

an allowance for depreciation. Since the recognized losses (\$2,000) do not exceed the recognized gains (\$4,000) from the involuntary conversion for 1970 as a result of fire, storm, shipwreck, or other casualty, or from theft, of any property used in the trade or business or of any capital asset held for more than 6 months, such gains and losses are included in making the computations under section 1231. Since the aggregate of the recognized gains to which section 1231 applies (\$5,000) exceeds the aggregate of the recognized losses to which such section applies (\$2,000), such gains and losses are treated under section 1231 as gains and losses from the sale or exchange of capital assets held for more than 6 months. The \$6,000 loss upon the sale of stock is not taken into account in making such computation since it is not a loss to which section 1231 applies.

[T.D. 6500, 25 FR 12006, Nov. 26, 1960, as amended by T.D. 6841, 30 FR 9309, July 27, 1965; T.D. 7369, 40 FR 29841, July 16, 1975; T.D. 7728, 45 FR 72650, Nov. 3, 1980; T.D. 7829, 47 FR 38515, Sept. 1, 1982]

**§ 1.1231-2 Livestock held for draft, breeding, dairy, or sporting purposes.**

(a)(1) In the case of cattle, horses, or other livestock acquired by the taxpayer after December 31, 1969, section 1231 applies to the sale, exchange, or involuntary conversion of such cattle, horses, or other livestock, regardless of age, held by the taxpayer for draft, breeding, dairy, or sporting purposes, and held by him:

(i) For 24 months or more from the date of acquisition in the case of cattle or horses, or

(ii) For 12 months or more from the date of acquisition in the case of such other livestock.

(2) In the case of livestock (including cattle or horses) acquired by the taxpayer on or before December 31, 1969, section 1231 applies to the sale, exchange, or involuntary conversion of such livestock, regardless of age, held by the taxpayer for draft, breeding, or dairy purposes, and held by him for 12 months or more from the date of acquisition.

(3) For the purposes of section 1231, the term *livestock* is given a broad, rather than a narrow, interpretation and includes cattle, hogs, horses, mules, donkeys, sheep, goats, fur-bearing animals, and other mammals. However, it does not include poultry, chick-

ens, turkeys, pigeons, geese, other birds, fish, frogs, reptiles, etc.

(b)(1) Whether or not livestock is held by the taxpayer for draft, breeding, dairy, or sporting purposes depends upon all of the facts and circumstances in each case. The purpose for which the animal is held is ordinarily shown by the taxpayer's actual use of the animal. However, a draft, breeding, dairy, or sporting purpose may be present if an animal is disposed of within a reasonable time after its intended use for such purpose is prevented or made undesirable by reason of accident, disease, drought, unfitness of the animal for such purpose, or a similar factual circumstance. Under certain circumstances, an animal held for ultimate sale to customers in the ordinary course of the taxpayer's trade or business may be considered as held for draft, breeding, dairy, or sporting purposes. However, an animal is not held by the taxpayer for draft, breeding, dairy, or sporting purposes merely because it is suitable for such purposes or merely because it is held by the taxpayer for sale to other persons for use by them for such purposes. Furthermore, an animal held by the taxpayer for other purposes is not considered as held for draft, breeding, dairy, or sporting purposes merely because of a negligible use of the animal for such purposes or merely because of the use of the animal for such purposes as an ordinary or necessary incident to the other purposes for which the animal is held. See paragraph (c) of this section for the rules to be used in determining when horses are held for racing purposes and, therefore, are considered as held for sporting purposes.

(2) The application of this paragraph is illustrated by the following examples:

*Example 1.* An animal intended by the taxpayer for use by him for breeding purposes is discovered to be sterile or unfit for the breeding purposes for which it was held, and is disposed of within a reasonable time thereafter. This animal is considered as held for breeding purposes.

*Example 2.* The taxpayer retires from the breeding or dairy business and sells his entire herd, including young animals which would have been used by him for breeding or dairy purposes if he had remained in business. These young animals are considered as

held for breeding or dairy purposes. The same would be true with respect to young animals which would have been used by the taxpayer for breeding or dairy purposes but which are sold by him in reduction of his breeding or dairy herd, because of, for example, drought.

*Example 3.* A taxpayer in the business of raising hogs for slaughter customarily breeds sows to obtain a single litter to be raised by him for sale, and sells these brood sows after obtaining the litter. Even though these brood sows are held for ultimate sale to customers in the ordinary course of the taxpayer's trade or business, they are considered as held for breeding purposes.

*Example 4.* A taxpayer in the business of raising horses for sale to others for use by them as draft horses uses them for draft purposes on his own farm in order to train them. This use is an ordinary or necessary incident to the purpose of selling the animals, and, accordingly, these horses are not considered as held for draft purposes.

*Example 5.* The taxpayer is in the business of raising registered cattle for sale to others for use by them as breeding cattle. It is the business practice of this particular taxpayer to breed the offspring of his herd which he is holding for sale to others prior to sale in order to establish their fitness for sale as registered breeding cattle. In such case, the taxpayer's breeding of such offspring is an ordinary and necessary incident to his holding them for the purpose of selling them as bred heifers or proven bulls and does not demonstrate that the taxpayer is holding them for breeding purposes. However, those cattle held by the taxpayer as additions or replacements to his own breeding herd to produce calves are considered to be held for breeding purposes, even though they may not actually have produced calves.

*Example 6.* A taxpayer, engaged in the business of buying cattle and fattening them for slaughter, purchased cows with calf. The calves were born while the cows were held by the taxpayer. These cows are not considered as held for breeding purposes.

