

2021 NATIONAL INCOME TAX WORKBOOK

CHAPTER 3: BUSINESS TAX ISSUES



TOPICS AND OBJECTIVES

Issue 1: Marijuana-Related (taught by Mary Jane)

This session will cover:

Issue 2: Business-Use-of-Home Deduction for Day Care Providers

Issue 3: Calculating Cost of Goods Sold on Schedule C (Form 1040)

Issue 4: Maximizing the Qualified Business Income (QBI) Deduction

Issue 5: Partnership Capital Account Reporting Requirements

Issue 6: Like-Kind Exchanges

Issue 7: Involuntary Conversions

ISSUE #2 - BUSINESS-USE-OF-HOME DEDUCTION FOR DAY CARE PROVIDERS

PP. 89-94

Losses more likely due to pandemic

- Income ↓
- Expenses ↑

IRS Audit Technique Guide available at [IRS.gov](https://www.irs.gov)

- day care providers often overstate the deduction for business use of the home
- Inadequate records

GENERAL RULES FOR DEDUCTION

P. 90

- Practitioner Note (p. 90) – **not** for employee through 2025
- Misc itemized deductions suspended before 1/1/26

GENERAL RULES FOR DEDUCTION

P. 89

- General rules - regular and **exclusive use**
- Meet at least one of three tests:
 - ***If within dwelling unit***
 - Principal place of business, or
 - must be used to meet or deal with patients, clients, or customers, or
 - ***If separate structure*** – used in connection with taxpayer's business

GENERAL RULES FOR DEDUCTION

P. 89

- Substantial administrative or management activities may suffice (if no other fixed location)
- Separately identifiable space
- Does not meet exclusive use test if used solely for business during office hours and personal at other times
- Exception for stored inventory

DAY CARE EXCEPTION TO EXCLUSIVE USE RULE

P. 90

HUGE benefit for daycare!!

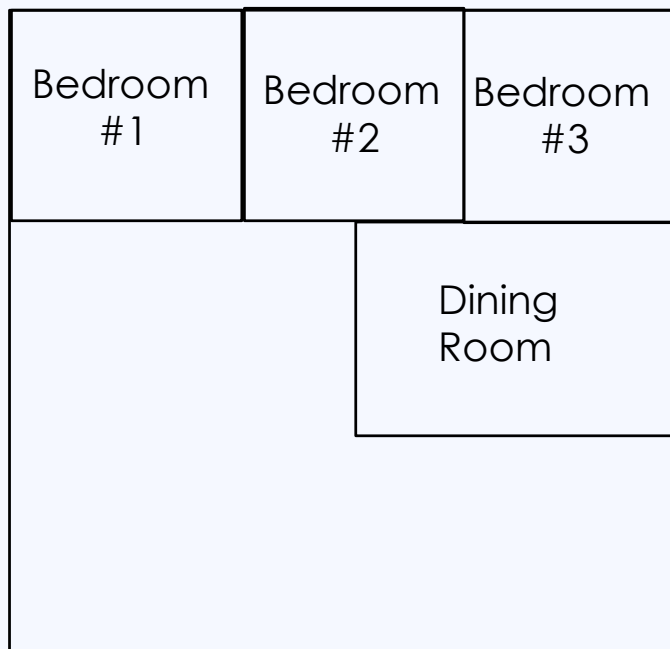
- Exclusive use test does not apply to areas used for daycare!

Daycare for whom?

- Children, adults age 65 and older, or persons who are physically or mentally unable to care for themselves
- **Rev Rul 92-3:** *“Available for day care use throughout each business day and is regularly used as part of the provider’s routine provision of day care”*

EXAMPLE 3.1

P. 90



Used for naps



Kids primarily
eat in kitchen

YES – available
and regularly
used

NO – available
and not regularly
used

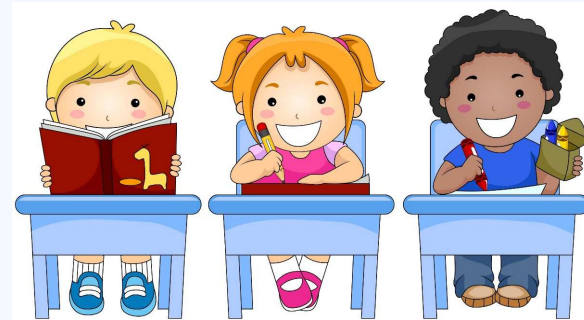
DAY CARE SERVICES

P. 90

Custodial in nature

Incidental educational, developmental, etc...

- Not primarily educational



Must be licensed:

Applied for, be granted a license or be exempt from licensing under state law.

ALLOCATING EXPENSES

P. 91

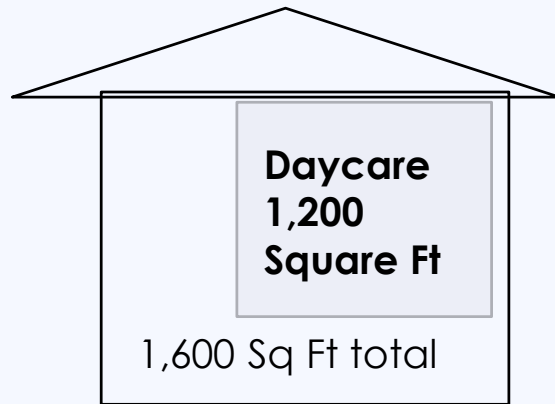
- General rule is allocation based on square footage

Rev Rul 92-3:

- Day care: **square footage multiplied by % of time used for day care**
- Deduction allowed only to the extent that income exceeds
 - direct expenses, and
 - Allocable home costs that would otherwise be deductible (interest and taxes)
- Record-keeping crucial

EXAMPLE 3.2

P. 91 & 92



4,380 hours /year

$$\begin{array}{rclcl} 1,200 / 1,600 = 75\% & 4,380 / 8,760 = 50\% & & & \\ & 75\% & \times & 50\% & = 37.5\% \end{array}$$

Expenses

Home office deduction

10,000
3,750

See Form 8829 page 92

SAFE HARBOR METHOD

P. 93

- Safe harbor method available, but limited to 300 square feet.
- $300 \text{ sq ft} \times 5.00 = 1,500 \text{ max}$
- Downside - Still must determine hour of use percentage

Daycare Facility Worksheet (for simplified method)

Keep for Your Records



1. <u>Multiply days</u> used for daycare during the year by <u>hours used per day</u>	1. _____
2. <u>Total hours</u> available for use during the year. See the Instructions for the Daycare Facility Worksheet	2. _____
3. Divide line 1 by line 2. Enter the result as a decimal amount here and on line 3b of the Simplified Method Worksheet	3. _____

RECORDKEEPING

P. 93

IRC 6001 taxpayers must keep records to substantiate the amount of any deduction

Rev Proc 2003-22 optional standard meal costs

2020 rates

Breakfast - 1.33

Lunch/supper – 2.49

Snack - .74

Document number of hours spent in daycare activities. Reconstruct, if necessary?

Any questions on
Daycare?

ISSUE #3 CALCULATING COST OF GOODS SOLD

PP. 94

Part III Cost of Goods Sold (see instructions)

33	Method(s) used to value closing inventory: a <input type="checkbox"/> Cost b <input type="checkbox"/> Lower of cost or market c <input type="checkbox"/> Other (attach explanation)	
34	Was there any change in determining quantities, costs, or valuations between opening and closing inventory? If "Yes," attach explanation	<input type="checkbox"/> Yes <input type="checkbox"/> No
35	Inventory at beginning of year. If different from last year's closing inventory, attach explanation	35 <input type="text"/>
36	Purchases less cost of items withdrawn for personal use	36 <input type="text"/>
37	Cost of labor. Do not include any amounts paid to yourself	37 <input type="text"/>
38	Materials and supplies	38 <input type="text"/>
39	Other costs	39 <input type="text"/>
40	Add lines 35 through 39	40 <input type="text"/>
41	Inventory at end of year	41 <input type="text"/>
42	Cost of goods sold. Subtract line 41 from line 40. Enter the result here and on line 4	42 <input type="text"/>

Part IV Information on Your Vehicle Complete this part **only** if you are claiming car or truck expenses on line 9

CALCULATING COGS

PP. 94

Why a separate calculation?

1. Have to deal with inventories
2. “Sales” and “Gross receipts” \neq “Gross Income”

Manufacturing, merchandising, mining activities:

$$\begin{array}{l} \text{Sales} \\ \text{less } \text{COGS} \\ \hline = \text{Gross Income} \end{array}$$

CALCULATING COGS

PP. 94

COGS formula – (required tax return reporting)

Beginning inventory

+ production and acquisition costs (471 + 263A)

- Ending inventory

= COGS

SMALL BUSINESS TAXPAYERS

PP. 94

Over 26 million

Inventory

Follow all the rules
and regulations of 471
and 263A

Part 3 – Cost of goods sold

Under 26 million

other non inventory methods

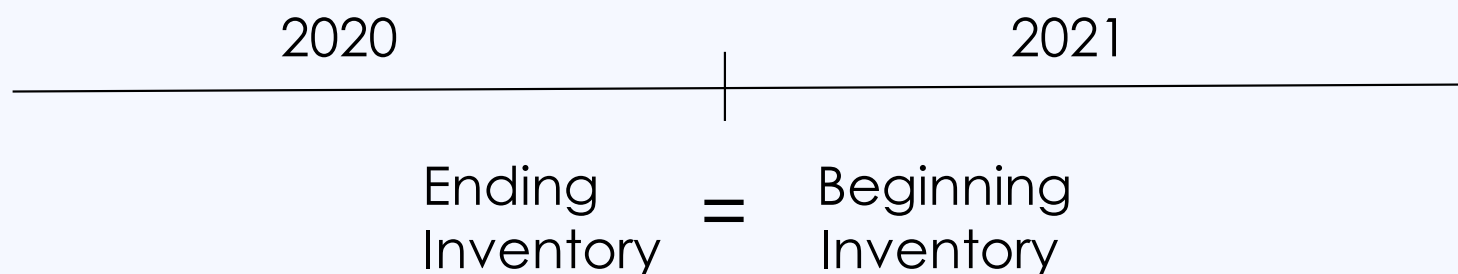
Treat as non incidental
materials and supplies
(used or consumed)

Conforms to taxpayer's
financial accounting

Balance sheet and other
deductions

CALCULATING COST OF GOODS SOLD ON SCHEDULE C (FORM 1040)

PP. 94



Found mistake in beginning inventory calculation
Change of Accounting
Sale or purchase of part of the business
New preparer
Different from balance sheet inventory

CALCULATING COST OF GOODS SOLD ON SCHEDULE C (FORM 1040)

PP. 94-95

- Purchases:
 - Raw materials, parts, and merchandise for resale
 - Net of discounts and personal/family use
- Labor Costs:
 - Includes both direct and indirect labor
 - Includes payroll taxes and fringe benefits
- Material and Supply Costs:
 - Direct and indirect

Split costs between:
Part II - line 26 wages
Part III - line 37 labor

CALCULATING COST OF GOODS SOLD ON SCHEDULE C (FORM 1040)

P. 95

Other Costs incurred in the resale or manufacturing activity:

- Shipping and handling
- Overhead costs allocable to the resale or manufacturing activity
- Maintenance and quality control

Not included:

- Marketing
- Advertising
- Selling

INVENTORY METHOD USED

P. 95

Cost

Lower cost or market

Other

Most common

FASB Accounting
Standards Update:
"lower of cost and net
realizable value."

Line 33

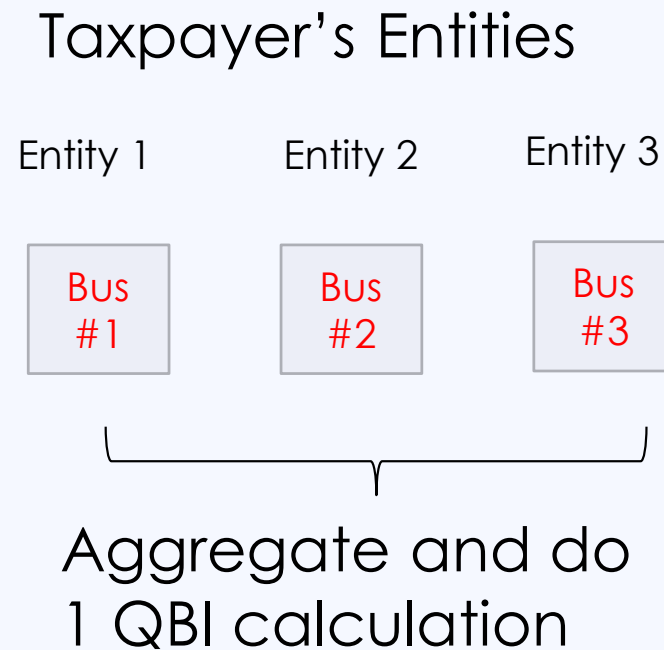
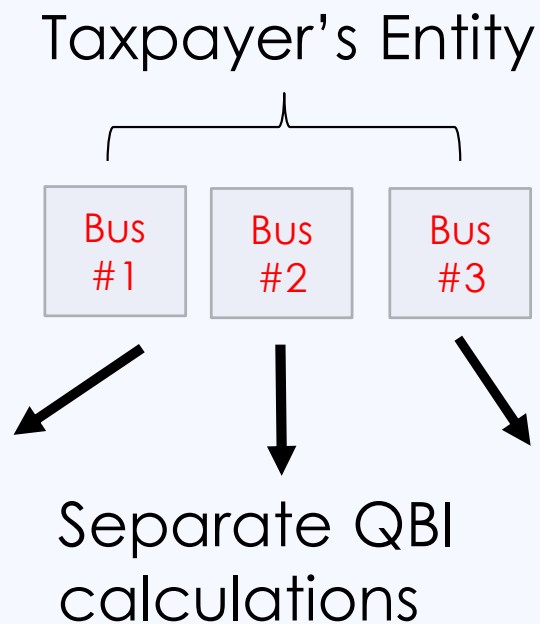
Your inventories can be valued at cost,
the lower of cost or market, or any other
method approved by the IRS.

Must attach an
explanation

Any questions on
preparing the
COGS section of
the tax return?

