

(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 § 1.1245-4 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

of the gift on the excess deductions accounts of A and B, see paragraph (e)(2) of § 1.1251-2.

Example 2. Assume the same facts as in example (1), except that A transfers the land to B for \$50,000. Thus, the gain realized is \$10,000 (amount realized, \$50,000, minus adjusted basis \$40,000), and A has made a gift of \$15,000 (fair market value, \$65,000, minus amount realized, \$50,000). Since under subparagraph (2)(ii) of this paragraph, the potential gain (\$3,000) is lower than the gain realized (\$10,000), the gain to which section 1251(c)(1) could apply is limited by subparagraph (2)(ii) of this paragraph to \$3,000. Thus, as A has \$25,000 in his excess deductions account, \$3,000 is recognized as ordinary income under section 1251(c)(1). See example (2) of paragraph (a)(4) of § 1.1252-2 for computation of gain of \$7,000 which is recognized as ordinary income by A under section 1252(a)(1). For treatment of the land in the hands of B, see example (2) of paragraph (g)(3) of this section.

(b) *Exception for transfers at death*—(1) *General rule.* Section 1251(d)(2) provides that, except as provided in section 691 (relating to income in respect of a decedent), no gain shall be recognized under section 1251(c)(1) upon a transfer at death. For purposes of this paragraph, the term *transfer at death* shall have the same meaning as in paragraph (b) of § 1.1245-4 and, with respect to the application of this paragraph, principles illustrated by the examples of paragraph (b)(2) of § 1.1245-4 shall apply.

(2) *Treatment of land in hands of transferee.* If as of the date a person acquires land which is farm recapture property from a decedent such person's basis is determined, by reason of the application of section 1014(a), solely by reference to the fair market value of the property on the date of the decedent's death or on the applicable date provided in section 2032 (relating to alternate valuation date), then on such date the potential gain in respect to such land is zero.

(c) *Certain corporate transactions*—(1) *Limitation on amount of gain.* Under section 1251(d)(3), upon a transfer of property described in subparagraph (2) of this paragraph, the amount of gain recognized as ordinary income by the transferor under section 1251(c)(1) shall not exceed an amount equal to the excess (if any) of (i) the amount of gain recognized to the transferor on the transfer (determined without regard to section 1251) over (ii) the amount (if

any) of gain recognized as ordinary income under section 1245(a)(1). For purposes of this subparagraph, the principles of paragraph (c)(1) of § 1.1245-4 shall apply. Thus, in case of a transfer of both farm recapture property and property other than farm recapture property in a single transaction, the amount realized from the disposition of the farm recapture property (as determined in a manner consistent with the principles of paragraph (a)(5) of § 1.1245-1) shall be deemed to consist of that portion of the fair market value of each property acquired which bears the same ratio to the fair market value of such acquired property as the amount realized from the disposition of farm recapture property bears to the total amount realized. The preceding sentence shall be applied solely for purposes of computing the portion of the total gain (determined without regard to section 1251) which is eligible to be recognized as ordinary income under section 1251(c)(1). Section 1251(d)(3) does not apply to a disposition of property to an organization (other than a cooperative described in section 521) which is exempt from the tax imposed by chapter 1 of the Code.

(2) *Transfers covered.* The transfers referred to in subparagraphs (1) of this paragraph are transfers of farm recapture property in which the basis of such property in the hands of the transferee is determined by reference to its basis in the hands of the transferor by reason of the application of any of the following provisions:

(i) Section 332 (relating to distributions in complete liquidation of an 80-percent-or-more controlled subsidiary corporation). For the application of section 1251(d)(3) to such a complete liquidation, the principles of paragraph (c)(3) of § 1.1245-4 shall apply. Thus, for example, the provisions of subparagraph (1) of this paragraph do not apply to a liquidating distribution of farm recapture property by an 80-percent-or-more controlled subsidiary to its parent if the parent's basis for the property is determined, under section 334(b)(2), by reference to its basis for the stock of the subsidiary.

(ii) Section 351 (relating to transfer to corporation controlled by transferor).

(iii) Section 351 (relating to exchanges pursuant to certain corporate reorganizations).

