

§ 1.1251-3

26 CFR Ch. I (4-1-02 Edition)

If for 1972, H and W were to file separate returns, then the separately maintained excess deductions account balances as of January 1, 1972, would be \$26,000 and zero respectively. See subparagraph (5)(ii) of this paragraph.

[T.D. 7418, 41 FR 18816, May 7, 1976; 41 FR 23669, June 11, 1976]

§ 1.1251-3 Definitions relating to section 1251.

(a) *Farm recapture property*—(1) *In general.* (i) The term *farm recapture property* means any property (other than section 1250 property as defined in section 1250(c)) which, in the hands of the taxpayer is or was property:

(a) Which is described in section 1231(b)(1) (relating to business property held for more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977), section 1231(b)(3) (relating to livestock), or section 1231(b)(4) (relating to an unharvested crop), and

(b) Which, at the time the property qualifies under (a) of this subdivision, is used in the trade or business of farming (as defined in paragraph (e) of this section).

(ii) The term *farm recapture property* also includes:

(a) Property acquired by gift and property acquired in a transaction to which section 1251(b)(5)(A) applies, if such property was farm recapture property within the meaning of subdivision (i) of this subparagraph in the hands of the transferor, and

(b) Property the basis of which in the hands of the taxpayer holding such property is determined by reference to the basis of other property which in the hands of such taxpayer was farm recapture property within the meaning of subdivision (i) of this paragraph. For purposes of (b) of this subdivision (ii) property whose basis is determined in accordance with the last sentence of section 1033(c) shall be considered as having as basis determined by reference to the property whose conversion gave rise to the application of such section.

(iii) *Leasehold of farm recapture property.* If property is farm recapture property under this subparagraph, a leasehold of such property is also farm recapture property to the same extent as described in, and in accordance with the

principles of paragraph (a)(2) of § 1.1245-3.

(iv) If property described in subdivision (ii) of this subparagraph is stock or securities received in certain corporate transactions described in section 1251(d)(6), see paragraph (f) of § 1.1251-4 for determination as to extent such stock or securities is farm recapture property.

(2) *Examples.* The provisions of subparagraph (1) of this paragraph may be illustrated by the following example:

Example: On December 15, 1971, A, an individual calendar year taxpayer engaged in the trade or business of farming (as defined in paragraph (e) of this section) exchanges in a transaction which qualifies under section 1031(a) (relating to an exchange of property held for productive use or investment) tractor No. 1 which A acquired on March 1, 1971, for tractor No. 2. Under subparagraph (1)(i) of this paragraph, tractor No. 1 is farm recapture property as the tractor was used in the trade or business of farming and was held for a period in excess of 6 months. Under subparagraph (1)(ii) of this paragraph, tractor No. 2 is farm recapture property as the basis of tractor No. 2 in the hands of A is determined with reference to the adjusted basis of tractor No. 1.

(b) *Farm net loss*—(1) *In general.* The term *farm net loss* means the amount by which:

(i) The deductions allowed or allowable for the taxable year by chapter 1 of subtitle A of the Code which are directly connected with the carrying on of the trade or business of farming, exceed

(ii) The gross income derived from such trade or business.

(2) *Disposition of farm recapture property.* For purposes of subparagraph (1) of this paragraph, no gain or loss (regardless of how treated) resulting from the disposition of farm recapture property shall be taken into account, except that under subparagraph (1)(ii) of this paragraph gain upon disposition of such property which is recognized as ordinary income by reason of section 1245(a)(1) shall be taken into account. Thus, for example, if land used in the trade or business of farming were disposed of and gain of \$3,000 was realized, then none of such gain would be taken into account in computing farm net loss and farm net income even if all or a portion of such gain is recognized as

ordinary income by reason of section 1251(c)(1), section 1252(a)(1), or both. If such land were disposed of at a loss, the result would be the same. See paragraph (d)(1)(ii) of this section with respect to the exclusion of gain or loss from the disposition of farm recapture property from the computation of non-farm adjusted gross income.

(3) *Amount of deduction under section 172(a) attributable to farm net loss.* (i) If all or a portion of a net operating loss (within the meaning of section 172(c)) for a taxable year is absorbed in another taxable year as a carryover or carry back, then for purposes of determining the amount of deductions referred to in subparagraph (1)(i) of this paragraph for such other taxable year the portion of the amount absorbed in such other taxable year which is attributable to amounts directly connected with the carrying on of the trade or business of farming shall be an amount equal to the amount absorbed, multiplied by a fraction the numerator of which is the amount of the farm net loss for the taxable year the net operating loss arose (but not in excess of the net operating loss for such year) and the denominator of which is the amount of the net operating loss for such year.

(ii) No portion of a farm net loss added to the excess deductions account in the year a net operating loss arose (or which would have been added to such account but for the application of the \$25,000 or \$12,500 farm net loss exclusion under paragraph (b) (2)(ii) or (4)(i)(b) of § 1.1251-2) shall be taken into account under subparagraph (1)(i) of this paragraph in any other taxable year. Accordingly the same farm net loss shall not be added to the excess deductions account more than once and a farm net loss for any taxable year shall not be subject to the \$25,000 or \$12,500 exclusion more than once.

(iii) If a net operating loss for a current taxable year attributable in whole or part to a farm net loss is carried back and absorbed in a preceding taxable year no redetermination shall be made with respect to (a) the amount of gain recognized as ordinary income under section 1251(c)(1) and paragraph (b) of § 1.1251-1 in any taxable year preceding the current taxable year, and (b)

the amount of the taxpayer's excess deductions account allocated under paragraph (e)(2) of § 1.1251-2 to a donee as of the close of any taxable year preceding the current taxable year.