ISSUE #4 -MAXIMIZING THE QBI DEDUCTION

PP. 96-107



DEFINITION OF QBI

P. 96

QBI, generally:

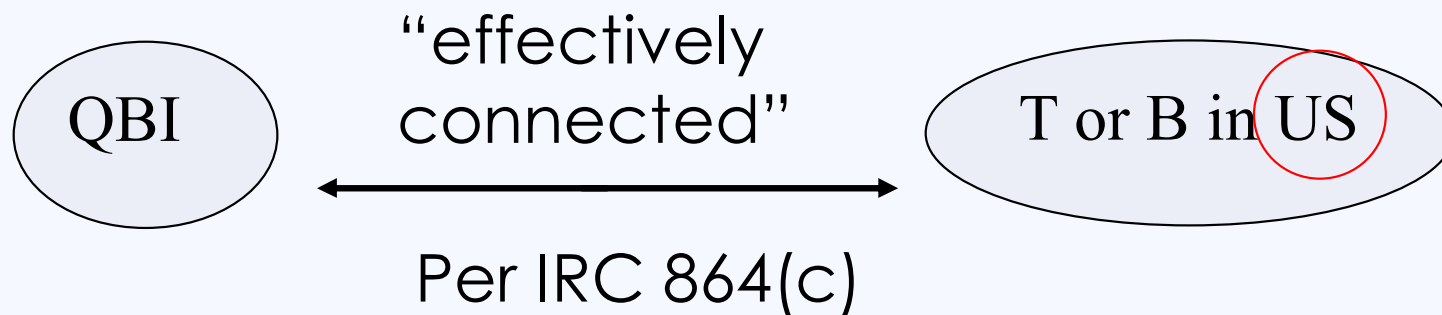
Qualified item of income, gain, deduction and loss
with respect to any qualified *trade or business*

Trade or business:

Reference to IRC 162 and certain self-rentals
Effectively connected with US trade or business

EFFECTIVELY CONNECTED WITH A US TRADE OR BUSINESS

p. 96



Office / fixed place
Material factor in realization of income
Substantial activities

QBI excludes:



Dividends

Interest Income (unless allocated to T or B)

Capital Gains and Losses

Foreign personal holding companies

Annuities

$\text{QBI} \times 20\% = \text{preliminary QBI deduction}$

limitations:

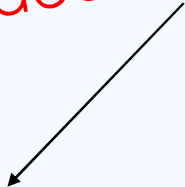
Everyone:

Taxable income limit

Above the Threshold:

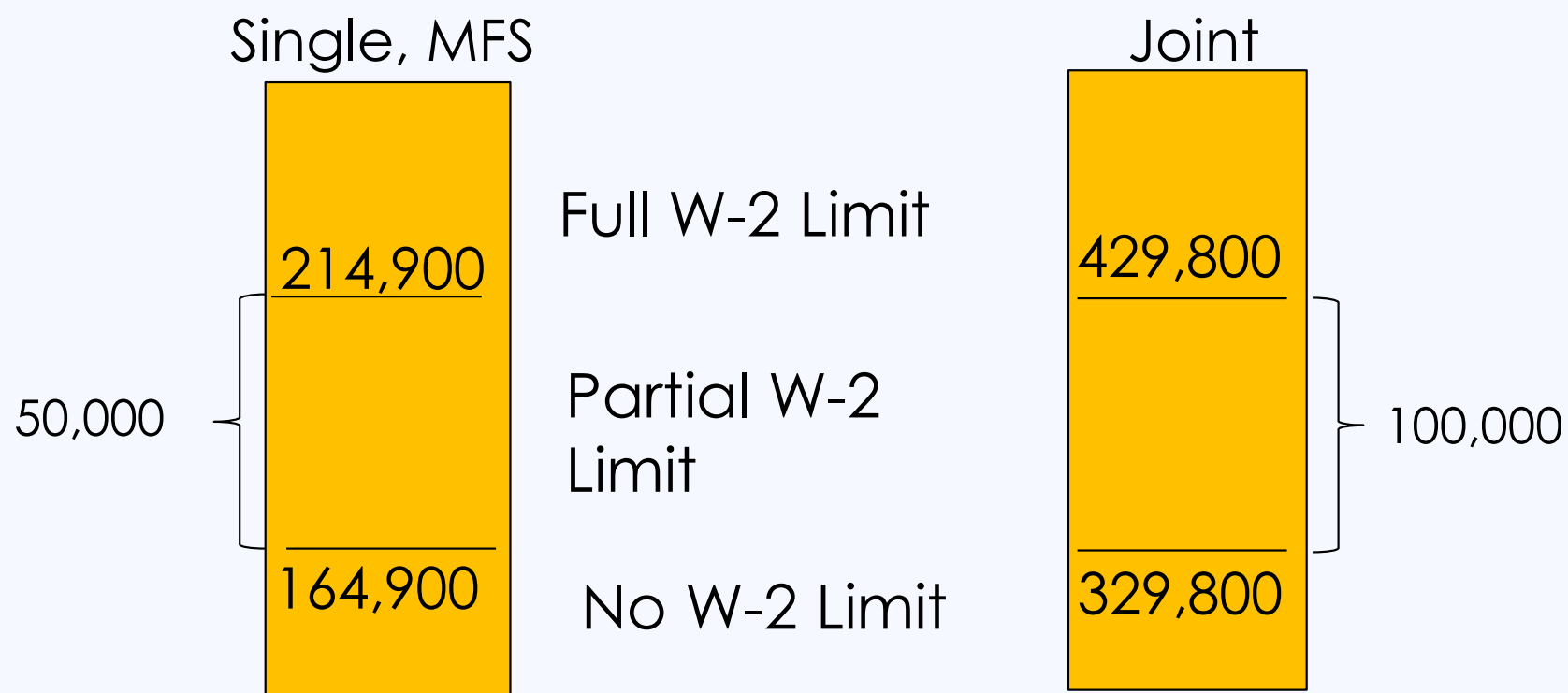
W-2 wage and capital limit – Aggregate
SSTB limit - Separate

Maximize
deduction?



2021 PHASEIN RANGES

p. 97



1. QBI x 20%
2. Taxable Income x 20%

NOW a 3rd limit, if above threshold:

3. W-2 and Capital Limit:
Greater of:
50% of W-2 wages, or
25% of W-2 wages, plus 2.5% of the UBIA
(remember – definition of W-2 wages? UBIA?)

EXAMPLE 3.5 - ABOVE PHASE IN

p. 98

Facts: Single, Wages paid 15,000, UBI 10,000

Wages	200,000		
S Corp – QBI	75,000	$\times 20\% = 15,000$	QBID
Standard ded	<u>(12,550)</u>		
Taxable income	262,450	$\times 20\% = 52,490$	TI limit
			Lesser 7,500
W-2 Limitation:			
$15,000 \times 50\% =$		7,500	greater
$15,000 \times 25\% + 10,000 \times 2.5\% =$		4,000	

SPECIFIED SERVICE T OR B LIMITATION

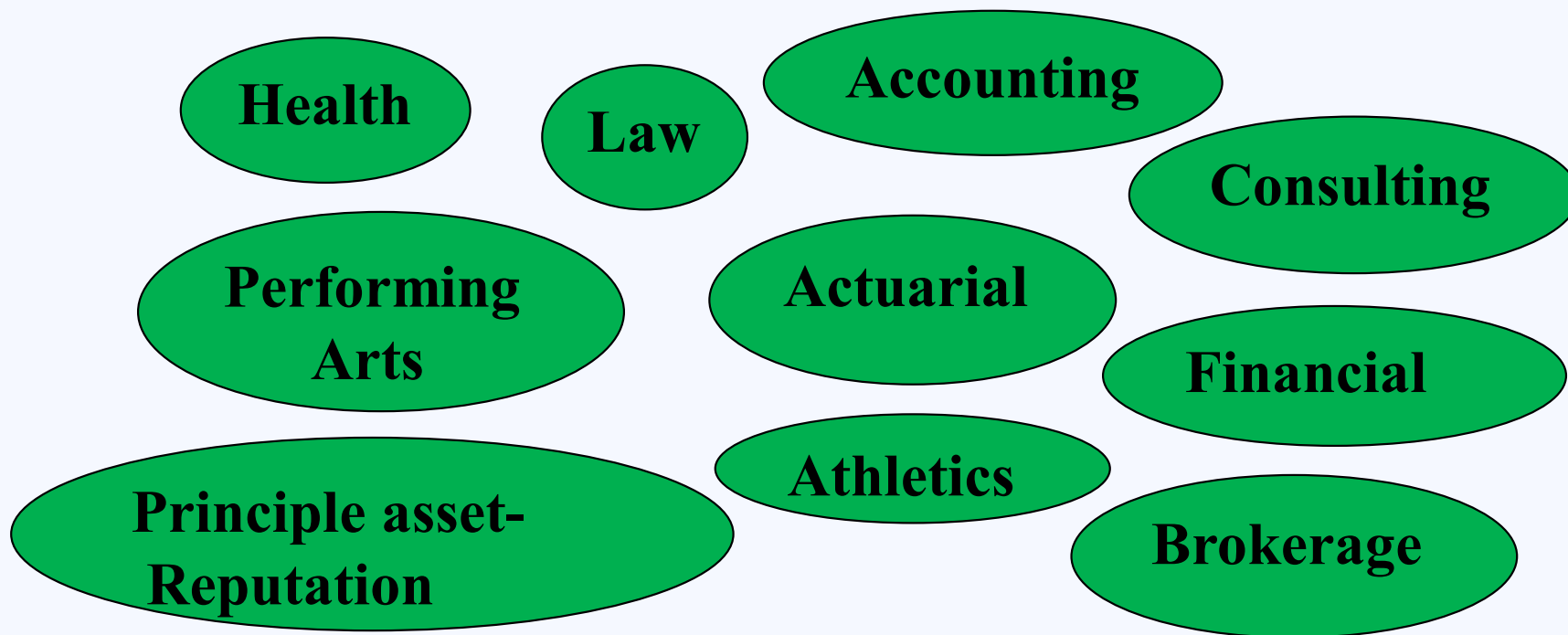
p. 98

The SSTB Limitation may *reduce or eliminate* the QBI Deduction for an SSTB Owner with taxable income above the Threshold.

Above	- NO QBI, W-2 Wages, UBLA can be used
Within	- Limitation partially applies
Below	- Limitation has no effect

DEFINITION OF SSTB –
IRC 199A(D)(2) FROM IRC 1202

p. 98



DEFINITION OF SSTB – IRC 199A(D)(2)B ADDED AND SUBTRACTED:

p. 98

Investing

**Investment
Management**

Trading

**Dealing in securities, partnership
interests or commodities**

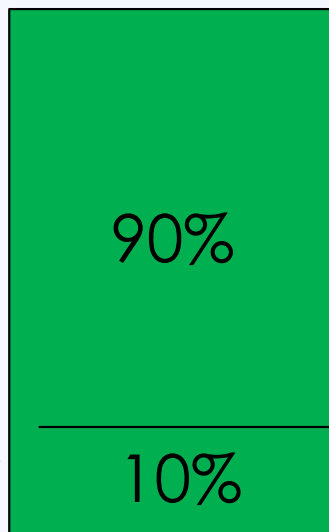
~~**Engineers**~~

~~**Architecture**~~

DE MINIMIS RULE – NOT TREATED AS AN SSTB

p. 99

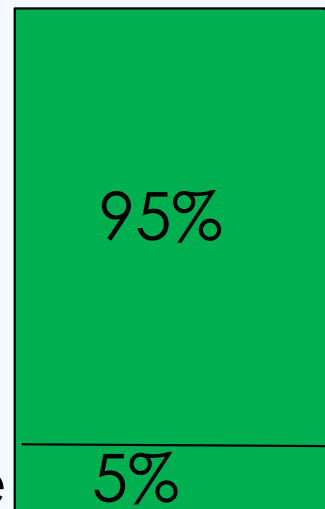
Gross Receipts
under 25,000,000



Not SSTB
income

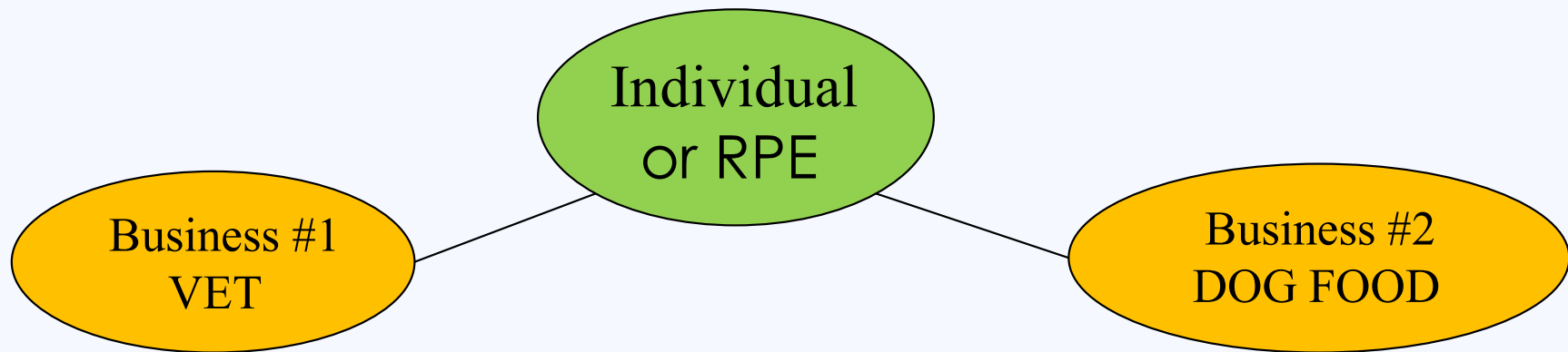
SSTB income

Gross Receipts
over 25,000,000



Not SSTB
income

SSTB income



Each business separately tested to determine whether that business is an SSTB.

The de minimis threshold is applied to each business separately.

DE MINIMIS RULE – EXAMPLE 3.6

p. 99

Veterinarian Services & develops and sells organic dog food at clinics and on line.

Maintains separate set of books, separate employees.

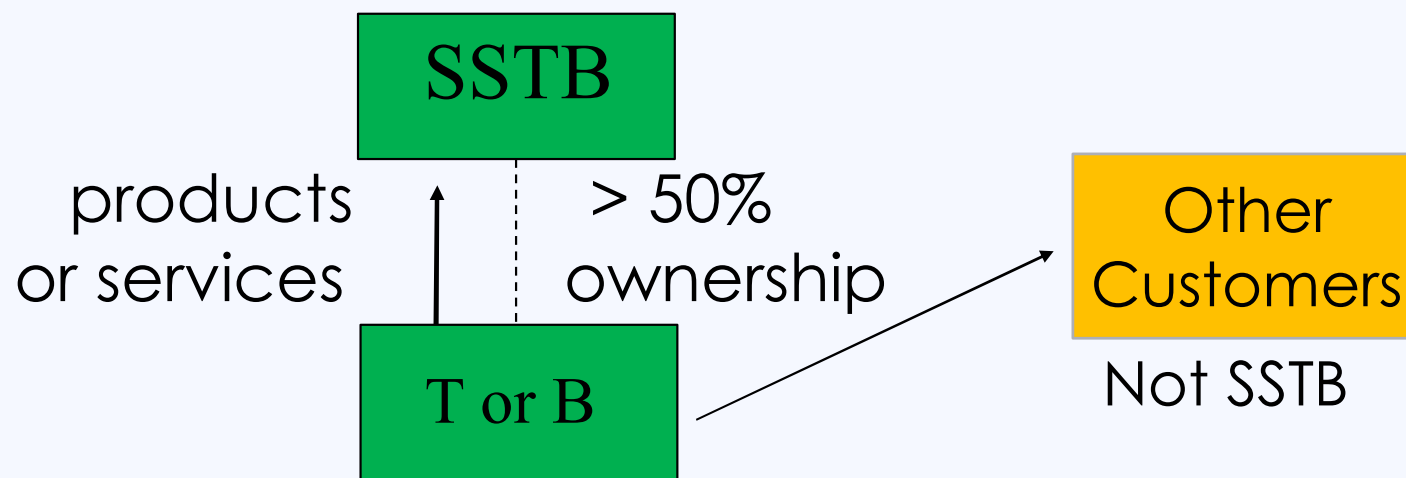
Treats as separate trades or businesses for 162 & 199A

3,000,000	Gross Receipts
1,000,000	Vet - SSTB

Vet GR over 10%, But NOT an SSTB because Vet and Dog Food separate trade or businesses under 162.

