to have purchased property or stock only if, but for the provisions of subsection (b) of this section , the unadjusted basis of such property or stock would be its cost within the meaning of section 1012 .

(B) Period within which property must be replaced. The period referred to in subparagraph (A) shall be the period beginning with the date of the disposition of the converted property, or the earliest date of the threat or imminence of requisition or condemnation of the converted property, whichever is the earlier, and ending—

(i) 2 years after the close of the first taxable year in which any part of the gain upon the conversion is realized, or

(ii) subject to such terms and conditions as may be specified by the Secretary, at the close of such later date as the Secretary may designate on application by the taxpayer. Such application shall be made at such time and in such manner as the Secretary may by regulations prescribe.

(C) Time for assessment of deficiency attributable to gain upon conversion. If a taxpayer has made the election provided in subparagraph (A) , then—

(i) the statutory period for the assessment of any deficiency, for any taxable year in which any part of the gain on such conversion is realized, attributable to such gain shall not expire prior to the expiration of 3 years from the date the Secretary is notified by the taxpayer (in such manner as the Secretary may by regulations prescribe) of the replacement of the converted property or of an intention not to replace, and

(ii) such deficiency may be assessed before the expiration of such 3-year period notwithstanding the provisions of section 6212(c) or the provisions of any other law or rule of law which would otherwise prevent such assessment.

(D) Time for assessment of other deficiencies attributable to election. If the election provided in subparagraph (A) is made by the taxpayer and such other property or such stock was purchased before the beginning of the last taxable year in which any part of the gain upon such conversion is realized, any deficiency, to the extent resulting from such election, for any taxable year ending before such last taxable year may be assessed (notwithstanding the provisions of section 6212(c) or 6501 or the provisions of any other law or rule of law which would otherwise prevent such assessment) at any time before the expiration of the period within which a deficiency for such last taxable year may be assessed.

(E) Definitions. For purposes of this paragraph —

(i) Control. The term “control” means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation.

(ii) Disposition of the converted property. The term “disposition of the converted property” means the destruction, theft, seizure, requisition, or condemnation of the converted property, or the sale or exchange of such property under threat or imminence of requisition or condemnation.

(b) Basis of property acquired through involuntary conversion.

(1) Conversions described in subsection (a)(1) . If the property was acquired as the result of a compulsory or involuntary conversion described in subsection (a)(1) , the basis shall be the same as in the case of the property so converted—

(A) decreased in the amount of any money received by the taxpayer which was not expended in accordance with the provisions of law (applicable to the year in which such conversion was made) determining the taxable status of the gain or loss upon such conversion, and

(B) increased in the amount of gain or decreased in the amount of loss to the taxpayer recognized upon such conversion under the law applicable to the year in which such conversion was made.

(2) Conversions described in subsection (a)(2) . In the case of property purchased by the taxpayer in a transaction described in subsection (a)(2) which resulted in the nonrecognition of any part of the gain realized as the result of a compulsory or involuntary conversion, the basis shall be the cost of such property decreased in the amount of the gain not so recognized; and if the property purchased consists of more than 1 piece of property, the basis determined under this sentence shall be allocated to the purchased properties in proportion to their respective costs.

(3) Property held by corporation the stock of which is replacement property.

(A) In general. If the basis of stock in a corporation is decreased under paragraph (2) , an amount equal to such decrease shall also be applied to reduce the basis of property held by the corporation at the time the taxpayer acquired control (as defined in subsection (a)(2)(E) ) of such corporation.

(B) Limitation. Subparagraph (A) shall not apply to the extent that it would (but for this subparagraph) require a reduction in the aggregate adjusted bases of the

property of the corporation below the taxpayer's adjusted basis of the stock in the corporation (determined immediately after such basis is decreased under paragraph (2) ).

(C) Allocation of basis reduction. The decrease required under subparagraph (A) shall be allocated—

- (i) first to property which is similar or related in service or use to the converted property,
- (ii) second to depreciable property (as defined in section 1017(b)(3)(B) ) not described in clause (i) , and
- (iii) then to other property.

(D) Special rules.

- (i) Reduction not to exceed adjusted basis of property. No reduction in the basis of any property under this paragraph shall exceed the adjusted basis of such property (determined without regard to such reduction).
- (ii) Allocation of reduction among properties. If more than 1 property is described in a clause of subparagraph (C) , the reduction under this paragraph shall be allocated among such property in proportion to the adjusted bases of such property (as so determined).

(g) Condemnation of real property held for productive use in trade or business or for investment.

(1) Special rule. For purposes of subsection (a) , if real property (not including stock in trade or other property held primarily for sale) held for productive use in trade or business or for investment is (as the result of its seizure, requisition, or condemnation, or threat or imminence thereof) compulsorily or involuntarily converted, property of a like kind to be held either for productive use in trade or business or for investment shall be treated as property similar or related in service or use to the property so converted.

(2) Limitation. Paragraph (1) shall not apply to the purchase of stock in the acquisition of control of a corporation described in subsection (a)(2)(A) .

(3) Election to treat outdoor advertising displays as real property.