(4) *Special rules as to estates and trusts.* In the case of an estate or trust, computations of amounts under this paragraph shall be made without regard to any deductions under section 651 or 661. If on the termination of an estate or trust the beneficiaries succeeding to its property are allowed a deduction under section 642(h) (relating to unused loss carryovers and excess deductions on termination available to beneficiaries), to the extent the carryover or excess deduction is attributable to a farm loss it shall have the same character in the hands of the beneficiary as in the hands of the estate or trust. The amount of a carryover or of excess deductions from a particular taxable year of an estate or trust succeeded to under section 642(h) shall be allocated between amounts attributable to a farm net loss and other amounts in the same proportion as the farm net loss for such year bears to the amount of such carryover or of excess deductions. If there is more than one beneficiary, the total farm net loss succeeded to by all the beneficiaries shall be allocated to each beneficiary in proportion to the deduction of each under section 642(h).

(c) *Farm net income.* The term *farm net income* means the amount by which the amount referred to in paragraph (b)(1)(ii) of this section exceeds the amount referred to in paragraph (b)(1)(i) of this section.

(d) *Nonfarm adjusted gross income*—(1) *In general.* The term *nonfarm adjusted gross income* means adjusted gross income (taxable income in the case of a taxpayer other than an individual) computed without regard to:

(i) Income or deductions taken into account in computing farm net loss and farm net income,

(ii) Gains and losses (regardless of how treated) resulting from the disposition of farm recapture property, and

(iii) In the case of an estate or trust, the principles of paragraph (b)(4) of this section, to the extent applicable, shall apply.

(2) *Special rules.* The following rules in addition to the rules of subparagraph (1) of this paragraph, shall apply in computing the adjusted gross income of a shareholder of an electing small business corporation:

(i) The amount of any distribution described in section 1373 (c)(2) made by the corporation shall be disregarded,

(ii) For purposes of computing the amount includible in the gross income of a shareholder under section 1373(b), the corporation's undistributable taxable income shall equal the corporation's nonfarm adjusted gross income (as defined in subparagraph (1) of this paragraph) minus the amount described in section 1373(c)(1), and

(iii) For purposes of computing a shareholder's deduction under section 1374, the corporation's net operating loss shall be computed without regard to the items referred to in subparagraph (1) (i) and (ii) of this paragraph.

(e) *Trade or business of farming*—(1) *In general.* For purposes of section 1251, the term *trade or business of farming* includes any trade or business with respect to which the taxpayer may compute gross income under §1.61-4, expenses under §1.162-12, make an election under section 175, 180, or 182, or use an inventory method referred to in §1.471-6. Such term does not include any activity not engaged in for profit within the meaning of section 183 and section 183-2.

(2) *Horse racing.* If a taxpayer is engaged in the raising of horses, including horses which are bred or purchased, then for purposes of section 1251 the term *trade or business of farming* also includes the racing of such horses by the taxpayer. Thus, for example, if a taxpayer purchases a yearling and develops it to the racing stage, the term *trade or business of farming* includes the racing of such horse.

(3) *Several businesses of farming.* If a taxpayer is engaged in more than one trade or business of farming, all such trades and businesses shall be treated as one trade or business.

[T.D. 7418, 41 FR 18826, May 7, 1976, as amended by T.D. 7728, 45 FR 72650, Nov. 3, 1980]

§ 1.1251-4 Exceptions and limitations.

(a) *Exception for gifts*—(1) *General rule.* Section 1251(d)(1) provides that no gain

shall be recognized under section 1251(c)(1) upon a disposition by gift. For purposes of this paragraph, the term *gift* shall have the same meaning as in paragraph (a) of §1.1245-4 and, with respect to the application of this paragraph, principles illustrated by the examples of paragraph (a)(2) of §1245-4 shall apply. For reduction in amount of charitable contribution in case of a gift of farm recapture property, see section 170(e) and §1.170A-4.

(2) *Disposition in part a sale or exchange and in part a gift.* Where a disposition of farm recapture property is in part a sale or exchange and in part a gift, the amount of gain recognized as ordinary income under section 1251(c)(1) shall not exceed:

(i) In the case of farm recapture property other than land, the excess of the amount realized over adjusted basis, and

(ii) In the case of land, the lower of the amount in subdivision (i) of this subparagraph or the potential gain (as defined in paragraph (b)(2)(ii) of §1.1251-1.

(3) *Treatment of land in hand of transferee.* See paragraph (g) of this section for treatment of transferee in the case of a disposition of land to which this paragraph applies.

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

Example 1. A, a calendar year taxpayer, makes one disposition of farm recapture property during 1976. On March 2, 1976, A makes a gift to B (also a calendar year taxpayer) of a parcel of land which he had on January 15, 1971. On the date of such disposition, the excess of the fair market value (\$65,000) over the adjusted basis of the land (\$40,000) is \$25,000 and the sum of the deductions allowable in respect of such land under sections 175 and 182 is \$21,000 for 1971 and \$3,000 (attributable to 1975) for the taxable year of disposition and the four immediately preceding taxable years. Thus, the potential gain (as defined in paragraph (b)(2)(ii) of §1.1251-1) is limited to \$3,000. At the end of 1976 (after making the applicable additions and subtractions under section 1251(b) (2) and (3)(A)), there is a balance in A's excess deductions account of \$25,000. However, upon making the gift, A recognizes no gain under section 1251(c)(1) or section 1252(a)(1). See subparagraph (a)(1) of this paragraph and paragraph (a)(1) of §1.1252-2. For treatment of the land in the hands of B, see example (1) of paragraph (g)(3) of this section. For effect