SERVICES OR PROPERTY PROVIDED TO SSTB – ANTIABUSE RULE

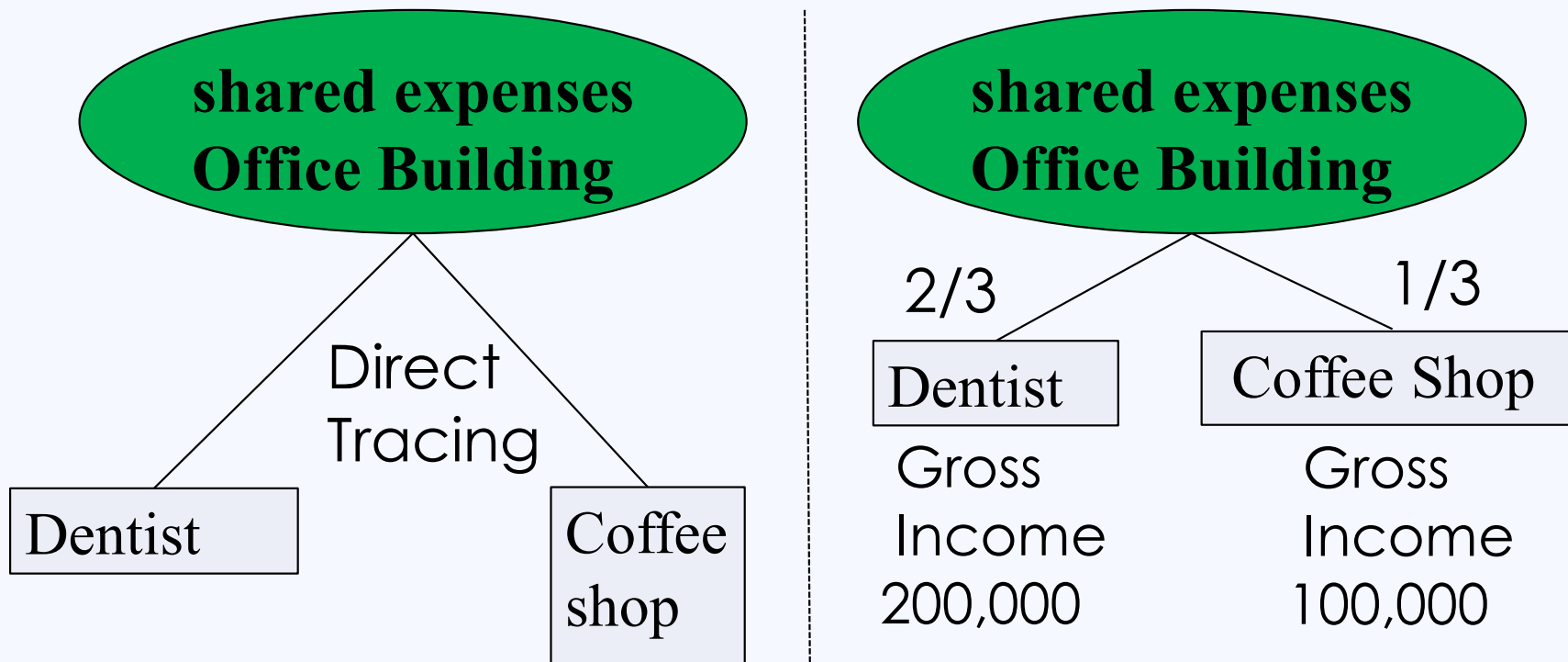
p. 99



Portion provided to SSTB must be treated as a *separate* SSTB. Portion not provided to SSTB, eligible for 199A

ALLOCATIONS OF EXPENSES

p. 100



BOOKS AND RECORDS

p. 100

Multiple trade or businesses?

Factual

IRS:

1. Different methods of accounting could be used for each business
2. Complete, separate set of books

EXAMPLE 3.7 – DIVIDING LINES OF BUSINESSES

p. 100



Brenda wages 50,000 50,000

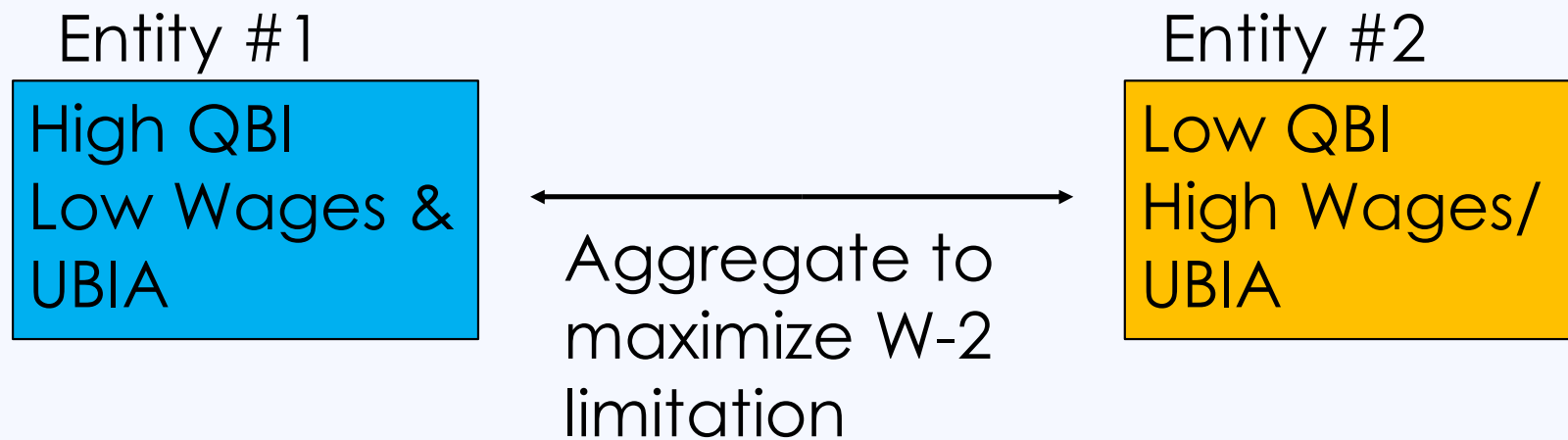
But, if separated:

Lesser: QBI 75,000 x 20%	= 15,000
TI 225,000 x 20%	= 45,000
wages 50,000 x 50%	= 25,000

Treated as one
trade or business
TI – 225,000, so
over threshold.
Zero QBID

AGGREGATION OF ACTIVITIES

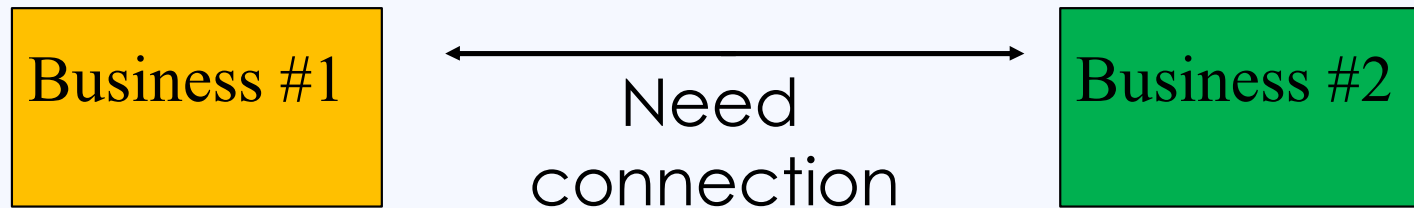
p. 102



(also look for loss entities with wages)

- NOT an SSTB
- Business Relationship
- Common Ownership

See flow chart on page 103

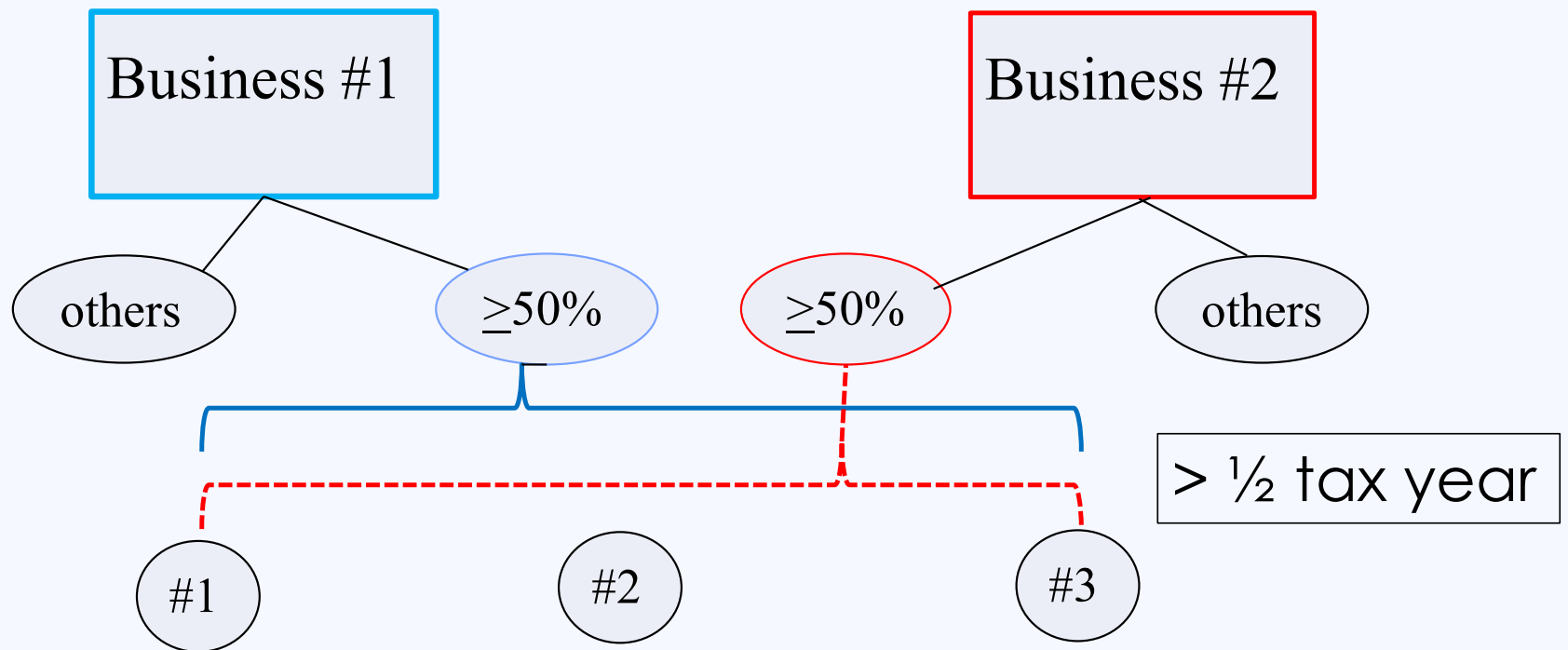


2 of 3 required:

1. Provide products, property or services that are the same or customarily offered together
2. Share facility or business function: personnel, accounting, legal, manufacturing, etc..
3. Coordination or interdependence between businesses