(A) In general. A taxpayer may elect, at such time and in such manner as the Secretary may prescribe, to treat property which constitutes an outdoor advertising display as real property for purposes of this chapter. The election provided by this subparagraph may not be made with respect to any property with respect to which an election under section 179(a) (relating to election to expense certain depreciable business assets) is in effect.

(B) Election. An election made under subparagraph (A) may not be revoked without the consent of the Secretary.

(C) Outdoor advertising display. For purposes of this paragraph , the term “outdoor advertising display” means a rigidly assembled sign, display, or device permanently affixed to the ground or permanently attached to a building or other inherently permanent structure constituting, or used for the display of, a commercial or other advertisement to the public.

(D) Character of replacement property. For purposes of this subsection , an interest in real property purchased as replacement property for a compulsorily or involuntarily converted outdoor advertising display defined in subparagraph (C) (and treated by the taxpayer as real property) shall be considered property of a like kind as the property converted without regard to whether the taxpayer's

interest in the replacement property is the same kind of interest the taxpayer held in the converted property.

(4) Special rule. In the case of a compulsory or involuntary conversion described in paragraph (1), subsection (a)(2)(B)(i) shall be applied by substituting “3 years” for “2 years”.

(h) Special rules for property damaged by federally declared disasters.

(1) Principal residences. If the taxpayer's principal residence or any of its contents is located in a disaster area and is compulsorily or involuntarily converted as a result of a federally declared disaster—

(A) Treatment of insurance proceeds.

(i) Exclusion for unscheduled personal property. No gain shall be recognized by reason of the receipt of any insurance proceeds for personal property which was part of such contents and which was not scheduled property for purposes of such insurance.

(ii) Other proceeds treated as common fund. In the case of any insurance proceeds (not described in clause (i)) for such residence or contents—

(I) such proceeds shall be treated as received for the conversion of a single item of property, and

(II) any property which is similar or related in service or use to the residence so converted (or contents thereof) shall be treated for purposes of subsection (a)(2) as property similar or related in service or use to such single item of property.

(B) Extension of replacement period. Subsection (a)(2)(B) shall be applied with respect to any property so converted by substituting “4 years” for “2 years”.

(2) Trade or business and investment property. If a taxpayer's property held for productive use in a trade or business or for investment located in a disaster area and compulsorily or involuntarily converted as a result of a federally declared disaster, tangible property of a type held for productive use in a trade or business shall be treated for purposes of subsection (a) as property similar or related in service or use to the property so converted.

(3) Federally declared disaster; disaster area. The terms “federally declared disaster” and “disaster area” shall have the respective meaning given such terms by section 165(h)(3)(C).

(4) Principal residence. For purposes of this subsection, the term “principal residence” has the same meaning as when used in section 121, except that such term shall include a residence not treated as a principal residence solely because the taxpayer does not own the residence.

(i) Replacement property must be acquired from unrelated person in certain cases.

(1) In general. If the property which is involuntarily converted is held by a taxpayer to which this subsection applies, subsection (a) shall not apply if the replacement property or stock is acquired from a related person. The preceding sentence shall not apply to the extent that the related person acquired the replacement property or stock from an unrelated person during the period applicable under subsection (a)(2)(B).

(2) Taxpayers to which subsection applies. This subsection shall apply to—

(A) a C corporation,

(B) a partnership in which 1 or more C corporations own, directly or indirectly (determined in accordance with section 707(b)(3) ), more than 50 percent of the capital interest, or profits interest, in such partnership at the time of the involuntary conversion, and

(C) any other taxpayer if, with respect to property which is involuntarily converted during the taxable year, the aggregate of the amount of realized gain on such property on which there is realized gain exceeds \$100,000.

In the case of a partnership, subparagraph (C) shall apply with respect to the partnership and with respect to each partner. A similar rule shall apply in the case of an S corporation and its shareholders.

(3) Related person. For purposes of this subsection , a person is related to another person if the person bears a relationship to the other person described in section 267(b) or 707(b)(1).

## **§1041 Transfers of property between spouses or incident to divorce**

- (a) General rule. No gain or loss shall be recognized on a transfer of property from an individual to (or in trust for the benefit of)—
  - (1) a spouse, or
  - (2) a former spouse, but only if the transfer is incident to the divorce.
- (b) Transfer treated as gift; transferee has transferor's basis. In the case of any transfer of property described in subsection (a) —
  - (1) for purposes of this subtitle, the property shall be treated as acquired by the transferee by gift, and
  - (2) the basis of the transferee in the property shall be the adjusted basis of the transferor.
- (c) Incident to divorce. For purposes of subsection (a)(2) , a transfer of property is incident to the divorce if such transfer—
  - (1) occurs within 1 year after the date on which the marriage ceases, or
  - (2) is related to the cessation of the marriage.
- (d) Special rule where spouse is nonresident alien. Subsection (a) shall not apply if the spouse (or former spouse) of the individual making the transfer is a nonresident alien.
- (e) Transfers in trust where liability exceeds basis. Subsection (a) shall not apply to the transfer of property in trust to the extent that—
  - (1) the sum of the amount of the liabilities assumed, plus the amount of the liabilities to which the property is subject, exceeds
  - (2) the total of the adjusted basis of the property transferred.

Proper adjustment shall be made under subsection (b) in the basis of the transferee in such property to take into account gain recognized by reason of the preceding sentence.