(iv) Section 371(a) (relating to exchanges pursuant to certain receivership and bankruptcy proceedings).

(v) Section 374(a) (relating to exchanges pursuant to certain railroad reorganizations).

(3) *Partnerships.* For the application of section 1251 to partnerships, see paragraph (e) of this section.

(4) *Treatment of land in hands 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.

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

Example 1. (i) A, an individual calendar year taxpayer, makes one disposition of farm recapture property during 1971. On January 20, 1971, A transfers farm recapture property (other than land and section 1245 property), having an adjusted basis of \$22,000, to corporation M in exchange for stock in M worth \$35,000 plus \$15,000 in cash in a transaction qualifying under section 351. Thus, the amount realized is \$50,000, and the gain realized is the excess of the amount realized, \$50,000, over the adjusted basis, \$22,000, or \$28,000. Without regard to section 1251, A would recognize gain of \$15,000 under section 351(b), and M's basis for the farm recapture property would be determined under section 362(a) by reference to its basis in the hands of A. Assume further that the balance in A's excess deductions account (after making the applicable additions and subtractions under section 1251(b) (2) and (3)(A)) at the close of 1971 is \$20,000. Thus, since such balance in the excess deductions account (\$20,000) is lower than the gain realized (\$28,000), is subparagraph (1) of this paragraph did not apply, gain of \$20,000 would be recognized as ordinary income under section 1251(c)(1). However, subparagraph (1) of this paragraph limits the amount of gain to be recognized as ordinary income under section 1251(c)(1) to \$15,000.

(ii) If, however, A transferred the farm recapture property to M solely in exchange for stock worth \$50,000, then, because of the application of subparagraph (1) of this paragraph he would not recognize any gain under section 1251(c)(1). If, instead, A transferred the farm recapture property to M in exchange for stock worth \$25,000 and \$25,000 cash, only \$20,000 (the amount of such balance in the excess deductions account) of the gain of \$25,000 recognized under section 351(b) would be recognized as ordinary income under section 1251(c)(1). The remaining \$5,000

of gain recognized under section 351(b) may be treated as gain from the sale or exchange of property described in section 1231. In the hands of M, the property received from A is farm recapture property under the provisions of paragraph (a)(11)(ii) of § 1.1251-3. For treatment of the property received by A in such transaction; see section 1251(d)(6) and paragraph (f) of this section.

Example 2. Assume the same facts as in subdivision (i) of example (1), except that the farm recapture property is section 1245 property. Assume further that \$5,000 is recognized as ordinary income under section 1245(a)(1), and that as of the close of 1971, A has a balance of \$15,000 in his excess deductions account (after making the applicable additions and subtractions under section 1251(b) (2) and (3)(A) which, under paragraph (b) of § 1.1251-3, is computed by treating the \$5,000 of gain to which section 1245 applies as gross income derived from the trade or business of farming). The amount of gain recognized as ordinary income under section 1251(c)(1) is \$10,000, computed as follows:

(1) Amount of gain under section 1251(c)(1) (determined without regard to subparagraph (1) of this paragraph):	
(a) Portion of gain realized (\$28,000) in excess of amount recognized as ordinary income under section 1245(a)(1) (\$5,000)	\$23,000
(b) Excess deductions account balance	15,000
(c) Lower of (a) or (b)	15,000
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(2) Limitation in subparagraph (1) of this paragraph:	
(a) Gain recognized (determined without regard to section 1251)	15,000
(b) Minus: Gain recognized as ordinary income under section 1245(a)(1)	5,000
(c) Difference	10,000
(3) Lower of line (1)(c) or line (2)(c)	10,000

(d) *Limitation for like kind exchanges and involuntary conversions—(1) General rule.* Under section 1251(d)(4), if farm recapture property is disposed of and gain (determined without regard to section 1251) is not recognized in whole or in part under section 1031 (relating to like kind exchanges) or section 1033 (relating to involuntary conversions), then the amount of gain recognized as ordinary income by the transferor under section 1251(c)(1) shall not exceed an amount equal to the excess (if any) of (i) the amount of gain recognized on such disposition (determined without regard to section 1251) or (ii) the amount (if any) of gain recognized as ordinary income under section 1245(a)(1).