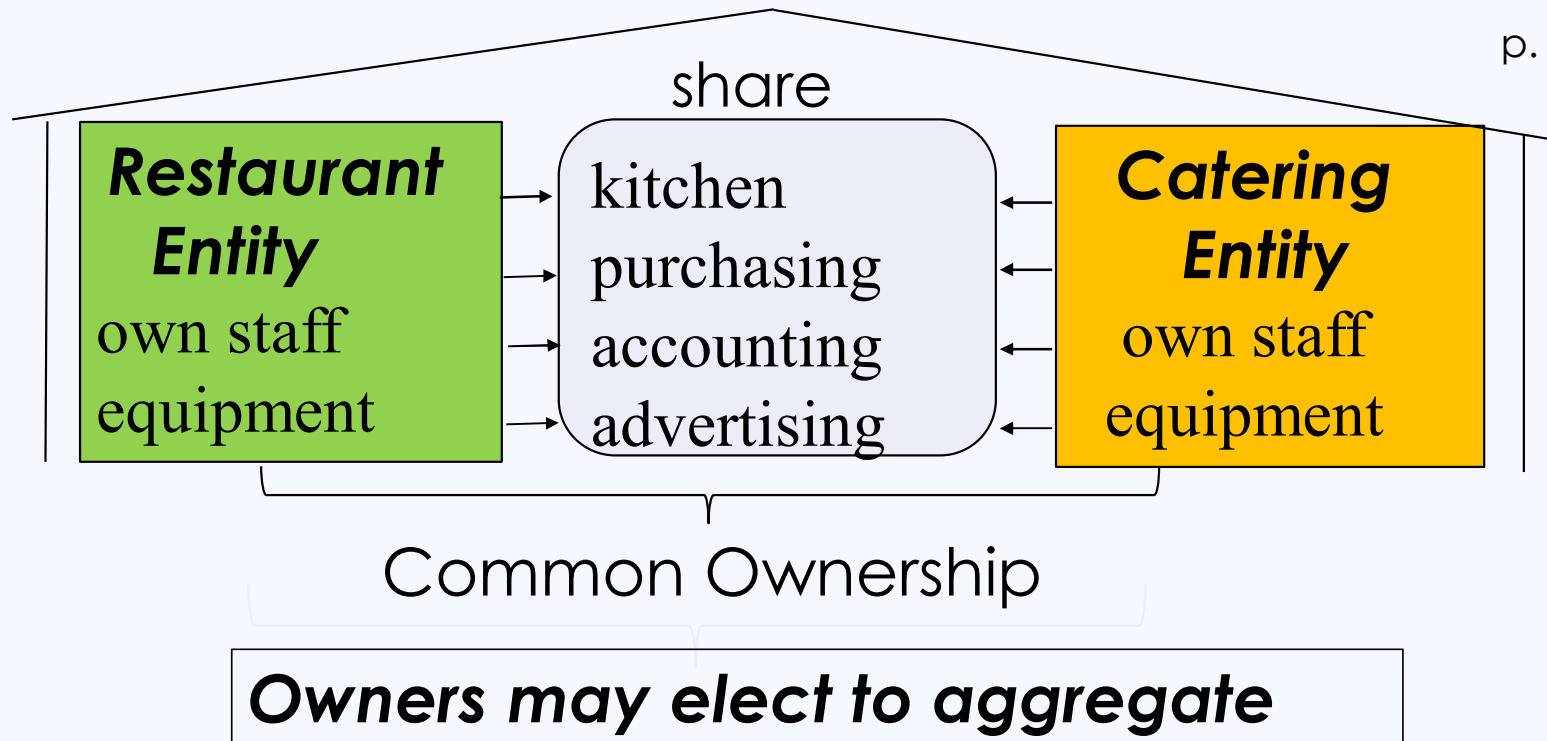
COMMON OWNERSHIP

p. 89



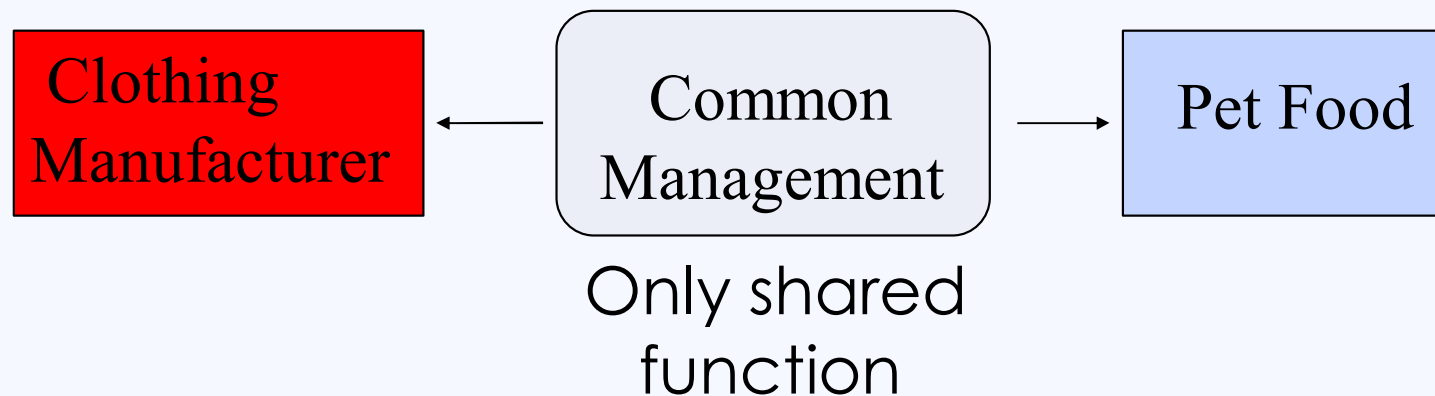
EXAMPLE 3.8 SIMILAR PRODUCTS, SHARED FACILITIES

p. 104



EXAMPLE 3.9 DISSIMILAR PRODUCTS, SHARED FUNCTIONS

p. 104



Owners cannot elect to aggregate the businesses. Need to meet 2 tests

EXAMPLE 3.11 AGGREGATION INCREASES QBI

p. 105

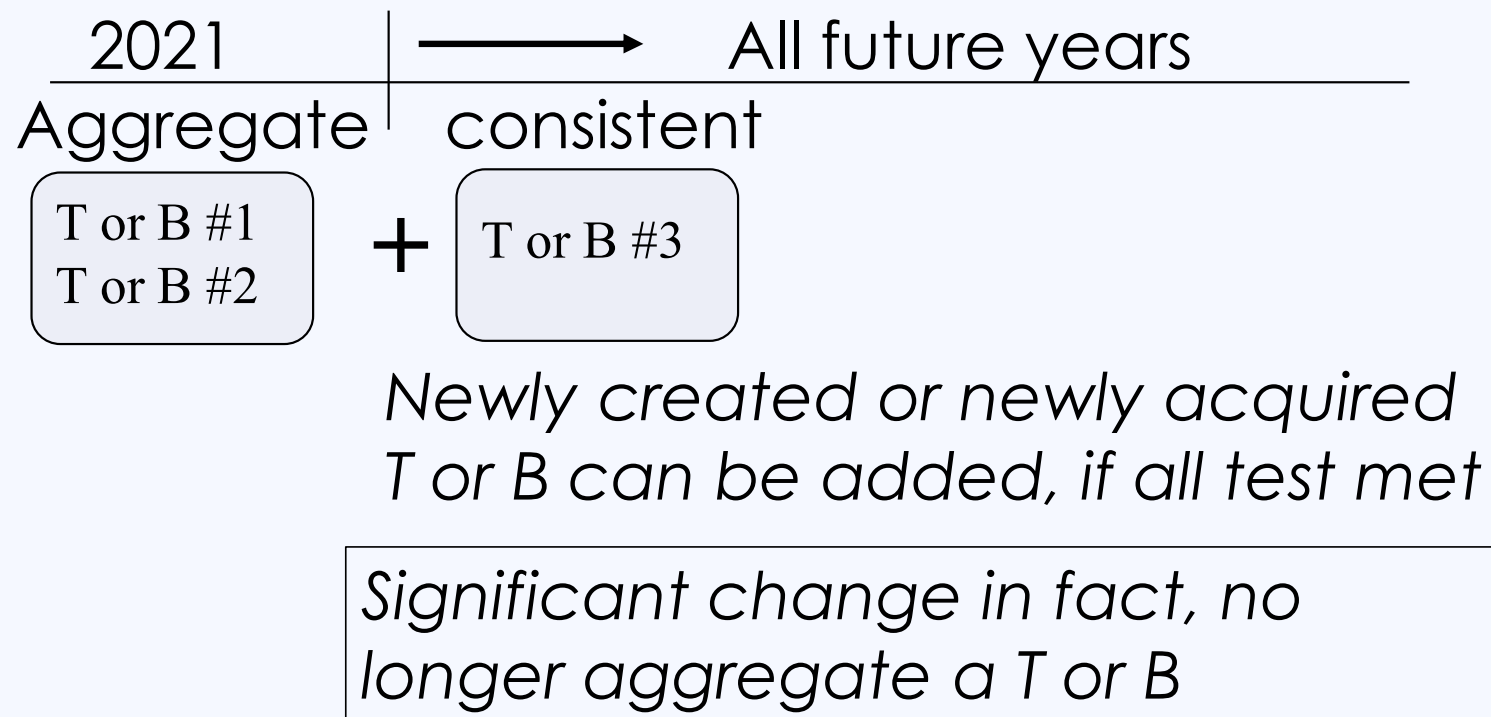
	<u>Rafting S corp</u>	<u>Fishing S corp</u>	
QBI	1,000,000	1,000,000	Share facility
Wages	600,000	150,000	Share boats
UBIA	3,000,000	0	Share account & admin
			Similar customers

↑ Excess wages & UBIA ↑ W-2 limitation

Increases QBI deduction by 100,000

CONSISTENCY AND REPORTING

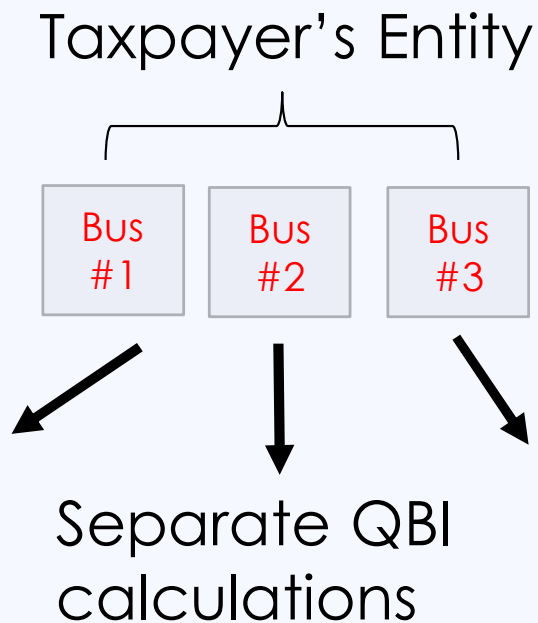
p. 106



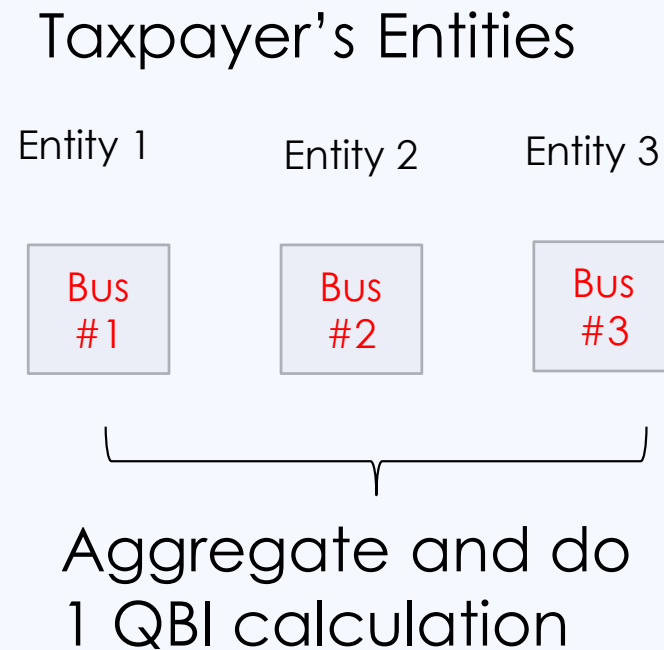
SCHEDULE B (Form 8995-A) Department of the Treasury Internal Revenue Service	<h2 style="margin: 0;">Aggregation of Business Operations</h2> <p style="margin: 5px 0;">▶ Attach to Form 8995-A.</p> <p style="margin: 5px 0;">▶ Go to www.irs.gov/Form8995A for instructions and the latest information.</p>	OMB No. 1545-2294 <div style="font-size: 2em; font-weight: bold; margin: 0;">2020</div> Attachment Sequence No. 55C
Name(s) shown on return	Your taxpayer identification number	
<p><i>If you have more than one aggregated group, complete and attach as many Schedules B as needed. Number the first aggregation "1" and any additional aggregations in numerical order (2, 3, 4, etc.). See instructions.</i></p>		
<p>Aggregation No.: </p>		
<p>1 Provide a description of the aggregated trade or business and an explanation of the factors met that allow the aggregation in accordance with Regulations section 1.199A-4. In addition, if you hold a direct or indirect interest in a relevant pass-through entity (RPE) that aggregates multiple trades or businesses, you must attach a copy of the RPE's aggregations.</p> <div style="border: 1px solid black; height: 40px; margin-top: 10px;"></div> <div style="border: 1px solid black; height: 40px; margin-top: 10px;"></div> <div style="border: 1px solid black; height: 40px; margin-top: 10px;"></div>		

ISSUE #4 -MAXIMIZING THE QBI DEDUCTION

PP. 96-107



SSTB limitation



W-2 limitation

Ready for a break?

How about 5 minutes!



ISSUE #5 - PARTNERSHIP CAPITAL ACCOUNT REPORTING REQUIREMENTS

PP. 107-114

- 4 million partnership returns were filed (FY 2019)
- IRS stepping up compliance selection
- As of January 1, 2020, must report tax basis capital accounts
- Prior reporting may have been based on GAAP, book, or any other method

CAPITAL ACCOUNTS

Capital Accounts options:

Book Value



Must maintain for “special allocations” - 704(b)

FMV

Tax Basis



If required to report capital accounts, must use on Form 1065 after 1/1/20

BOOK VALUE CAPITAL ACCOUNTS

+



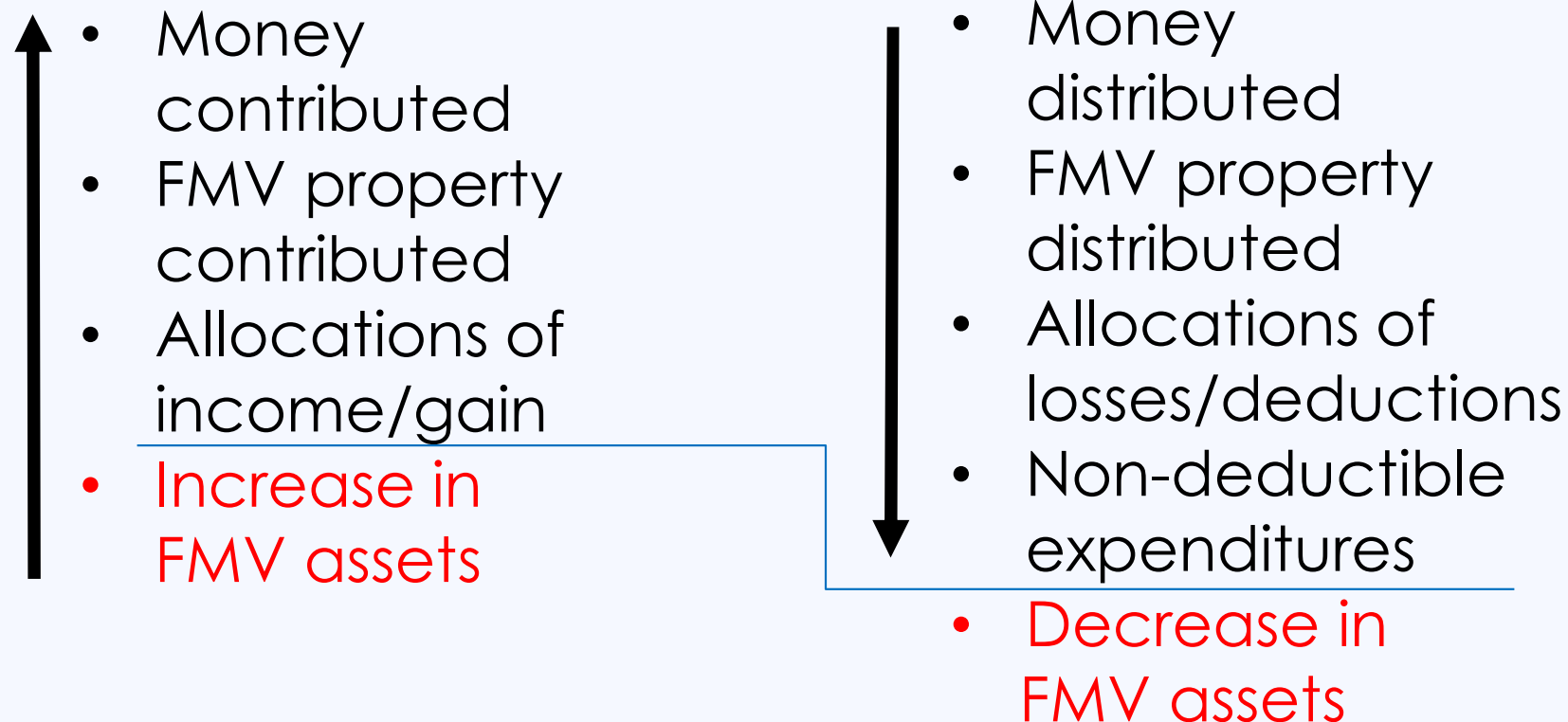
- Money contributed
- FMV property contributed
- Allocations of income/gain

-



- Money distributed
- FMV property distributed
- Allocations of losses/deductions
- Non-deductible expenditures

FMV CAPITAL ACCOUNTS



TAX BASIS CAPITAL ACCOUNT

May be needed for 2020 and later 1065 returns!!

= Equity using “*tax principles*”

NOT —→ GAAP, FMV, 704(b), etc..


INCREASES TO TAX BASIS CAPITAL ACCOUNT



- Money contributed
- **Adjusted basis** property contributed
- Distributive share income/gain
- Excess % depletion over basis in property subject to depletion
- Liabilities distributed to the partner
- Increases in tax basis under IRC 734(b)




DECREASES TO TAX BASIS CAPITAL ACCOUNT

P. 108

- 
- Money distributed
 - **Adjusted basis** property distributed (less liabilities)
 - Distributive share losses/ deductions
 - Oil and gas depletion, to extent does not exceed adjusted basis
 - Basis charitable property contributed & foreign taxes
 - Partners liabilities assumed by partnership
 - Decrease in tax basis for 734(b)

743(B) BASIS ADJUSTMENTS

P. 108

-  743(b) adjustments do NOT affect a partner's tax basis capital account.
-  743(b) adjustments only affect the partner acquiring an interest in the partnership .
-  1065 instructions – if 743(b) adjustments in tax basis capital account they must be remove. Treat as other increase or decrease.

