

1960, which is the closest first day (of a calendar month) to the middle of the taxable year, is July 1, 1960. Accordingly, for purposes of computing applicable percentage, elements A and B are each treated as placed in service on July 1, 1960.

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§ 1.1251-1 General rule for treatment of gain from disposition of property used in farming where farm losses offset nonfarm income.

(a) *Applicability.* The provisions of section 1251, this section, and §§ 1.1251-2 through 1.1251-4 shall apply with respect to any taxable year beginning after December 31, 1969, but only if (1) there is a farm net loss (as defined in section 1251(e)(2) and paragraph (b) of § 1.1251-3) for the taxable year, or (2) there is a balance in the excess deductions account (as described in § 1251-2) as of the close of the taxable year before subtracting any amount under paragraph (c)(1)(i) of § 1251-2. See section 1251(a). In general, a taxpayer who has a farm net loss and certain other taxpayers are required to establish and maintain an excess deductions account as provided in section 1251(b). Certain additions and subtractions are made to the excess deductions account, and upon the disposition of *farm recapture property* any gain to the extent of the balance in the excess deductions account is recognized as ordinary income under section 1251(c)(1). See paragraph (b)(1) of this section. *Farm recapture property* is, in general, certain farming property (other than section 1250 property) described in paragraph (1), (3), or (4) of section 1231(b). See paragraph (a) of § 1.1251-3.

(b) *Ordinary income—(1) General rule.* In general, subject to the provisions of subparagraphs (2), (3), (4), and (5) of this paragraph, upon a disposition of an item of farm recapture property during a taxable year beginning after December 31, 1969, the amount of which:

(i) In the case of a sale, exchange, or involuntary conversion, the amount realized, or

(ii) In the case of any other disposition, the fair market value of such property

exceeds the adjusted basis of such property shall be recognized under section 1251(c)(1) as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231 (that is, shall be recognized as ordinary income). The amount of gain recognized as ordinary income under section 1251(c)(1) shall be determined separately for each item of farm recapture property in a manner consistent with the principles of subparagraphs (4) and (5) of § 1.1245-1(a) (relating to gain from dispositions of certain depreciable property). Generally, such ordinary income treatment applies even though in the absence of section 1251(c)(1) no gain would be recognized under the Code. For example, if a corporation distributes farm recapture property as a dividend gain may be recognized as ordinary income to the corporation even though, in the absence of section 1251(c)(1), section 311(a) would preclude any recognition of gain to the corporation. For purposes of section 1251, the term *disposition* shall have the same meaning as in paragraph (a)(3) of § 1.1245-1. For the relation of section 1251 to other provisions of the Code, see paragraph (e) of this section.

(2) *Limitation as to dispositions of land—(i) In general.* In the case of a disposition of land, gain shall be recognized as ordinary income under section 1251(c)(1) only to the extent of the land's *potential gain*. See section 1251(c)(2)(C).

(ii) *Potential gain.* For purposes of section 1251, the term *potential gain* means in respect of land an amount equal to the excess of its fair market value over its adjusted basis, but limited to the extent of the deductions allowable in respect to such land pursuant to an election (if any) under sections 175 (relating to soil and water conservation expenditures) and 182 (relating to expenditures by farmers for clearing land) for the taxable year of disposition and the four immediately preceding taxable years regardless of whether any such preceding taxable year begins before December 31, 1969. See section (e)(5).

(iii) *Cross reference.* For additional recapture of certain deductions allowed under sections 175 and 182 in respect of farm land, see section 1252.

(3) *Exceptions and special rules.* The amount of gain to be recognized as ordinary income under section 1251(c)(1) after applying subparagraph (2) of this paragraph, if applicable, shall be subject to the exceptions and special rules of section 1251(d) and § 1.1251-4.

