

§ 1.1033(a)-3

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real estate affected for benefits accruing in connection with the condemnation, the amount so retained shall be deducted from the gross award in determining the amount of the net award.

(11) If, in a condemnation proceeding, the Government retains out of the award sufficient funds to satisfy liens (other than liens due to special assessments levied against the remaining portion of the plot or parcel of real estate affected for benefits accruing in connection with the condemnation) and mortgages against the property, and itself pays the same, the amount so retained shall not be deducted from the gross award in determining the amount of the net award. If, in a condemnation proceeding, the Government makes an award to a mortgagee to satisfy a mortgage on the condemned property, the amount of such award shall be considered as a part of the *amount realized* upon the conversion regardless of whether or not the taxpayer was personally liable for the mortgage debt. Thus, if a taxpayer has acquired property worth \$100,000 subject to a \$50,000 mortgage (regardless of whether or not he was personally liable for the mortgage debt) and, in a condemnation proceeding, the Government awards the taxpayer \$60,000 and awards the mortgagee \$50,000 in satisfaction of the mortgage, the entire \$110,000 is considered to be the *amount realized* by the taxpayer.

(12) An amount expended for replacement of an asset, in excess of the recovery for loss, represents a capital expenditure and is not a deductible loss for income tax purposes.

(Secs. 1033 (90 Stat. 1920, 26 U.S.C. 1033), and 7805 (68A Stat. 917, 26 U.S.C. 7805))

[T.D. 6500, 25 FR 11910, Nov. 26, 1960, as amended by T.D. 6679, 28 FR 10515, Oct. 1, 1963; T.D. 7075, 35 FR 17996, Nov. 24, 1970; T.D. 7625, 44 FR 31013, May 30, 1979; T.D. 7758, 46 FR 6925, Jan. 22, 1981]

§ 1.1033(a)-3 Involuntary conversion of principal residence.

Section 1033 shall apply in the case of property used by the taxpayer as his principal residence if the destruction, theft, seizure, requisition, or condemnation of such residence, or the sale or exchange of such residence

under threat or imminence thereof, occurs before January 1, 1951, or after December 31, 1953. However, section 1033 shall not apply to the seizure, requisition, or condemnation (but not destruction), or the sale or exchange under threat or imminence thereof, of such residence property if the seizure, requisition, condemnation, sale, or exchange occurs after December 31, 1957, and if the taxpayer properly elects under section 1034(i) to treat the transaction as a sale (see paragraph (h)(2)(ii) of § 1.1034-1). See section 121 and paragraphs (d) and (g) of § 1.121-5 for special rules relating to the involuntary conversion of a principal residence of individuals who have attained age 65.

[T.D. 6856, 30 FR 13319, Oct. 20, 1965. Redesignated and amended by T.D. 7625, 44 FR 31013, May 30, 1979]

§ 1.1033(b)-1 Basis of property acquired as a result of an involuntary conversion.

(a) The provisions of the first sentence of section 1033(b) may be illustrated by the following example:

Example: A's vessel which has an adjusted basis of \$100,000 is destroyed in 1950 and A receives in 1951 insurance in the amount of \$200,000. If A invests \$150,000 in a new vessel, taxable gain to the extent of \$50,000 would be recognized. The basis of the new vessel is \$100,000; that is, the adjusted basis of the old vessel (\$100,000) minus the money received by the taxpayer which was not expended in the acquisition of the new vessel (\$50,000) plus the amount of gain recognized upon the conversion (\$50,000). If any amount in excess of the proceeds of the conversion is expended in the acquisition of the new property, such amount may be added to the basis otherwise determined.