EXAMPLES 3.12 AND 3.13

PP. 108-109

Land contributed:

FMV	200,000
Tax Cost	175,000
Tax Basis	150,000
Debt assumed	50,000

450,000 income / 3
100,000 distribution
to each partner

FIGURE 3.12
Robert's Initial Capital Account in RPL, LLC

	Tax Basis	Book	FMV
Land	\$150,000	\$200,000	\$200,000
Debt	(50,000)	(50,000)	(50,000)
Capital account	\$100,000	\$150,000	\$150,000



FIGURE 3.13
Robert's Adjusted Tax Basis
Capital Account in RPL, LLC

	Tax Basis
Beginning capital account	\$100,000
Income	150,000
Distribution	(100,000)
Ending capital account	\$150,000

See page 110
for the K-1

EXAMPLE 3.14 NEGATIVE CAPITAL ACCOUNT

P. 109 & 110

		<u>tax basis capital</u>
Tax basis beginning of year		100,000
Allocation of tax losses	Can claim	(150,000)
Distributions	Can take	<u>(100,000)</u>
Negative tax basis capital account		(150,000)
Robert's share of liabilities		<u>+200,000</u>
Robert's basis in partnership interest		50,000

See K-1 pg 110

May not be negative





What if you are required to use tax basis capital accounts, and don't have the data to calculate it?

2 methods:

Modified outside basis

Modified previously taxed capital method

EXAMPLE 3.15 MODIFIED OUTSIDE BASIS

P. 111

Facts

Purchase 25% interest	250,000
Allocation of partnership liabilities	<u>425,000</u>
Basis in partnership	675,000
Basis in share of assets	<u>(525,000)</u>
743(b) basis adjustment	150,000
Tax basis capital account:	
Basis in partnership	675,000
Less liabilities	(425,000)
Less 743(b) adjustment	<u>(150,000)</u>
Tax basis capital account	100,000

*Tax basis
capital
account*

EXCEPTION TO ITEM L 1065 REPORTING

Schedule B, 1065 Question #4

All 4!

- | | Yes | No |
|---|-----|----|
| 4 Does the partnership satisfy all four of the following conditions? | | |
| a The partnership's total receipts for the tax year were less than \$250,000. | | |
| b The partnership's total assets at the end of the tax year were less than \$1 million. | | |
| c Schedules K-1 are filed with the return and furnished to the partners on or before the due date (including extensions) for the partnership return. | | |
| d The partnership is not filing and is not required to file Schedule M-3 | | |
| If "Yes," the partnership is not required to complete Schedules L, M-1, and M-2; item F on page 1 of Form 1065; or item L on Schedule K-1. | | |

Next slide!

EXCEPTION TO ITEM L 1065 REPORTING

SCHEDULE M-3 (Form 1065)	Net Income (Loss) Reconciliation for Certain Partnerships	OMB No. 1545-0123
Department of the Treasury Internal Revenue Service	▶ Attach to Form 1065. ▶ Go to www.irs.gov/Form1065 for instructions and the latest information.	2019
Name of partnership		Employer identification number
This Schedule M-3 is being filed because (check all that apply):		
A	<input checked="" type="checkbox"/> The amount of the partnership's total assets at the end of the tax year is equal to \$10 million or more.	
B	<input checked="" type="checkbox"/> The amount of the partnership's adjusted total assets for the tax year is equal to \$10 million or more. If box B is checked, enter the amount of adjusted total assets for the tax year <input type="text"/> .	
C	<input checked="" type="checkbox"/> The amount of total receipts for the tax year is equal to \$35 million or more. If box C is checked, enter the total receipts for the tax year <input type="text"/> .	
D	<input checked="" type="checkbox"/> An entity that is a reportable entity partner with respect to the partnership owns or is deemed to own an interest of 50% or more in the partnership's capital, profit, or loss on any day during the tax year of the partnership.	

Any one

Must file M-3

PENALTIES

P. 113

- Penalty for failure to timely file complete and accurate Schedule K-1 (I.R.C. §6698)
- Penalty relief for 2020 under **Notice 2021-13**
 - No penalty for error on beginning tax basis capital account
 - No penalty for error on ending tax basis capital account due to incorrect beginning
 - “Ordinary and prudent business care” standard is applied

Any questions on
Tax Basis Capital
Accounts?

ISSUE #6 LIKE-KIND EXCHANGES

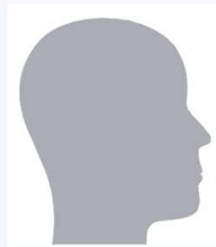
PP. 114-124

- Gain (loss) not recognized
- Property given up and received must be
 - Used in a trade or business, or
 - Held for investment purposes
 - Property must be like-kind
- TCJA eliminated like-kind exchanges of personal property



LIKE KIND – REAL PROPERTY

P. 115



Like
kind?



Same nature and character,
not grade or quality

Does not matter if improved
or unimproved

Real property? Final regulations – for exchanges after
12/2/20.

REAL PROPERTY

P. 115

Land improvements*

Real property prior to
the TCJA

Leaseholds

Crops, plants,
timber

Options

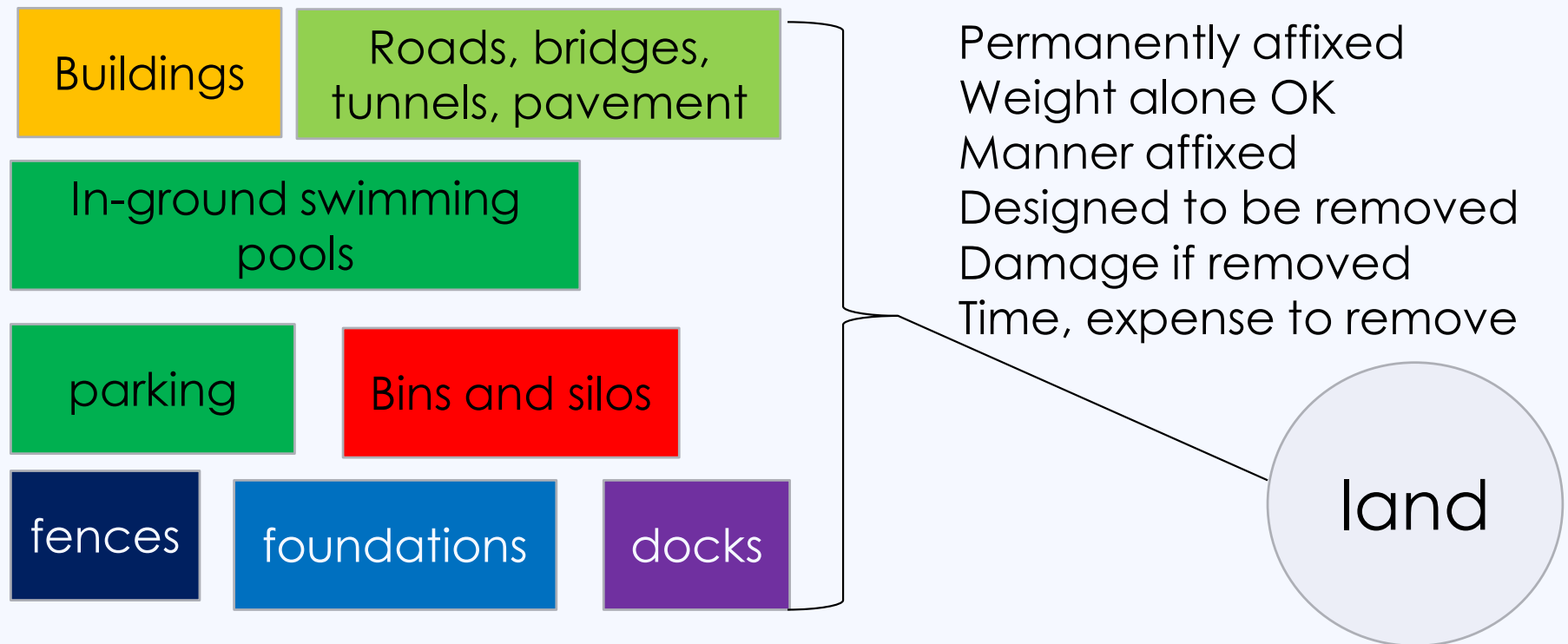
Water and air
space

Stock in cooperative
housing

Real property under
state law

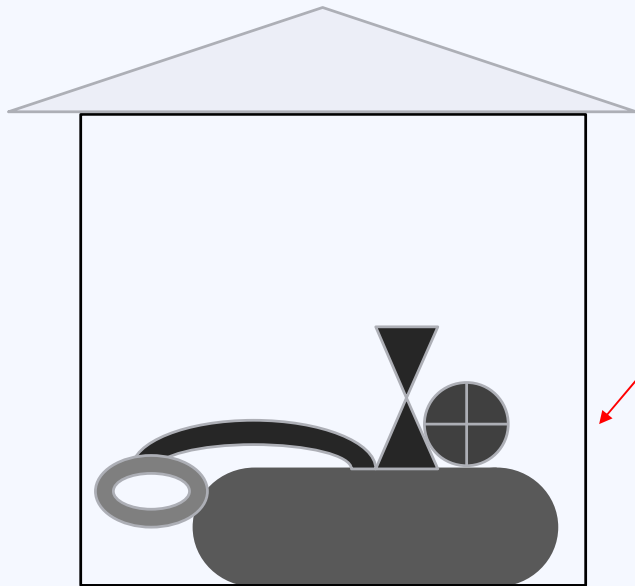
IMPROVEMENTS TO LAND

P. 115 & 116



MACHINERY AND EQUIPMENT

P. 116



- Inherently permanent if:*
- Permanently affixed to real property
 - Ordinarily remain affixed for an indefinite period

STRUCTURAL COMPONENT

P. 116

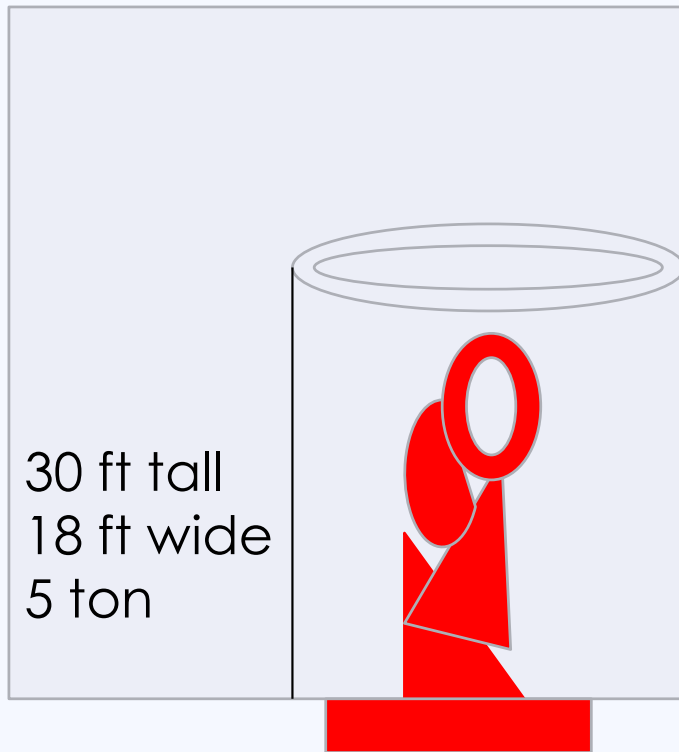


Not on list? 4 Factors:

- Time, manner expense to install
- Designed to be moved
- Damage if removed
- Installed during construction

EXAMPLE 3.17

P. 117

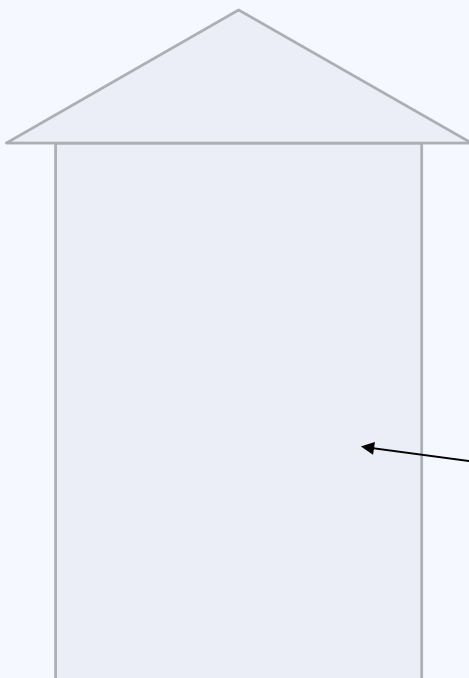


- Building designed to support sculpture
- Permanently affixed
- Removal time consuming, costly and destroy sculpture
- Expected to remain in building

Applying 4 factors, sculpture is a structural component of building

INTANGIBLE ASSETS

P. 117



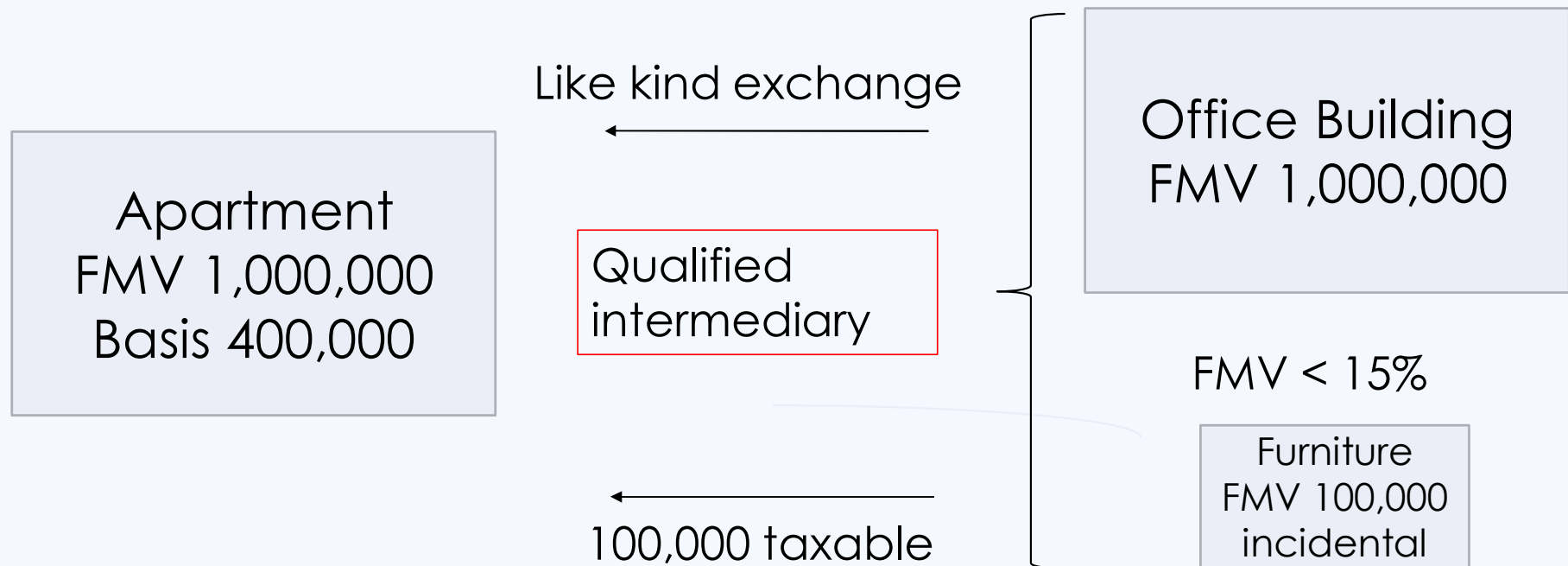
- Derives value from real property
- Inseparable from real property