(4) *Limitation as to amount in excess deductions account—(i) In general.* The aggregate of the amount of gain recognized as ordinary income under section 1251(c)(1) (after applying subparagraphs (2) and (3) of this paragraph, if applicable) shall not exceed the amount in the excess deductions account at the close of the taxable year after subtracting from the account the amount specified in section 1251(b)(3)(A) and paragraph (c)(1)(i) of § 1.1251-2. See section 1251(c)(2)(A). For transfer of amount in an excess deductions account, see section 1251(b)(5).

(ii) *Dispositions taken into account.* If the aggregate of the amount to which section 1251(c)(1) applies is limited for any taxable year by the application of subdivision (i) of this subparagraph, section 1251(c)(1) shall apply in respect of dispositions of items of farm recapture property in the order made. See section 1251(c)(2)(B).

(5) *Relationship to section 1245.* If property is disposed of which qualifies as both section 1245 property (as defined in section 1245(a)(3)) as well as farm recapture property, then gain shall be recognized as ordinary income under section 1251(c)(1) only to the extent that the amount of any gain realized (in the case of a sale, exchange, or involuntary conversion), or to the extent that the excess of the fair market value of the property over its adjusted basis (in the case of any other disposition), was not recognized as ordinary income under section 1245(a)(1). The amount of gain recognized as ordinary income under section 1245(a)(1) upon a disposition of farm recapture property (i) is taken into account under paragraph (b)(2) of § 1.1251-3 for purposes of computing farm net loss (or farm net income) and (ii) is not under paragraph (c)(1)(ii) of § 1.1251-2 subtracted from the excess deductions account.

(6) *Examples.* The principles of this paragraph may be illustrated by the following examples:

Example 1. A, an unmarried individual who uses the calendar year as his taxable year, makes one disposition of farm recapture property during 1970. On June 30, 1970, he sells for \$75,000 farm recapture property (other than land) with an adjusted basis of \$43,000 for a realized gain of \$32,000 none of which is recognized under section 1245. The balance in A's excess deductions account is \$39,000 at the close of 1970 (after making the applicable additions and subtractions under section 1251(b)(2) and (3)(A)). Hence, the entire gain of \$32,000 is recognized as ordinary income under section 1251(c)(1), and the balance remaining in A's excess deductions account is \$7,000. If, however, the original balance in the excess deductions account were only \$15,000, then only \$15,000 would be recognized as ordinary income under section 1251(c)(1) and A's excess deductions account balance would be reduced to zero. The remaining gain of \$17,000 may be treated as gain from the sale or exchange of property described in section 1231.

Example 2. M, a calendar year corporation makes one disposition of farm recapture property during 1975. On January 15, 1975, M distributes as a dividend to its shareholders land which it had acquired on March 3, 1970. On that date, the excess of the fair market value (\$67,500) over the adjusted basis of land (\$45,000) is \$22,500 and the sum of the deductions allowable in respect of such land under sections 175 and 182 is \$5,000 for 1970 and \$13,000 for the taxable year of disposition and the four immediately preceding taxable years. Thus, the potential gain (as defined in subparagraph (2)(i) of this paragraph) is limited to \$13,000. At the end of M's taxable year (after making the applicable additions and subtractions under section 1251(b)(2) and (3)(A) there is a balance of \$25,000 in the excess deductions account of M. Since such balance exceeds the potential gain, M recognizes \$13,000 as ordinary income under section 1251(c)(1) even though, in the absence of that provision, section 311(a) would preclude recognition of gain to M. The balance in M's excess deductions account is reduced by \$13,000, from \$25,000 to \$12,000. With respect to the treatment of the remaining gain (\$9,500) from the disposition of the land, see section 1252 and example (2) of paragraph (e) § 1.1252-1.