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

Example 1. (i) A, an individual calendar year taxpayer, owns a herd of breeding cattle having an adjusted basis of \$75,000 which he acquired on March 30, 1970. A receives insurance proceeds of \$90,000. Thus, the gain realized is \$15,000 (that is, the excess of the amount realized, \$75,000), A makes no other disposition of farm recapture property during 1970. Assume that had the herd been sold at its fair market value on March 15, 1970, no gain would have been recognized as ordinary income under section 1245(a)(1). As of the close of 1970, A has a balance of \$12,000 in his excess deductions account (after making the applicable additions and subtractions under section 1251(b)(2) and (3)(A)). Thus, since the balance in the excess deductions account, \$12,000, is lower than the gain realized, \$15,000, the amount of gain which would be recognized under section 1251(c)(1) (determined without regard to subparagraph (1) of this paragraph) would be \$12,000.

(ii) Assume further that A spends \$72,000 of the insurance proceeds to purchase another breeding herd, \$10,000 to purchase stock in the acquisition of control of a corporation which owns property similar or related in service or use to the destroyed breeding herd, and retains cash of \$8,000. Both of the acquisitions by A qualify under section 1033(a)(3)(A), and A properly elects under section 1033(a)(3)(A) and the regulations thereunder to limit recognition of gain to \$8,000 (that is, the amount by which the amount realized from the conversion, \$90,000 exceeds the cost of the stock and other property acquired to replace the converted property, \$72,000 plus \$10,000). Thus, since \$8,000 is the amount of gain which would be recognized under section 1033(a)(3) (determined without regard to section 1251), and since that amount is lower than the gain of \$12,000 which would be recognized under section 1251(c)(1) (determined without regard to subparagraph (1) of this paragraph), under subparagraph (1) of this paragraph the amount of gain recognized under section 1251(c)(1) is limited to \$8,000. The stock purchased for \$10,000 qualifies under paragraph (a)(1)(ii)(b) of § 1.1251-3 as farm recapture property.

Example 2. (i) A, an individual calendar year taxpayer, owns land which he had acquired on March 7, 1970, having an adjusted basis of \$48,000, and a fair market value of \$67,500. On January 15, 1975, A, as a result of a condemnation action, receives \$67,500 (its fair market value) for the land. The aggregate of the deductions allowable in respect of such land under sections 175 and 182 is \$18,000, with \$5,000 of such aggregate attributable to 1970 and \$13,000 of such aggregate attributable to 1970 and \$13,000 of such aggregate attributable to 1975 and the four pre-

ceding taxable years. Thus, the potential gain (as defined in paragraph (b)(2)(ii) of § 1.1251-1) is limited to \$13,000, since that amount is lower than \$19,500 (the excess of the fair market value of the land, \$67,500, over its adjusted basis, \$48,000). The gain realized by A is also \$19,500. At the end of A's taxable year (after making the applicable additions and subtractions under section 1251(b)(2) and (3)(A)) there is a balance of \$21,000 in the excess deductions account of A. Since the potential gain, \$13,000, is lower than both the excess deductions account balance, \$21,000, and the gain realized, \$19,500, A would recognize \$13,000 as ordinary income under section 1251(c)(1) (determined without regard to subparagraph (1) of this paragraph).

(ii) Assume further that A spends the entire amount received, \$67,500, to purchase stock in the acquisition of control of a corporation which owns property similar or related in service or use to A's condemned land which qualifies under section 1033(a)(3)(A), and A properly elects under section 1033(a)(3)(A) and the regulations thereunder to limit recognition of gain to zero (that is, the amount by which the amount realized from the conversion, \$67,500, exceeds the cost of the stock acquired to replace the converted land, \$67,500). Thus, since no gain would be recognized under section 1033(a)(3) (determined without regard to section 1251), under subparagraph (1) of this paragraph, no gain is recognized under section 1251(c)(1). The stock purchased for \$67,500 qualifies under paragraph (a)(1)(ii)(b) of § 1.1251-3 as farm recapture property. See example (1) of paragraph (d)(2) of § 1.1252-2 for a computation of gain recognized as ordinary income under section 1252(a)(1).