le: Fee ownership
Co-ownership
Leasehold
Option to acquire
Easement

License
Permits

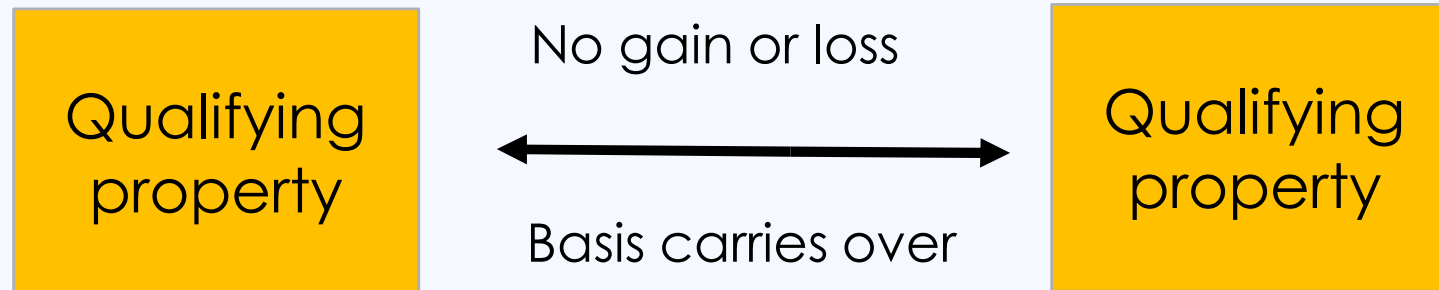
EXAMPLE 3.19 INCIDENTAL PROPERTY RULE

P. 118



TAXATION OF LIKE-KIND EXCHANGES

PP. 118



RELATED PARTY EXCHANGE

PP. 118

Exchange with
related party

2 years



***If either party sells one of the properties, the deferred gain is recognized on the date of sale.
(certain exceptions)***

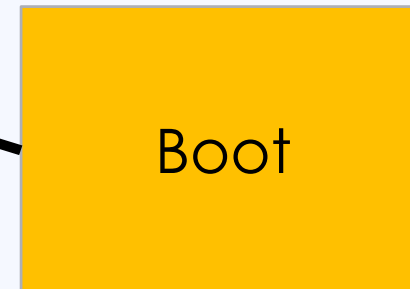
BOOT

PP. 119

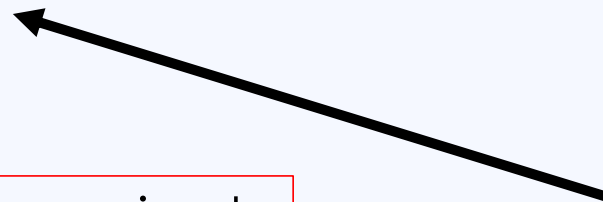
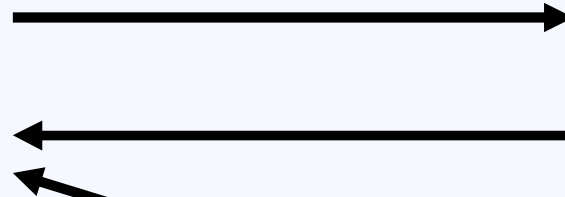
Given up



Received

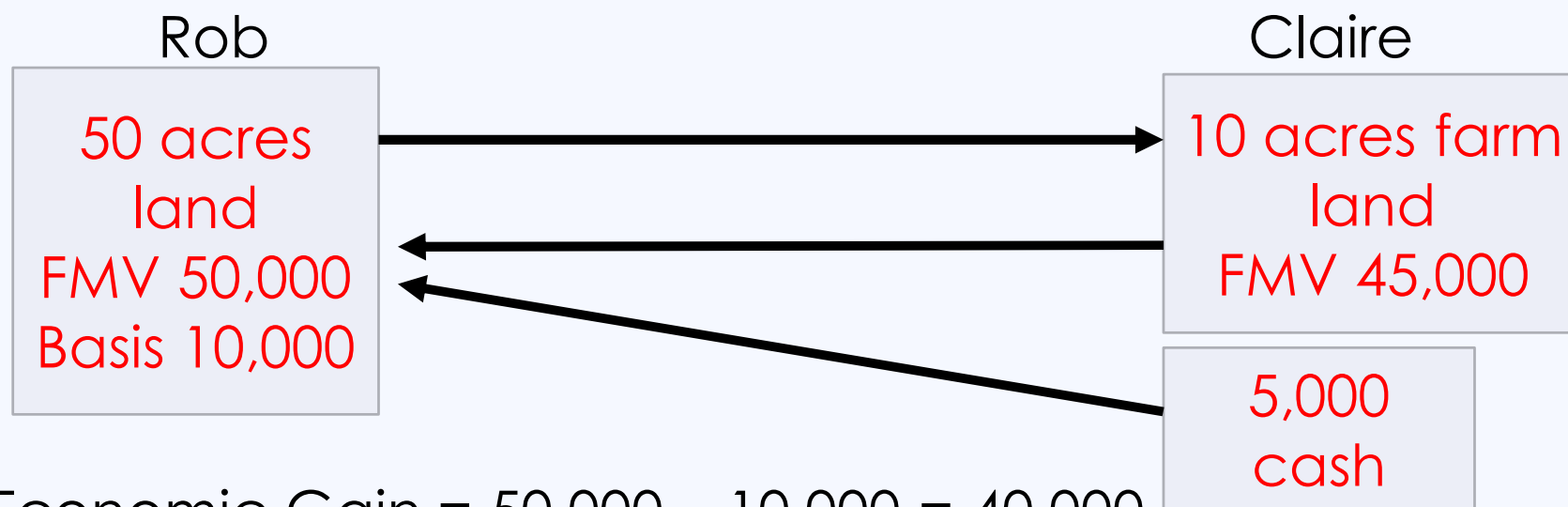


Gain recognized,
up to boot



EXAMPLE 3.20 – RECEIPT OF BOOT

PP. 119



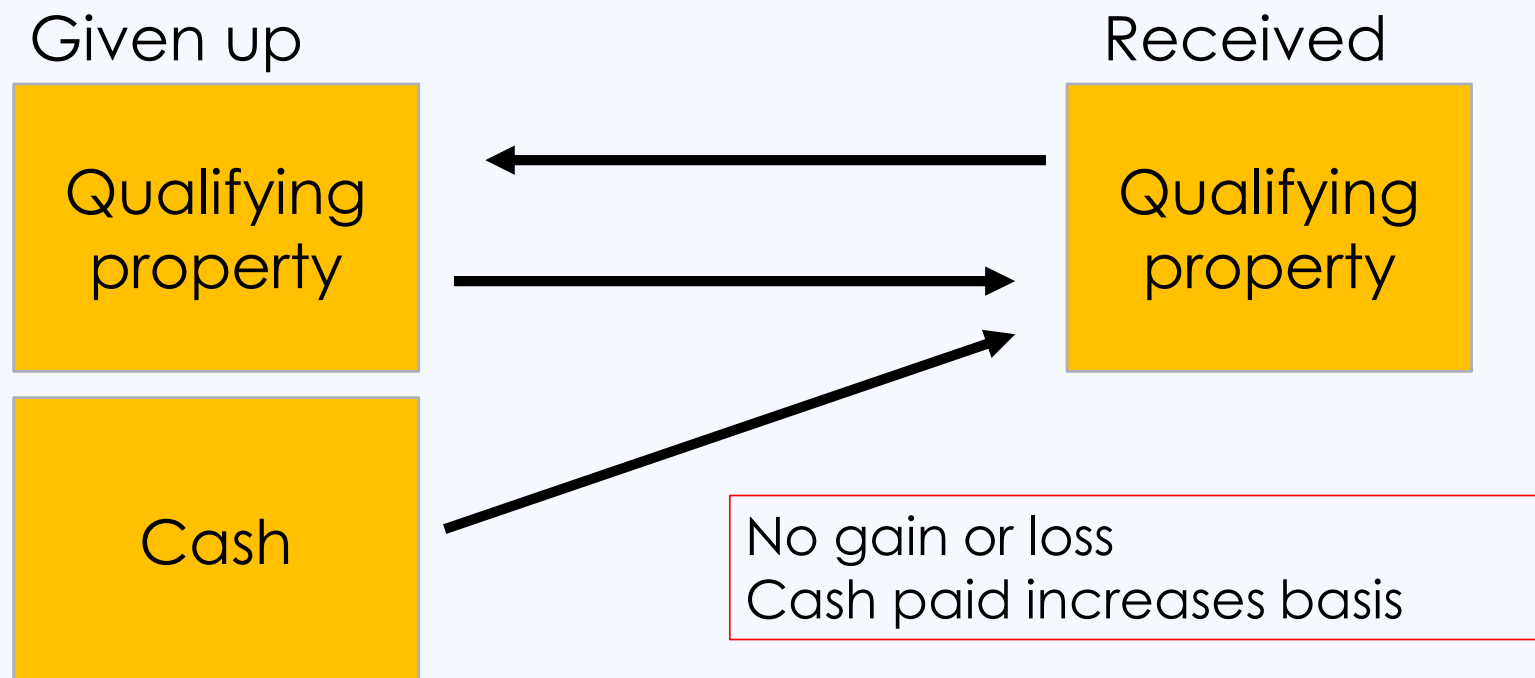
Economic Gain = $50,000 - 10,000 = 40,000$

Taxable Gain = 5,000 boot

Basis = $10,000 + 5,000 \text{ gain} - 5,000 \text{ reported} = 10,000$

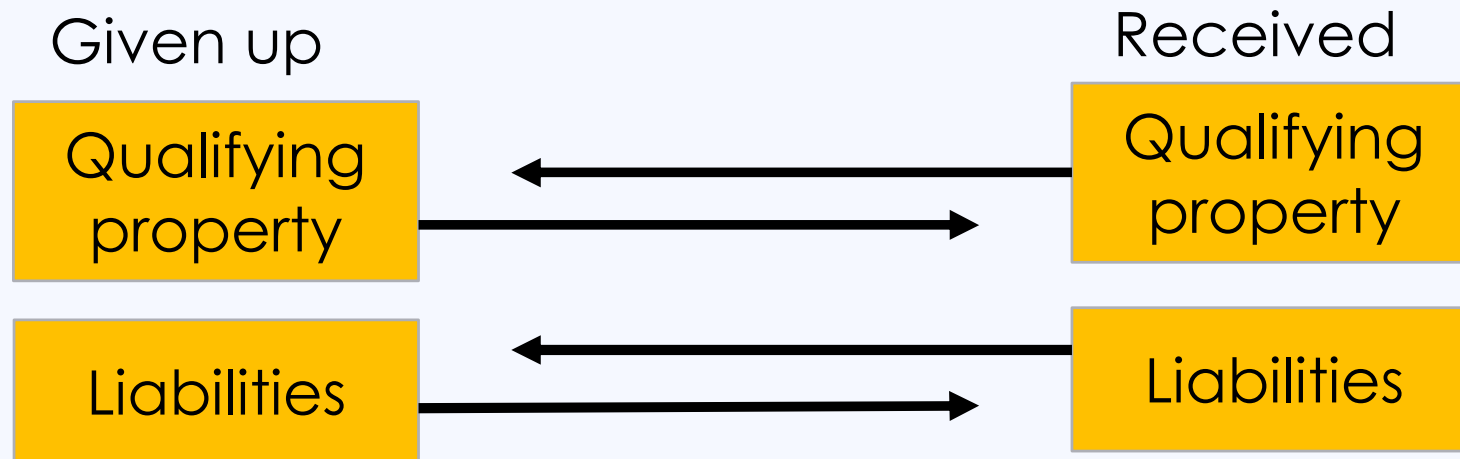
PAYMENT OF BOOT

PP. 119



ASSUMPTION OF LIABILITIES

PP. 119



Assumption of liabilities treated as cash

RECAPTURE

PP. 120

Given up

1245 / 1250
recapture
property

If same – limited to
gain recognized, i.e.:
boot received. Rest
recognized upon a
later sale

Received

1245 / 1250
recapture
property

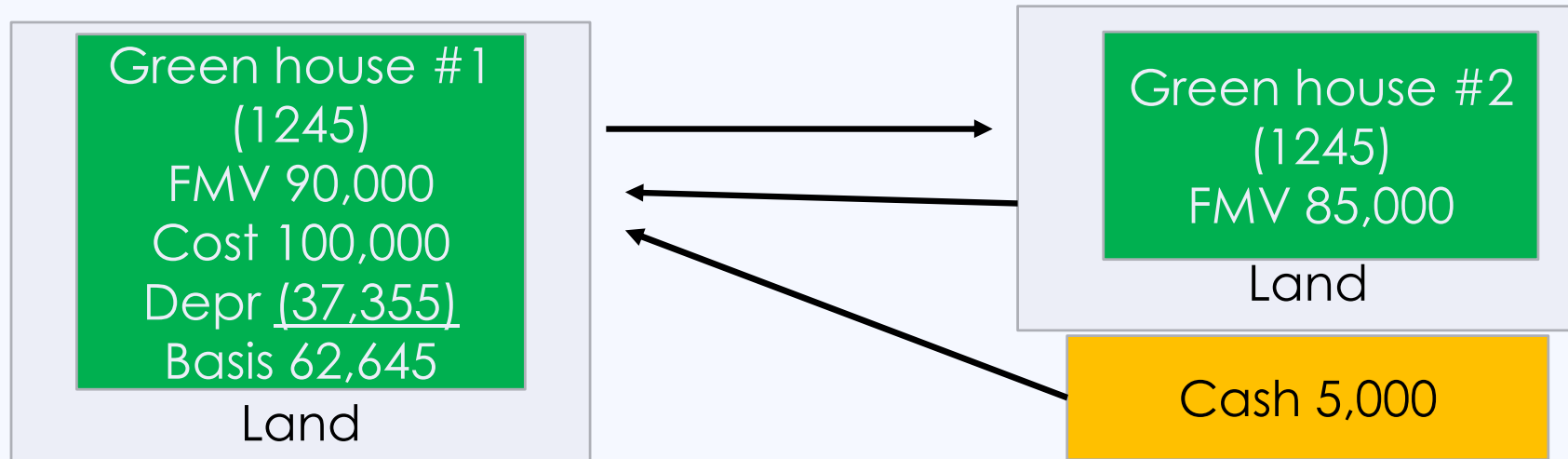
1245 / 1250
recapture
property

Recapture gain
recognized, even
if no boot or gain
under 1031.

