

§ 16A.126-2

the improvement. Therefore the taxpayer includes \$8,500 in gross income as a result of the USDA payment, computed as follows:

Value of the section 126 improvement	\$15,000
(Excludable portion)	(3,500)
(Taxpayer's contribution)	(3,000)
	8,500
Amount included in gross income	8,500

[T.D. 7748, 46 FR 27637, May 21, 1981; 46 FR 41043, Aug. 14, 1981]

§ 16A.126-2 Section 126 elections.

(a) *Election for section 126 not to apply in whole or in part.* A taxpayer may elect under section 126(c) not to have section 126 apply to all or any part of an improvement described in section 126.

(b) *Application of the section 126 exclusion.* To the extent the section 126 exclusion applies, the taxpayer should so indicate on an attachment to the tax return (or amended return) for the taxable year in which the taxpayer received the last payment made by a government for the improvement. The attachment should state the dollar amount of the section 126 cost funded by a government payment, the value of the section 126 improvement, and the amount that the taxpayer is excluding under section 126.

§ 16A.1255-1 General rule for treatment of gain from disposition of section 126 property.

(a) *Ordinary income—(1) General rule.* Except as otherwise provided in this section and § 16A.1255-2, if section 126 property is disposed of after September 30, 1979, then under section 1255(a)(1) there shall be recognized as ordinary income the lesser of—

(i) The “excludable portion” under section 126, or

(ii)(A) The excess of the amount realized (in the case of a sale, exchange, or involuntary conversion), or the fair market value of the section 126 property (in the case of any other disposition), over the adjusted basis of the property, less

(B) The amount recognized as ordinary income under the other provisions of Chapter I, Subchapter P, Part IV of the Code.

(2) *Application of section.* Any gain treated as ordinary income under section 1255(a)(1) shall be recognized as ordinary income notwithstanding any

other provision of subtitle A of the Code except that section 1255 does not apply to the extent the gain is recognized as ordinary income under the other provisions of Subchapter P, Part IV of the Code. For special rules with respect to the application of section 1255, see § 16A.1255-2. For the relation of section 1255 to other provisions, see paragraph (c) of this section.

(3) *Meaning of terms.* For purposes of section 1255 and these regulations—

(i) The term “section 126 property” means any property acquired, improved, or otherwise modified as a result of a payment listed in section 126(a) which has been certified by the Secretary of Agriculture as primarily for the purpose of conservation;

(ii) The term “excludable portion” is defined in § 16A.126-1(b)(5);

(iii) The term “disposition” has the same meaning as in § 1.1245-1(a)(3);

(iv) The term “date of receipt of the section 126 payment” means the last date the government made a payment for the improvements.

(4) *Applicable percentage.* If section 126 property is disposed of less than 10 years after the date of receipt of the last payment which has been certified by the Secretary of Agriculture as primarily for the purpose of conservation, the “applicable percentage” is 100 percent; if section 126 property is disposed of more than 10 years after that date, the applicable percentage is 100 percent reduced (but not below zero) by 10 percent for each year or part thereof in excess of 10 years such property was held after the date of the section 126 payment.

(5) *Portion of parcel.* The amount of gain to be recognized as ordinary income under section 1255(a)(1) shall be determined separately for each parcel of section 126 property in a manner consistent with the principles of § 1245-1(a) (4) and (5) relating to gain from disposition of certain depreciable property. If (i) only a portion of a parcel of section 126 property is disposed of in a transaction, or if two or more portions of a single parcel are disposed of in one transaction, and (ii) the aggregate of “excludable portions” with respect to any such portion cannot be established

to the satisfaction of the Commissioner, then the aggregate of the “excludable portions” in respect of the entire parcel shall be allocated to each portion in proportion to the fair market value of each at the time of the disposition.

(b) *Instances of nonapplication*—(1) *In general.* Section 1255 does not apply if a taxpayer disposes of section 126 property more than 20 years after receipt of the last section 126 payment with respect to the property.

(2) *Losses.* Section 1255(a)(1) does not apply to losses. Thus, section 1255(a)(1) does not apply if a loss is realized upon a sale, exchange, or involuntary conversion of property, all of which is section 126 property, nor does the section apply to a disposition of the property other than by way of sale, exchange, or involuntary conversion if at the time of the disposition the fair market value of the property is not greater than its adjusted basis.

(c) *Relation of section 1255 to other provisions*—(1) *General.* The provisions of section 1255 apply notwithstanding any other provisions of Subtitle A of the Code except that they do not apply to the extent gain is recognized as ordinary income under the other provisions of Subchapter P, Part IV of the Code. Thus, unless an exception or limitation under § 16A.1255-2 applies, gain under section 1255(a)(1) is recognized notwithstanding any contrary nonrecognition provision or income characterizing provision. For example, since section 1255 overrides section 1231 (relating to property used in the trade or business), the gain recognized under section 1255 upon a disposition of section 126 property will be treated as ordinary income and only the remaining gain, if any, from the disposition may be considered as gain from the sale or exchange of property to which section 1231 applies. See example (1) of paragraph (d) of this section.

(2) *Nonrecognition sections overridden.* The nonrecognition of gain provisions of Subtitle A of the Code which section 1255 overrides include, but are not limited to, sections 267(d), 311(a), 336, 337, and 512(b)(5). See § 16A.1255-2 for the extent to which section 1255(a)(1) overrides sections 332, 351, 361, 371(a), 374(a), 721, 731, 1031, and 1033.

(3) *Installment method.* Gain from a disposition to which section 1255(a)(1) applies may be reported under the installment method if such method is otherwise available under section 453 of the Code. In such a case, the portion of the installment payment that is gain is treated as follows: first as ordinary gain under other sections of Chapter I Subchapter P, Part IV of the Code until all that gain has been reported; next as ordinary gain to which section 1255 applies until all that gain is reported; and finally as gain under other sections of Chapter I, Subchapter D, Part IV of the Code. For treatment of amounts as interest on certain deferred payments, see section 483.

(4) *Exempt income.* With regard to exempt income, the principles of § 1.1245-6(e) shall be applicable.

(5) *Treatment of gain not recognized under section 1255(a)(1).* For treatment of gain not recognized under this section, the principles of § 1.1245-6(f) shall be applicable.

(d) *Example.* The provisions of this section may be illustrated by the following example:

Example. Individual A uses the calendar year as his taxable year. On April 10, 1995, A sells for \$75,000 section 126 property with an adjusted basis of \$52,500 for a realized gain of \$22,500. The excludable portion under section 126 was \$18,000. A received the section 126 payment on January 5, 1990. No gain is recognized as ordinary gain under sections 1231 through 1254. Because the applicable percentage, 100 percent, of the aggregate of the section 126 improvements (\$18,000), \$18,000, is lower than the gain realized, \$22,500, the amount of gain recognized as ordinary income under section 1255(a)(1) is \$18,000. The remaining \$4,500 of the gain may be treated as gain from the sale or exchange of property described in section 1231.

§ 16A.1255-2 Special rules.

(a) *Exception for gifts*—(1) *General rule.* In general, no gain shall be recognized under section 1255(a)(1) upon a disposition of section 126 property by gift. For purposes of section 1255 and this paragraph, the term “gift” shall have the same meaning as in § 1.1245-4(a) and, with respect to the application of this paragraph, principles illustrated by the examples of § 1.1245-4(a)(2) shall apply.