(c)(1) For purposes of paragraph (b) of this section, a horse held for racing purposes shall be considered as held for sporting purposes. Whether a horse is held for racing purposes shall be determined in accordance with the following rules:

(i) A horse which has actually been raced at a public race track shall, except in rare and unusual circumstances, be considered as held for racing purposes.

(ii) A horse which has not been raced at a public track shall be considered as held for racing purposes if it has been

trained to race and other facts and circumstances in the particular case also indicate that the horse was held for this purpose. For example, assume that the taxpayer maintains a written training record on all horses he keeps in training status, which shows that a particular horse does not meet objective standards (including, but not limited to, such considerations as failure to achieve predetermined standards of performance during training, or the existence of a physical or other defect) established by the taxpayer for determining the fitness and quality of horses to be retained in his racing stable. Under such circumstances, if the taxpayer disposes of the horse within a reasonable time after he determined that it did not meet his objective standards for retention, the horse shall be considered as held for racing purposes.

(iii) A horse which has neither been raced at a public track nor trained for racing shall not, except in rare and unusual circumstances, be considered as held for racing purposes.

(2) This paragraph may be illustrated by the following examples:

*Example 1.* The taxpayer breeds, raises, and trains horses for the purpose of racing. Every year he culls some horses from his racing stable. In 1971, the taxpayer decided that in order to prevent his racing stable from getting too large to be effectively operated he must cull six horses from it. All six of the horses culled by the taxpayer had been raced at public tracks in 1970. Under subparagraph (1)(i) of this paragraph, all these horses are considered as held for racing purposes.

*Example 2.* Assume the same facts as in example (1). Assume further that the taxpayer decided to cull four more horses from his racing stable in 1971. All these horses had been trained to race but had not been raced at public tracks. The taxpayer culled these four horses because the training log which the taxpayer maintains on all the horses he trains showed these horses to be unfit to remain in his racing stable. Horse A was culled because it developed shin splints during training. Horses B and C were culled because of poor temperament. B bolted every time a rider tried to mount it, and C became extremely nervous when it was placed in the starting gate. Horse D was culled because it did not qualify for retention under one of the objective standards the taxpayer had established for determining which horses to retain since it was unable to run a specified distance in a minimum time. These four horses

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were disposed of within a reasonable time after the taxpayer determined that they were unfit to remain in his stable. Under subparagraph (1)(ii) of this paragraph, all these horses are considered as held for racing purposes.

[T.D. 7141, 36 FR 18792, Sept. 22, 1971]

### § 1.1232-1 Bonds and other evidences of indebtedness; scope of section.

(a) *In general.* Section 1232 applies to any bond, debenture, note, or certificate or other evidence of indebtedness (referred to in this section and §§ 1.1232-2 through 1.1232-4 as an obligation) (1) which is a capital asset in the hands of the taxpayer, and (2) which is issued by any corporation, or by any government or political subdivision thereof. In general, section 1232(a)(1) provides that the retirement of an obligation, other than certain obligations issued before January 1, 1955, is considered to be an exchange and, therefore, is usually subject to capital gain or loss treatment. In general, section 1232(a)(2)(B) provides that in the case of a gain realized on the sale or exchange of certain obligations issued at a discount after December 31, 1954, which are either corporate bonds issued on or before May 27, 1969, or government bonds, the amount of gain equal to such discount or, under certain circumstances, the amount of gain equal to a specified portion of such discount, constitutes ordinary income. In the case of certain corporate obligations issued after May 27, 1969, in general, section 1232(a)(3) provides for the inclusion as interest in gross income of a ratable portion of original issue discount for each taxable year over the life of the obligation, section 1232(a)(3)(E) provides for an increase in basis equal to the original issue discount included in gross income, and section 1232(a)(2)(A) provides that any gain realized on such an obligation held more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977) shall be considered gain from the sale or exchange of a capital asset held more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977). For the requirements for reporting original issue discount on certain obligations issued after May 27, 1969, see section 6049(a) and the regulations

thereunder. Section 1232(c) treats as ordinary income a portion of any gain realized upon the disposition of (i) coupon obligations which were acquired after August 16, 1954, and before January 1, 1958, without all coupons maturing more than 12 months after purchase attached, and (ii) coupon obligations which were acquired after December 31, 1957, without all coupons maturing after the date of purchase attached.

(b) *Requirement that obligations be capital assets.* In order for section 1232 to be applicable, an obligation must be a capital asset in the hands of the taxpayer. See section 1221 and the regulations thereunder. Obligations held by a dealer in securities (except as provided in section 1236) or obligations arising from the sale of inventory or personal services by the holder are not capital assets. However, obligations held by a financial institution, as defined in section 582(c) (relating to treatment of losses and gains on bonds of certain financial institutions) for investment and not primarily for sale to customers in the ordinary course of the financial institution's trade or business, are capital assets. Thus, with respect to obligations held as capital assets by such a financial institution which are corporate obligations to which section 1232(a)(3) applies, there is ratable inclusion of original issue discount as interest in gross income under paragraph (a) of § 1.1232-3A, and gain on a sale or exchange (including retirement) may be subject to ordinary income treatment under section 582(c) and paragraph (a)(1) of § 1.1232-3.

(c) *Face-amount certificates*—(1) *In general.* For purposes of section 1232, this section and §§ 1.1232-2 through 1.1232-4, the term *other evidence of indebtedness* includes *face amount certificates* as defined in section 2(a)(15) and 4 of the Investment Company Act of 1940 (15 U.S.C. 80a-2 and 80a-4).

(2) *Amounts received in taxable years beginning prior to January 1, 1964.* Amounts received in taxable years beginning prior to January 1, 1964 under face amount certificates which were issued after December 31, 1954, are subject to the limitation on tax under section 72(e)(3). See paragraph (g) of § 1.72-11 (relating to limit on tax attributable to receipt of a lump sum received as an