NOT
recapture
property

EXAMPLE 3.21 - 2021

P. 120



Received 90,000	Depr recap - lesser	Recapture	27,355
Basis <u>(62,645)</u>	Depr 37,355	Gain recog <u>(5,000)</u>	
Gain 27,355	Gain 27,355	Deferred <u>22,355</u>	

FIG. 3.19

P. 122

Part III Realized Gain or (Loss), Recognized Gain, and Basis of Like-Kind Property Received

Caution: If you transferred **and** received (a) more than one group of like-kind properties or (b) cash or other (not like-kind) property, see **Reporting of multi-asset exchanges** in the instructions.

Note: Complete lines 12 through 14 **only** if you gave up property that was not like-kind. Otherwise, go to line 15.

12	Fair market value (FMV) of other property given up	12		
13	Adjusted basis of other property given up	13		
14	Gain or (loss) recognized on other property given up. Subtract line 13 from line 12. Report the gain or (loss) in the same manner as if the exchange had been a sale	14		
Caution: If the property given up was used previously or partly as a home, see Property used as home in the instructions.				
15	Cash received, FMV of other property received, plus net liabilities assumed by other party, reduced (but not below zero) by any exchange expenses you incurred. See instructions	15		5,000
16	FMV of like-kind property you received	16		85,000
17	Add lines 15 and 16	17		90,000
18	Adjusted basis of like-kind property you gave up, net amounts paid to other party, plus any exchange expenses not used on line 15. See instructions	18		62,645
19	Realized gain or (loss). Subtract line 18 from line 17	19		27,355
20	Enter the smaller of line 15 or line 19, but not less than zero	20		5,000
21	Ordinary income under recapture rules. Enter here and on Form 4797, line 16. See instructions	21		5,000
22	Subtract line 21 from line 20. If zero or less, enter -0-. If more than zero, enter here and on Schedule D or Form 4797, unless the installment method applies. See instructions	22		0
23	Recognized gain. Add lines 21 and 22	23		5,000
24	Deferred gain or (loss). Subtract line 23 from line 19. If a related party exchange, see instructions	24		22,355
25	Basis of like-kind property received. Subtract line 15 from the sum of lines 18 and 23	25		62,645

Taxed
deferred

EXAMPLE 3.22 - 2022

P. 123

2021

Green house #2 (1245) FMV 85,000
Land

Basis 62,645

2022

Sells for:	90,000
Basis	62,645
2022 Depr	<u>(25,890)</u>
Gain	<u>53,245</u>
Recapture carryover	(22,355)
2022 recapture	<u>(25,890)</u>
1231 gain	5,000

Any questions on like
kind exchanges?

ISSUE #7 INVOLUNTARY CONVERSION

PP. 124

Property destroyed, stolen,
seized, condemned,
involuntarily converted

```
graph TD; A[Property destroyed, stolen, seized, condemned, involuntarily converted] --> B[Gain?]; A --> C[Loss?]; B --> D[Taxable? 1033 – not if converted into money and the proceeds used to purchase replacement property]; C --> E[Deductible? 165 Casualty, theft loss];
```

Gain?

Taxable? 1033 – not if
converted into money and the
proceeds used to purchase
replacement property

Loss?

Deductible? 165
Casualty, theft loss

DESTRUCTION

PP. 124

- Total or partial destruction
- Involuntarily damaged
- No longer available to intended use
- No choice as to whether to dispose property
- Compelled to replace

1033

unexpected
unusual event

165

sudden
unexpected
unusual event

EXAMPLE 3.24

PP. 124

Tree Farm
Southern Pine Beetle
9 months later trees die.



Gain on subsequent
sale of trees qualify
under 1033 if
replanted trees.
Unusual and
unexpected

Loss will not qualify
as a casualty under
165 because not
sudden

PARTIAL DESTRUCTION - *WILLIS V COMM*

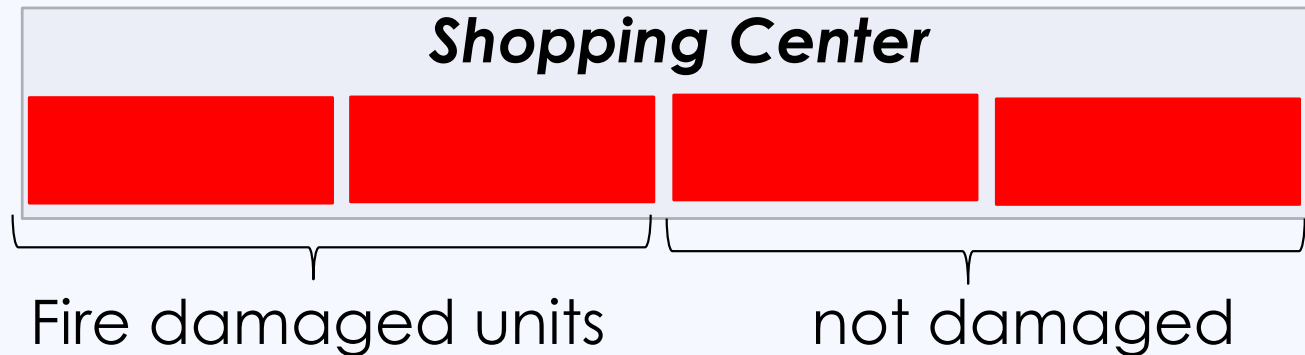
PP. 125

- Partially damaged ship
- Repairable
- Sold ship and used proceeds to purchase a barge

COURT – denied deferral.
Decided ship was not sold because of the conversion. Rather – a business decision to purchase the barge

EXAMPLE 3.25

PP. 125



Sold entire shopping center. Used insurance proceeds and sales proceeds to invest in online shopping platform.

Sales proceeds – can not defer. Mall could have been repaired

Insurance proceeds – may be able to defer, if replacement property is similar.

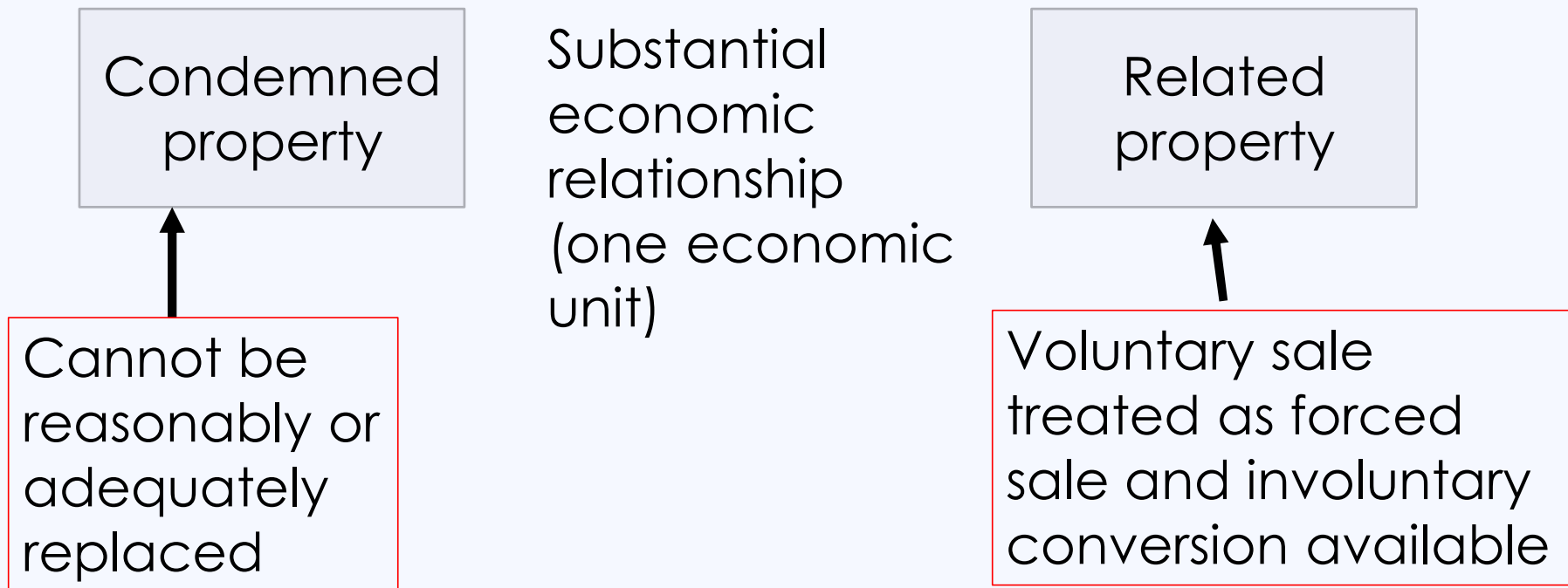
CONDEMNATIONS

PP. 125-126

- Eminent domain - needed for public use
- Condemnation awards – includes liabilities paid
- Award in excess in basis = gain
- Postpone recognition if replacement property purchased
- Severance Damages – compensate for decrease in value of remaining property.
 - Reduce basis of remaining property
 - Severance > basis, gain, unless reinvested

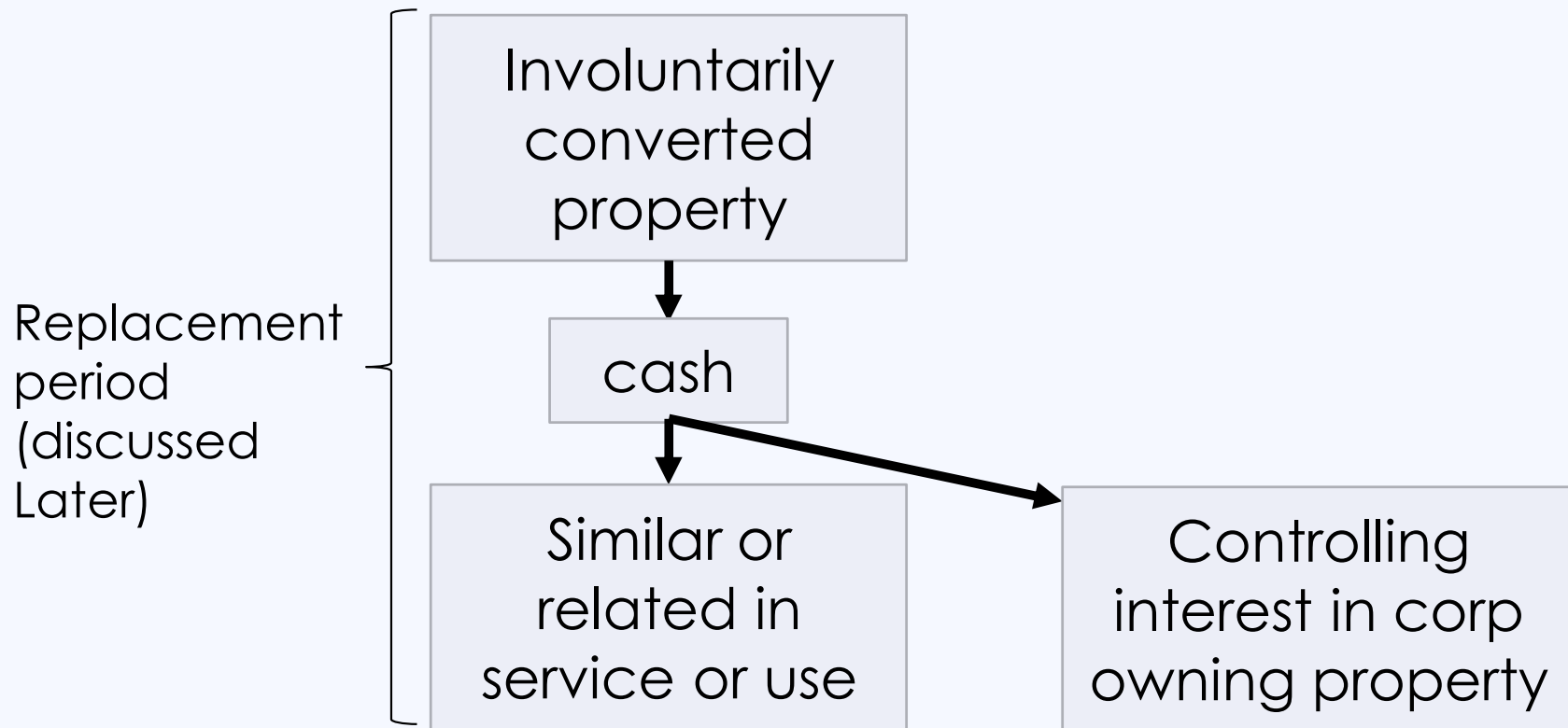
VOLUNTARY SALE RELATED PROPERTY

P. 126



SIMILAR REPLACEMENT PROPERTY

PP. 126



BUSINESS OR INVESTMENT REAL PROPERTY

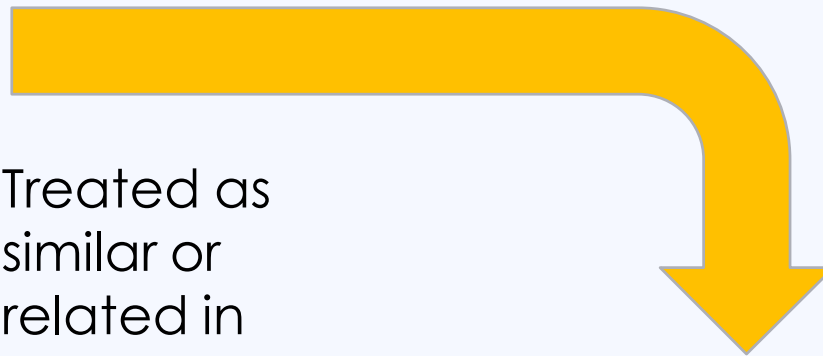
PP. 126 + 127

Real property held
for productive use in
a trade or business
or investment

Treated as
similar or
related in
service or use

*Function in
the same way*

Real property held
for productive use in
a trade or business
or investment



DISASTER AREA

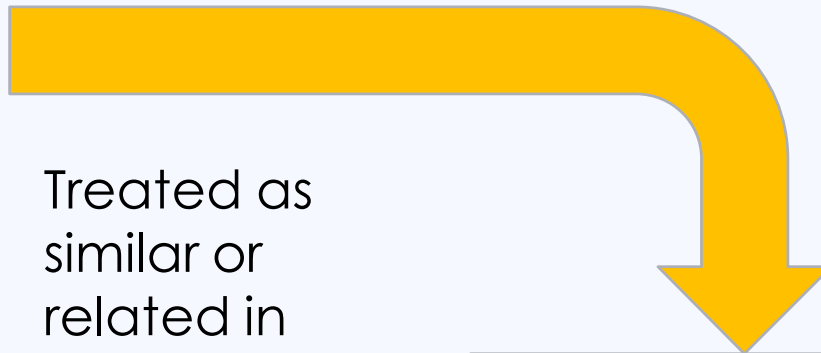
PP. 126

property held for
productive use in a
trade or business or
investment **located
in disaster area**