(b) The provisions of the last sentence of section 1033(b) may be illustrated by the following example:

Example: A taxpayer realizes \$22,000 from the involuntary conversion of his barn in 1955; the adjusted basis of the barn to him was \$10,000, and he spent in the same year \$20,000 for a new barn which resulted in the nonrecognition of \$10,000 of the \$12,000 gain on the conversion. The basis of the new barn to the taxpayer would be \$10,000—the cost of the new barn (\$20,000) less the amount of the gain not recognized on the conversion (\$10,000). The basis of the new barn would not be a substituted basis in the hands of the taxpayer within the meaning of section

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1016(b)(2). If the replacement of the converted barn had been made by the purchase of two smaller barns which, together, were similar or related in service or use to the converted barn and which cost \$8,000 and \$12,000, respectively, then the basis of the two barns would be \$4,000 and \$6,000, respectively, the total basis of the purchased property (\$10,000) allocated in proportion to their respective costs (8,000/20,000 of \$10,000 or \$4,000; and 12,000/20,000 of \$10,000, or \$6,000).

[T.D. 6500, 25 FR 11910, Nov. 26, 1960; 25 FR 14021, Dec. 31, 1960. Redesignated and amended by T.D. 7625, 44 FR 31013, May 30, 1979]

§ 1.1033(c)-1 Disposition of excess property within irrigation project deemed to be involuntary conversion.

(a) The sale, exchange, or other disposition occurring in a taxable year to which the Internal Revenue Code of 1954 applies, of excess lands lying within an irrigation project or division in order to conform to acreage limitations of the Federal reclamation laws effective with respect to such project or division shall be treated as an involuntary conversion to which the provisions of section 1033 and the regulations thereunder shall be applicable. The term *excess lands* means irrigable lands within an irrigation project or division held by one owner in excess of the amount of irrigable land held by such owner entitled to receive water under the Federal reclamation laws applicable to such owner in such project or division. Such excess lands may be either (1) lands receiving no water from the project or division, or (2) lands receiving water only because the owner thereof has executed a valid recordable contract agreeing to sell such lands under terms and conditions satisfactory to the Secretary of the Interior.

(b) If a disposition in order to conform to the acreage limitation provisions of Federal reclamation laws includes property other than excess lands (as, for example, where the excess lands alone do not constitute a marketable parcel) the provisions of section 1033(d) shall apply only to the part of the disposition that relates to excess lands.

(c) The provisions of §1.1033(a)-2 shall be applicable in the case of dispositions treated as involuntary conversions under this section. The details in connection with such a disposition required to be reported under paragraph

(c)(2) of §1.1033(a)-2 shall include the authority whereby the lands disposed of are considered *excess lands*, as defined in this section, and a statement that such disposition is not part of a plan contemplating the disposition of all or any nonexcess land within the irrigation project or division.

(d) The term *involuntary conversion*, where it appears in subtitle A of the Code or the regulations thereunder, includes dispositions of excess property within irrigation projects described in this section. (See, e.g., section 1231 and the regulations thereunder.)

[T.D. 6500, 25 FR 11910, Nov. 26, 1960; 25 FR 14021, Dec. 31, 1960. Redesignated and amended by T.D. 7625, 44 FR 31013, May 30, 1979]

§ 1.1033(d)-1 Destruction or disposition of livestock because of disease.

(a) The destruction occurring in a taxable year to which the Internal Revenue Code of 1954 applies, of livestock by, or on account of, disease, or the sale or exchange, in such a year, of livestock because of disease, shall be treated as an involuntary conversion to which the provisions of section 1033 and the regulations thereunder shall be applicable. Livestock which are killed either because they are diseased or because of exposure to disease shall be considered destroyed on account of disease. Livestock which are sold or exchanged because they are diseased or have been exposed to disease, and would not otherwise have been sold or exchanged at that particular time shall be considered sold or exchanged because of disease.

(b) The provisions of §1.1033(a)-2 shall be applicable in the case of a disposition treated as an involuntary conversion under this section. The details in connection with such a disposition required to be reported under paragraph (c)(2) of §1.1033(a)-2 shall include a recital of the evidence that the livestock were destroyed by or on account of disease, or sold or exchanged because of disease.

(c) The term *involuntary conversion*, where it appears in subtitle A of the