Example 3. Assume the same facts as in example (2), except that M makes a second disposition of farm recapture property during 1975. On June 5, 1975, M sells for \$55,000 a breeding herd of cattle having an adjusted basis of \$35,000 for a realized gain of \$20,000. M had acquired the herd on April 1, 1971. Assume further that \$6,000 of the \$20,000 gain realized is treated as ordinary income under section 1245(a)(1). Thus, the amount of gain M would recognize as ordinary income under section 1251(c)(1), computed before applying the excess deductions account limitation, is

\$14,000. In accordance with the computation in example (1) of paragraph (c)(2) of § 1.1251-2, the excess deductions account limitations limit the maximum amount of gain which can be recognized as ordinary income under section 1251(c)(1) upon the disposition of the land and the breeding herd to \$25,000. Under subparagraph (4)(ii) of this paragraph, the amount of such limitation, \$25,000, is assigned to each property in the order of disposition. Thus, the amount of gain recognized as ordinary income under section 1251 is \$13,000 (as in example (1) of this subparagraph) on the disposition of the land and \$12,000 on the disposition of the breeding herd. The remaining gain of \$2,000 (i.e., \$14,000 minus \$12,000) on the disposition of the breeding herd may be treated as gain from the sale or exchange of property described in section 1231.

(c) *Instances of nonapplication*—(1) *In general.* Section 1251 does not apply with respect to dispositions of farm recapture property by a taxpayer during a taxable year if at the close of such year after making the necessary additions and subtractions under section 1251(b) (2) and (3)(A), there is no balance in the taxpayer's excess deductions account.

(2) *Losses.* Section 1251(c)(1) does not apply to losses. Thus, section 1251(c)(1) does not apply if a loss is realized upon a sale, exchange or involuntary conversion of property, all of which is farm recapture property, nor does the section apply to a disposition of such property other than by way of sale, exchange, or involuntary conversion if at the time of the disposition the fair market value of such property is not greater than its adjusted basis.

(3) *Certain dispositions of interests in land.* Section 1251(c)(1) does not apply to dispositions of interests in land with respect to which no deductions were allowable pursuant to an election under section 175 (relating to soil and water conservation expenditures) and 182 (relating to expenditures by farmers for clearing land) for the taxable year of disposition and the four immediately preceding taxable years. For possible application of section 1252 in such a case, see example (1) of paragraph (e) of § 1.1252-1.

(d) *Partnerships.* [Reserved]

(e) *Relation of section 1251 to other provisions*—(1) *General.* The provisions of section 1251 apply (after applying paragraph (b)(5) of this section, relating to

section 1245 property) notwithstanding any other provision of subtitle A of the Code. Thus, unless an exception or special rule under section 1251(d) and § 1.1251-4 applies, gain under section 1251(c)(1) is recognized notwithstanding any contrary nonrecognition provision or income characterizing provision. For example, section 1251 overrides section 1231 (relating to property used in a trade or business). Accordingly, gain recognized under section 1251(c)(1) upon a disposition of farm recapture property will be treated as ordinary income to the extent of the balance in the taxpayer's excess deductions account, and only the remaining gain, if any, from the disposition may be considered as gain from the sale or exchange of a capital asset if section 1231 is applicable. See example (3) of paragraph (d)(6) of this section.

(2) *Nonrecognition sections overridden.* The nonrecognition of gain provisions of subtitle A of the Code which section 1251 overrides include, but are not limited to, sections 267(d), 311(a), 336, 337, and 512(b)(5). See section 1251(d) and § 1.1251-4 for the extent to which 1251(c)(1) overrides sections 332, 351, 361, 371(a), 374(a), 721, 1031, and 1033.

(3) *Treatment of gain not recognized under section 1251(c)(1).* For treatment of gain not recognized under section 1251(c)(1), the principles of paragraph (f) § 1.1251-6 shall be applicable. Thus section 1251 does not prevent gain which is not recognized under section 1251 from being considered as gain under another provision of the Code, such as for example, section 1252(a)(1) (relating to treatment of gain from disposition of farm land). See example (1) of paragraph (e) of § 1.1252-1.

(4) *Exempt income.* With regard to exempt income, the principles of paragraph (e) of § 1.1245-6 shall be applicable.