Example 3. B, an individual calendar year taxpayer, owns a herd of breeding cattle having an adjusted basis of \$25,000 which he acquired on March 30, 1970. On March 15, 1976, the entire herd is destroyed by a blizzard and on March 20, 1976, B receives insurance proceeds of \$90,000. Thus, the gain realized is \$65,000 (that is, the excess of the amount realized, \$90,000, over the adjusted basis, \$25,000). B makes no other disposition of farm recapture property during 1976. B spends \$60,000 of the insurance proceeds to purchase another breeding herd and retains cash of \$30,000. The acquisition by B qualifies under section 1033(a)(3)(A), and B properly elects under section 1033(a)(3)(A) and the regulations thereunder to limit recognition of gain to \$30,000 (that is, the amount by which the amount realized from the conversion, \$90,000, exceeds the cost of the property acquired to replace the converted property, \$60,000). Assume that the amount of gain recognized under section 1245(a)(1) is \$20,000, and that as of the close of 1976 B has a balance of \$100,000 in his excess deductions account (after making the applicable additions and

§ 1.1251-4

subtractions under section 1251(b) (2) and (3)(A) which, under paragraph (b) of §1.1251-3, is computed by treating the \$20,000 of gain to which section 1245 applies as gross income derived from the trade or business of farming). The amount of gain recognized as ordinary income under section 1251(c)(1) is \$10,000, computed as follows:

(1) Amount of gain under section 1251(c)(1) (determined without regard to subparagraph (1) of this paragraph):	
(a) Portion of gain realized (\$65,000) in excess of amount recognized as ordinary income under section 1245(a)(1) (\$20,000)	\$45,000
(b) Excess deductions account balance	100,000
(c) Lower of (a) or (b)	45,000
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(2) Limitation in subparagraph (1) of this paragraph:	
(a) Gain recognized (determined without regard to section 1251)	30,000
(b) Minus: Gain recognized as ordinary income under section 1245(a)(1)	\$20,000
(c) Difference	10,000
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(3) Lower of line (1)(c) or line (2)(c)	10,000

(3) *Application to single disposition of farm recapture property of one class and property of different class.* (i) If upon a sale of farm recapture property of one class gain would be recognized under section 1251(c)(1), and if such farm recapture property together with property of a different class or classes is disposed of in a single transaction in which gain is not recognized in whole or in part under section 1031 (without regard to section 1251(c)(1), then rules consistent with the principles of paragraph (d)(6) of §1.1250-3 (relating to gain from disposition of certain depreciable realty) shall apply for purposes of allocating the amount realized to each of the classes of property disposed of and for purposes of determining what property the amount realized for each class consists of.

(ii) For purposes of this subparagraph, the classes of property other than farm recapture property are (a) section 1245 property, (b) section 1250 property, and (c) other property.

(iii) For purposes of this subparagraph, the classes of farm recapture property are (a) hand, (b) farm recapture property other than land which is section 1245 property and (c) farm recapture property other than land which is not section 1245 property.

(4) *Treatment of land received in like kind exchange or involuntary conversion.*

The aggregate of the deductions allowed under sections 175 and 182 in respect of land acquired in a transaction described in subparagraph (1) of this paragraph shall include the aggregate of the deductions allowable under sections 175 and 182 in respect of the land transferred or converted (as the case may be) in such transaction minus the amount of gain taken into account under sections 1251(c) and 1252(a) with respect to the land transferred or converted. Upon a subsequent disposition of such land, such deductions shall be treated as having been allowable in the same taxable year as they were allowable with respect to the land transferred or converted.

(e) *Partnerships.* [Reserved]

(f) *Property transferred to controlled corporation.* [Reserved]

(g) *Treatment of land received by a transferee in a disposition by gift and certain tax-free transactions—(1) General rule.* If farm recapture property which is land is disposed of in a transaction which is either a gift to which paragraph (a)(1) of this section applies or a completely tax-free transfer to which section 1251(b)(5)(A) applies, then for purposes of section 1251:

(i) The aggregate of the deductions allowable under sections 175 and 182 in respect of the land in the hands of the transferee immediately after the disposition shall be an amount equal to the aggregate of such deductions for the taxable year and the four preceding taxable years in the hands of the transferor immediately before the disposition.

