

on the books of the cooperative association; and

(3) The stated dollar amount of which is fixed without reference to net earnings.

(h) *Effective date.* This section shall not apply to any amount the tax treatment of which is prescribed in section 1385 and § 1.1385-1. Paragraphs (d), (e), and (f) of this section shall apply to per-unit retain certificates as defined in paragraph (g) of this section issued by a cooperative association during taxable years of the association beginning after April 30, 1966, with respect to products marketed for patrons during such years.

[T.D. 6500, 25 FR 11402, Nov. 26, 1960, as amended by T.D. 6855, 30 FR 13134, Oct. 15, 1965]

§ 1.61-6 Gains derived from dealings in property.

(a) *In general.* Gain realized on the sale or exchange of property is included in gross income, unless excluded by law. For this purpose property includes tangible items, such as a building, and intangible items, such as goodwill. Generally, the gain is the excess of the amount realized over the unrecovered cost or other basis for the property sold or exchanged. The specific rules for computing the amount of gain or loss are contained in section 1001 and the regulations thereunder. When a part of a larger property is sold, the cost or other basis of the entire property shall be equitably apportioned among the several parts, and the gain realized or loss sustained on the part of the entire property sold is the difference between the selling price and the cost or other basis allocated to such part. The sale of each part is treated as a separate transaction and gain or loss shall be computed separately on each part. Thus, gain or loss shall be determined at the time of sale of each part and not deferred until the entire property has been disposed of. This rule may be illustrated by the following examples:

Example (1). A, a dealer in real estate, acquires a 10-acre tract for \$10,000, which he divides into 20 lots. The \$10,000 cost must be equitably apportioned among the lots so that on the sale of each A can determine his taxable gain or deductible loss.

Example (2). B purchases for \$25,000 property consisting of a used car lot and adjoining filling station. At the time, the fair market value of the filling station is \$15,000 and the fair market value of the used car lot is \$10,000. Five years later B sells the filling station for \$20,000 at a time when \$2,000 has been properly allowed as depreciation thereon. B's gain on this sale is \$7,000, since \$7,000 is the amount by which the selling price of the filling station exceeds the portion of the cost equitably allocable to the filling station at the time of purchase reduced by the depreciation properly allowed.

(b) *Nontaxable exchanges.* Certain realized gains or losses on the sale or exchange of property are not "recognized", that is, are not included in or deducted from gross income at the time the transaction occurs. Gain or loss from such sales or exchanges is generally recognized at some later time. Examples of such sales or exchanges are the following:

(1) Certain formations, reorganizations, and liquidations of corporations, see sections 331, 333, 337, 351, 354, 355, and 361;

(2) Certain formations and distributions of partnerships, see sections 721 and 731;

(3) Exchange of certain property held for productive use or investment for property of like kind, see section 1031;

(4) A corporation's exchange of its stock for property, see section 1032;

(5) Certain involuntary conversions of property if replaced, see section 1033;

(6) Sale or exchange of residence if replaced, see section 1034;

(7) Certain exchanges of insurance policies and annuity contracts, see section 1035; and

(8) Certain exchanges of stock for stock in the same corporation, see section 1036.

(c) *Character of recognized gain.* Under Subchapter P, Chapter 1 of the Code, relating to capital gains and losses, certain gains derived from dealings in property are treated specially, and under certain circumstances the maximum rate of tax on such gains is 25 percent, as provided in section 1201. Generally, the property subject to this treatment is a "capital asset", or treated as a "capital asset". For definition of such assets, see sections 1221 and 1231, and the regulations thereunder. For some of the rules either

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granting or denying this special treatment, see the following sections and the regulations thereunder:

- (1) Transactions between partner and partnership, section 707;
- (2) Sale or exchange of property used in the trade or business and involuntary conversions, section 1231;
- (3) Payment of bonds and other evidences of indebtedness, section 1232;
- (4) Gains and losses from short sales, section 1233;
- (5) Options to buy or sell, section 1234;
- (6) Sale or exchange of patents, section 1235;
- (7) Securities sold by dealers in securities, section 1236;
- (8) Real property subdivided for sale, section 1237;
- (9) Amortization in excess of depreciation, section 1238;
- (10) Gain from sale of certain property between spouses or between an individual and a controlled corporation, section 1239;
- (11) Taxability to employee of termination payments, section 1240.

§ 1.61-7 Interest.

(a) *In general.* As a general rule, interest received by or credited to the taxpayer constitutes gross income and is fully taxable. Interest income includes interest on savings or other bank deposits; interest on coupon bonds; interest on an open account, a promissory note, a mortgage, or a corporate bond or debenture; the interest portion of a condemnation award; usurious interest (unless by State law it is automatically converted to a payment on the principal); interest on legacies; interest on life insurance proceeds held under an agreement to pay interest thereon; and interest on refunds of Federal taxes. For rules determining the taxable year in which interest, including interest accrued or constructively received, is included in gross income, see section 451 and the regulations thereunder. For the inclusion of interest in income for the purpose of the retirement income credit, see section 37 and the regulations thereunder. For credit of tax withheld at source on interest on tax-free covenant bonds, see section 32 and the regulations thereunder. For rules relating to inter-

est on certain deferred payments, see section 483 and the regulations thereunder.

(b) *Interest on Government obligations—(1) Wholly tax-exempt interest.* Interest upon the obligations of a State, Territory, or a possession of the United States, or any political subdivision of any of the foregoing, or of the District of Columbia, is wholly exempt from tax. Interest on certain United States obligations issued before March 1, 1941, is exempt from tax to the extent provided in the acts of Congress authorizing the various issues. See section 103 and the regulations thereunder.

(2) *Partially tax-exempt interest.* Interest earned on certain United States obligations is partly tax exempt and partly taxable. For example, the interest on United States Treasury bonds issued before March 1, 1941, to the extent that the principal of such bonds exceeds \$5,000, is exempt from normal tax but is subject to surtax. See sections 35 and 103, and the regulations thereunder.

(3) *Fully taxable interest.* In general, interest on United States obligations issued on or after March 1, 1941, and obligations issued by any agency or instrumentality of the United States after that date, is fully taxable; but see section 103 and the regulations thereunder. A taxpayer using the cash receipts and disbursements method of accounting who owns United States savings bonds issued at a discount has an election as to when he will report the interest; see section 454 and the regulations thereunder.

(c) *Obligations bought at a discount; bonds bought when interest defaulted or accrued.* When notes, bonds, or other certificates of indebtedness are issued by a corporation or the Government at a discount and are later redeemed by the debtor at the face amount, the original discount is interest, except as otherwise provided by law. See also paragraph (b) of this section for the rules relating to Government bonds. If a taxpayer purchases bonds when interest has been defaulted or when the interest has accrued but has not been paid, any interest which is in arrears but has accrued at the time of purchase