Treated as
similar or
related in
service or use

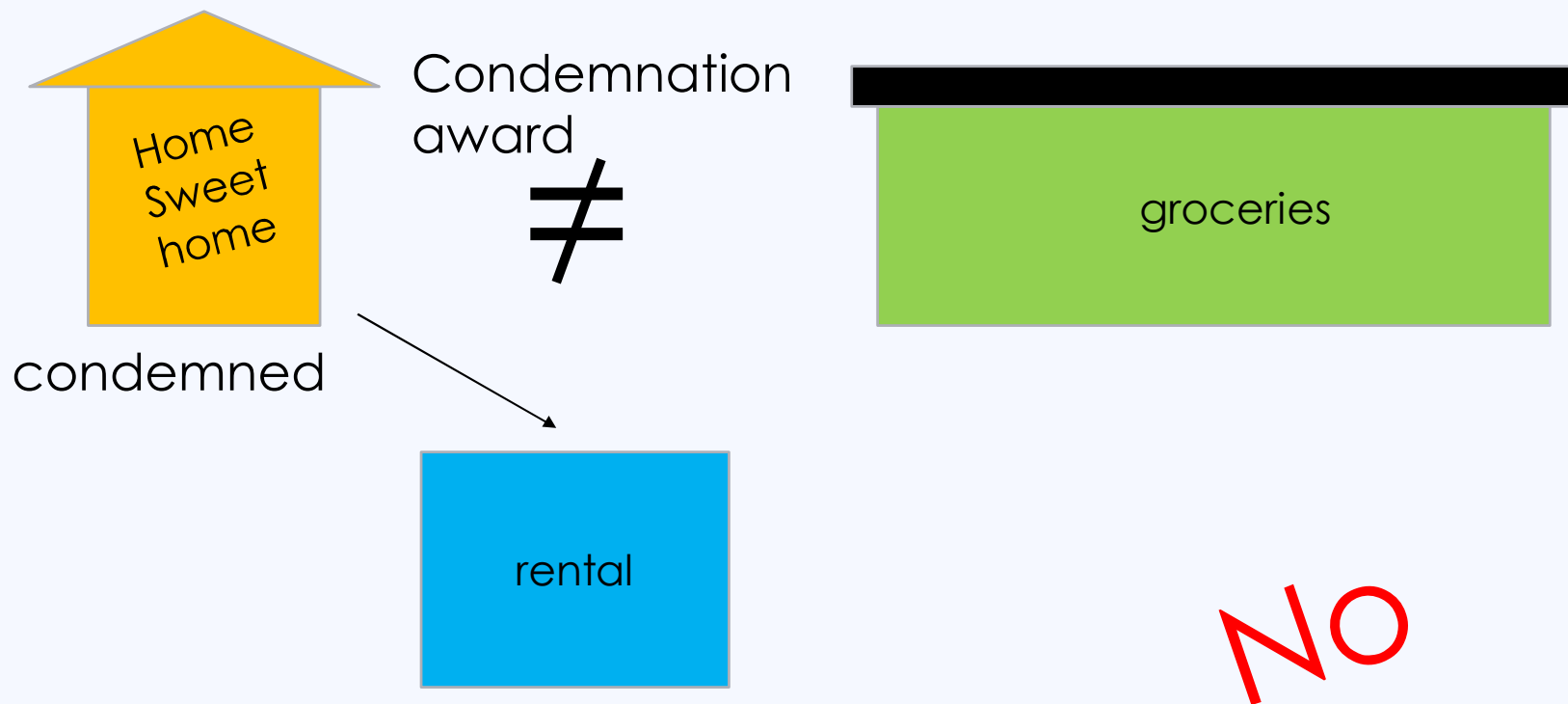
*Function in
the same way*

property held for
productive use in a
trade or business or
investment



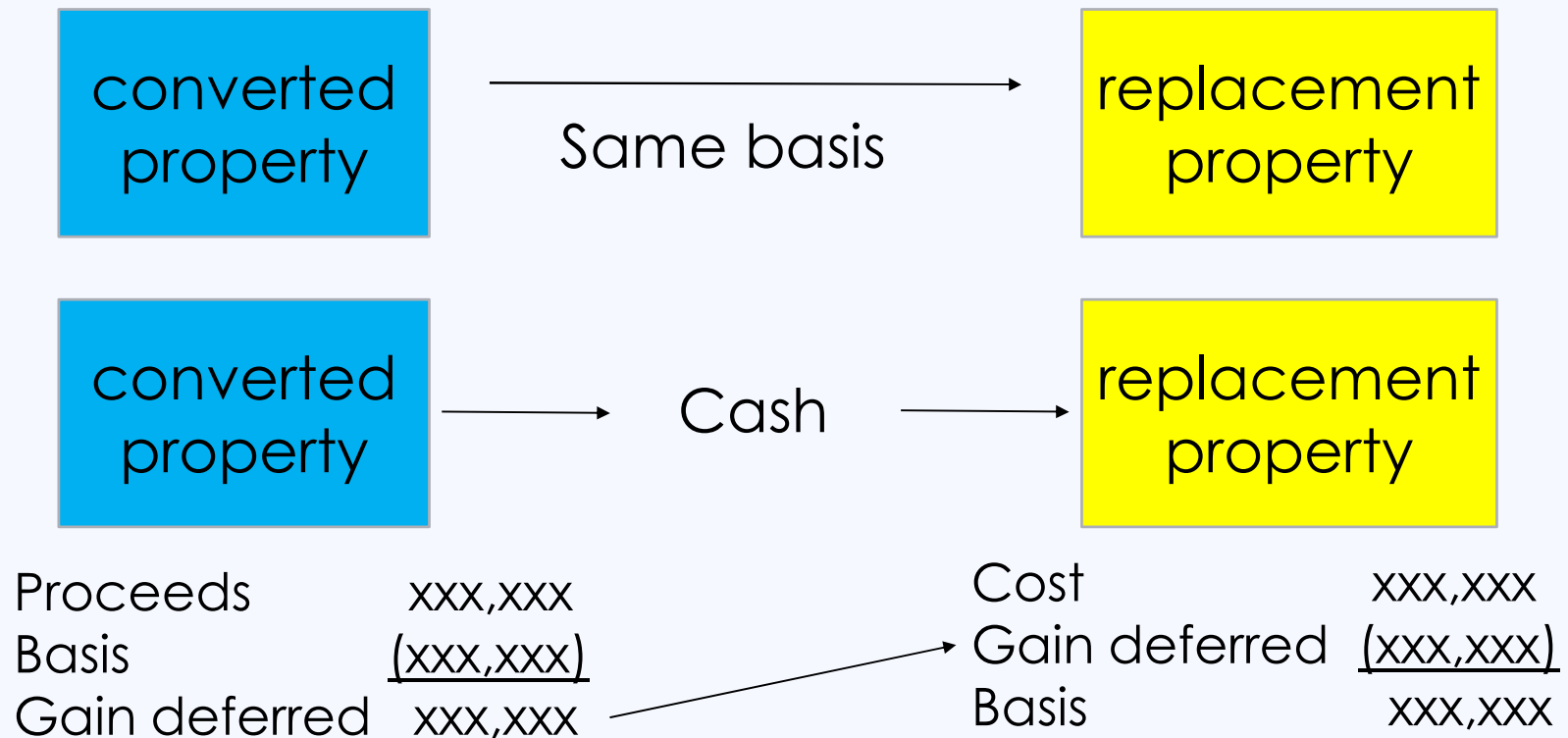
EXAMPLE 3.27

P. 127



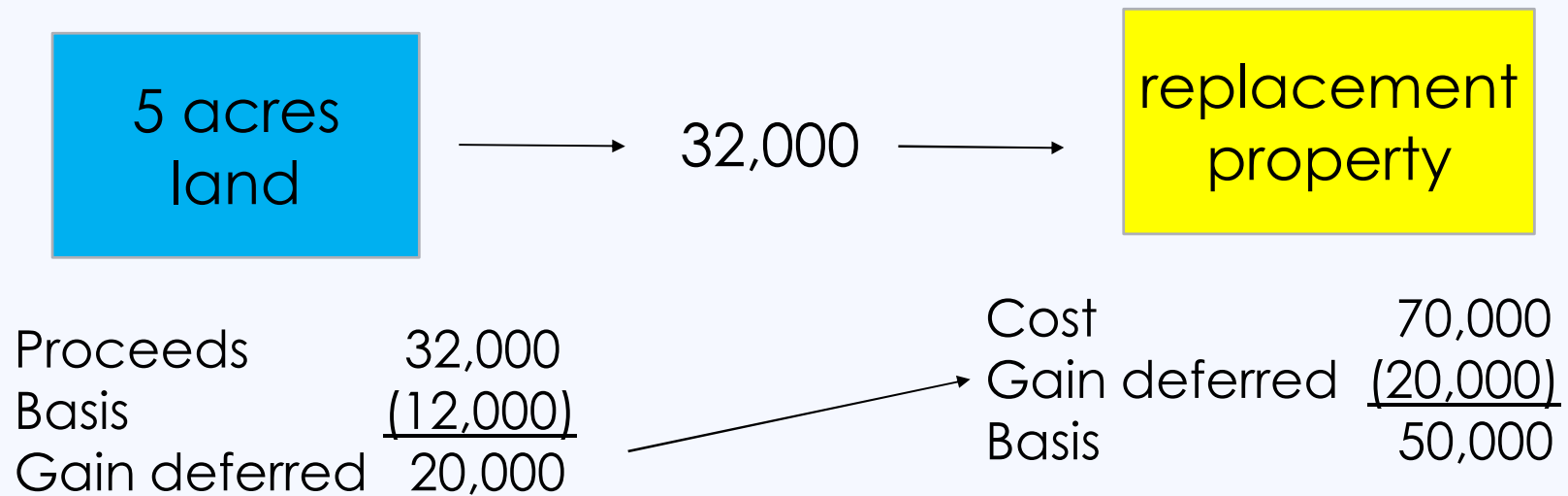
BASIS OF REPLACEMENT PROPERTY

P. 127



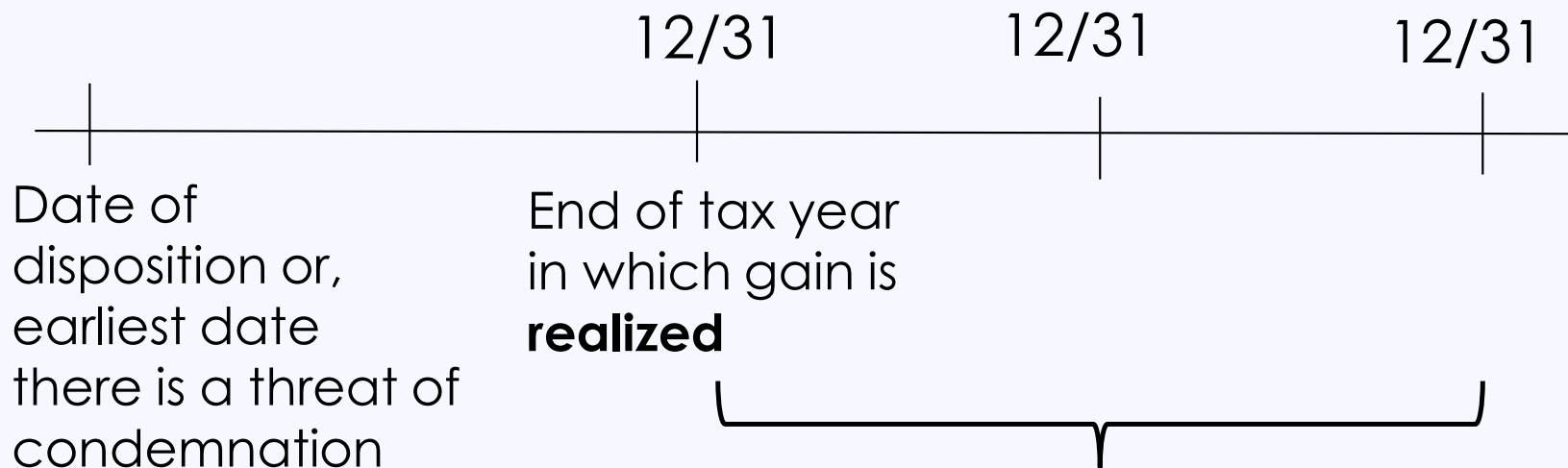
EXAMPLE 3.28

P. 127



REPLACEMENT PERIOD

P. 127



May request an extension

Generally 2 years
4 years if personal residence or
located in disaster area

INVOLUNTARY CONVERSION OF RESIDENCE

P. 128

Treated as a sale of the principle residence

What about the 250,000 (500,000) exclusion?

Can use it first, then, if gain greater, can purchase similar property costing more.

EXAMPLE 3.29

P. 128

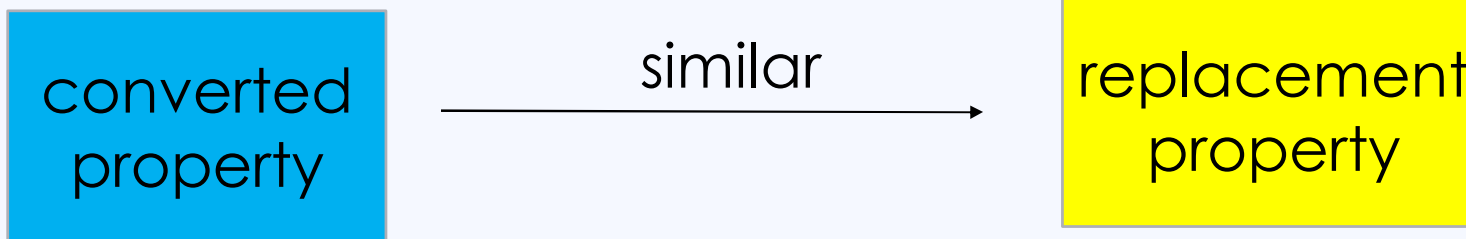
Condemnation award	700,000
Exclusion (joint)	<u>(500,000)</u>
Amount realized	200,000
Basis	<u>(150,000)</u>
Gain realized	50,000

Basis?

New Home purchased	800,000
(Can postpone 50,000 realized gain)	
Gain deferred	<u>(50,000)</u>
Basis in the new home	750,000

ELECTION AND REPORTING

P. 127

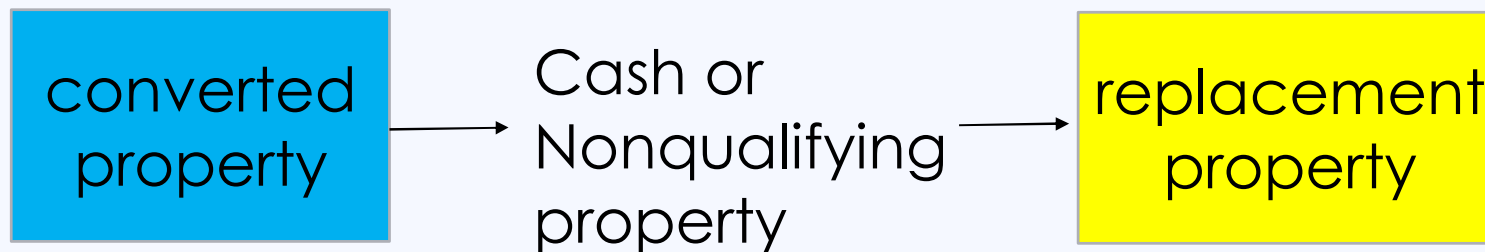


Nonrecognition treatment is mandatory

No reporting is required!!

ELECTION AND REPORTING

P. 129



- Report election to postpone reporting gain on a separate statement.
- Must contain detailed information about the replacement property
- See page 129 for example election

Any
Questions