(ii) Upon a subsequent disposition by the transferee (including a computation of potential gain as defined in paragraph (b)(2)(ii) of §1.1251-1), such deductions in the hands of the transferee shall be treated as having been allowable with respect to the transferee in the same taxable year they were allowable to the transferor, and

(iii) If the taxable years of the transferor and transferee regularly end on different dates, then the aggregate of such deductions allowable for taxable year with respect to the transferor shall be treated in the hands of the

transferee as allowable in the transferee's taxable year in which the taxable year of the transferor regularly ends.

(2) *Certain partially tax-free transfers.*

If farm recapture property which is land is disposed of in a transaction which either is in part a sale or exchange and in part a gift to which paragraph (a)(2) of this section applies, or is a partially tax-free transfer to which section 1251(b)(5)(A) applies, then for purposes of section 1251:

(i) The amount determined under subparagraph (1)(i) of this paragraph shall be reduced by the amount of gain taken into account under sections 1251(c) and 1252(a) to the extent such gain is attributable to the sections 175 and 182 deductions for the taxable year and the preceding four taxable years (determined by attributing gain under section 1252(a) to the oldest years first) by the transferor upon the disposition, and

(ii) For purposes of subparagraph (1)(ii) of this paragraph, the amount of such gain recognized under sections 1251(c) and 1252(a) shall reduce the aggregate of deductions allowable under sections 175 and 182 for the taxable year and each of the preceding four taxable years on a pro rata basis.

(3) *Examples.* The provisions of subparagraphs (1) and (2) of this paragraph may be illustrated by the following examples:

Example 1. Assume the same facts as in example (1) of paragraph (a)(4) of this section. Therefore, on the date B receives the land in the gift transaction, under subparagraph (1) (i) and (ii) of this paragraph, the aggregate of the deductions allowable under sections 175 and 182 in respect of the land in the hands of B is the amount in the hands of A, \$24,000, and for purposes of applying section 1251 upon a subsequent disposition by B (including the computation of potential gain) such deductions in the hands of B shall be treated as allowable in the same year as they were allowable to A. Thus, in respect to the land in the hands of B, the allowable section 175 and 182 deductions of \$3,000 shall be treated as allowable in 1975.

Example 2. Assume the same facts as in example (2) of Paragraph (a)(4) of this section. Under paragraph (2) of this paragraph, the aggregate of the allowable sections 175 and 182 deductions with respect to the land which pass over to B for purposes of section 1251 is zero (\$3,000 deduction allowable under sec-

tions 175 and 182 for the taxable year and the four preceding taxable years minus \$3,000 gain taken into account by A in accordance with example (2) of paragraph (a)(4) of this section).

[T.D. 7818, 41 FR 18828, May 7, 1976; 41 FR 23669, June 11, 1976]

§ 1.1252-1 General rule for treatment of gain from disposition of farm land.

(a) *Ordinary income—(1) General rule.*

(i) Except as otherwise provided in this section and § 1.1252-2, if farm land is disposed of during a taxable year beginning after December 31, 1969, then under section 1252(a)(1) there shall be treated 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 lower of:

(a) The applicable percentage of the amount computed in subdivision (ii) of this subparagraph, or

(b) The amount computed in subdivision (iii) of this subparagraph.

(ii) The amount computed in this subdivision is an amount equal to:

(a) The aggregate of the deductions allowed, in any taxable year any day of which falls within the period the taxpayer held (or is considered to have held) the farm land, under sections 175 (relating to soil and water conservation expenditures) and 182 (relating to expenditures by farmers for clearing land) for expenditures paid or incurred after December 31, 1969, with respect to the farm land disposed of, minus

(b) The amount of gain recognized as ordinary income under section 1251(c)(1) (relating to gain from disposition of property used in farming where farm losses offset nonfarm income) upon such disposition of such land.

(iii) The amount computed in this subdivision is an amount equal to:

(a) The gain realized, that is, the excess of the amount realized (in the case of a sale, exchange, or involuntary conversion) or the fair market value of the farm land (in the case of any other disposition), over the adjusted basis of the farm land, minus

(b) The amount of gain recognized as ordinary income under section 1251(c)(1) upon such disposition of such land.