(5) *Normal retirement of asset in multiple asset account.* Section 1251(c)(1) does not require recognition of gain upon normal retirements of farm recapture property in a multiple asset account as long as the taxpayer's method of accounting, as described in paragraph (e)(2) of § 1.167(a)-8 (relating to accounting treatment of asset retirements), does not require recognition of such gain.

(6) *Installment method*—(i) *In general.* Gain from a disposition to which section 1251(c)(1) applies may be reported under the installment method if such method is otherwise available under section 453 of the Code. In such case, the income (other than interest) on each installment payment shall be deemed to consist of gain to which section 1251(c)(1) applies until all such gain has been reported, and the remaining portion (if any) of such income shall be deemed to consist of gain to which section 1251(c)(1) does not apply. For treatment of amounts as interest on certain deferred payments, see section 483. For adjustments in the excess deductions account, see paragraph (c)(1)(ii) of § 1.1251-2.

(ii) *Special rule.* If a taxpayer disposes of property used in the trade or business of farming which qualifies as both section 1245 property as well as farm recapture property and elects to report the gain from such disposition under the installment method, then the income (other than interest) on each installment payment shall (a) first be deemed to consist of gain to which section 1245(a)(1) applies until all such gain has been reported, (b) The remaining portion (if any) of such income shall be deemed to consist of gain to which section 1251(e)(1) applies until all such gain has been reported, and (c) finally the remaining portion (if any) of such income shall be deemed to consist of gain to which neither section 1245(a)(1) nor 1251 (c)(1) applies. See paragraph (d)(3) of § 1.1252-1 with respect to the installment method in regard to the disposition of property which is both farm recapture property as well as farm land (as defined in section 1252(a)(2) and paragraph (a)(3)(i) of § 1.1252-1).

[T.D. 7418, 41 FR 18814, May 7, 1976; 41 FR 23669, June 11, 1976]

§ 1.1251-2 Excess deductions account.

(a) *Establishment and maintenance of account*—(1) *General rule.* With respect to any taxable year beginning after December 31, 1969, any taxpayer who:

(i) Has a farm net loss (as defined in section 1251(e)(2) and in paragraph (b) of § 1.1251-3) for such a taxable year, or

(ii) Has an excess deductions account balance as of the close of such a taxable year

shall establish (if not previously established) and maintain for purposes of section 1251 an excess deductions account. See section 1251(b)(1). Once an excess deductions account is established (or succeeded to under paragraph (e) of this section in the case of certain corporate transactions and gifts) all entries (including the entries prescribed by paragraph (f) of this section with respect to married taxpayers who file joint returns) with respect to the account must be part of the taxpayer's permanent records for all taxable years for which the account must be maintained. For purposes of applying section 1251 and this section, the term *taxpayer* in the case of a partnership means each partner of such partnership and in the case of an estate or trust means the estate or trust regardless of whether it is taxable under subpart A or E, subchapter J, chapter 1 of the Code.

(2) *Distributions from estate or trust.* If farm recapture property is distributed from an estate or trust in a transaction to which section 1251(d) (1) or (2) (relating to exceptions for gifts and transfers at death) applies, then the excess deductions account balance of the estate or trust shall be succeeded to by the distributee in the amount, if any, and manner prescribed in paragraph (e)(2) of this section. For purposes of the preceding sentence only, the rules of paragraph (e)(2) of this section shall be applied by treating each distribution as a gift at the time made. Thus; for example, if all of the farm recapture property of an estate or trust is distributed to a distributee on the date the estate or trust terminates, the distributee will succeed on that date to the excess deductions account balance of the estate or trust.

(3) *Exception.* A taxpayer is not required to maintain an excess deductions account under subparagraph (1) of this paragraph for a taxable year if:

(i) For such taxable year there would be no additions to the taxpayer's excess deductions account, and

(ii) For the immediately preceding taxable year the balance in the taxpayer's excess deductions account was