

§ 1.1033(h)-1

(4) *Character of replacement property.* For purposes of section 1033(g), an interest in real property purchased as replacement property for a compulsorily or involuntarily converted outdoor advertising display (with respect to which an election under this section is in effect) shall be considered property of a like kind as the property converted even though a taxpayer's interest in the replacement property is different from the interest held in the property converted. Thus, for example, a fee simple interest in real estate acquired to replace a converted billboard and a 5-year leasehold interest in the real property on which the billboard was located qualifies as property of a like kind under this section.

(c) *Special rule for period within which property must be replaced.* In the case of a disposition described in paragraph (a) of this section, section 1033(a)(2)(B) and § 1.1033(a)-2(c)(3) (relating to the period within which the property must be replaced) shall be applied by substituting 3 years for 2 years. This paragraph shall apply to any disposition described in section 1033(f)(1) and paragraph (a) of this section occurring after December 31, 1974, unless a condemnation proceeding with respect to the property was begun before October 4, 1976. Thus, regardless of when the property is disposed of, the taxpayer will not be eligible for the 3-year replacement period if a condemnation proceeding was begun before October 4, 1976. However, if the property is disposed of after December 31, 1974, and the condemnation proceeding was begun (if at all) after October 4, 1976, then the taxpayer is eligible for the 3-year replacement period. For the purposes of this paragraph, whether a condemnation proceeding is considered as having begun is determined under the applicable State or Federal procedural law.

(d) *Limitation on application of special rule.* This section shall not apply to the purchase of stock in the acquisition of

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control of a corporation described in section 1033(a)(2)(A).

(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; 25 FR 14021, Dec. 31, 1960. Redesignated and amended by T.D. 7625, 44 FR 31013, May 30, 1979; 44 FR 38458, July 2, 1979. Further redesignated and amended by T.D. 7758, 46 FR 6925, Jan. 22, 1981; T.D. 7758, 46 FR 23235, Apr. 24, 1981; T.D. 8121, 52 FR 414, Jan. 6, 1987]

§ 1.1033(h)-1 Effective date.

Except as provided otherwise in § 1.1033(e)-1 and § 1.1033(g)-1, the provisions of section 1033 and the regulations thereunder are effective for taxable years beginning after December 31, 1953, and ending after August 16, 1954.

(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; 25 FR 14021, Dec. 31, 1960. Redesignated and amended by T.D. 7625, 44 FR 31013, May 30, 1979. Further redesignated and amended by T.D. 7758, 46 FR 6925, Jan. 22, 1981]

§ 1.1034-1 Sale or exchange of residence.

(a) *Nonrecognition of gain; general statement.* Section 1034 provides rules for the nonrecognition of gain in certain cases where a taxpayer sells one residence after December 31, 1953, and buys or builds, and uses as his principal residence, another residence within specified time limits before or after such sale. In general, if the taxpayer invests in a new residence an amount at least as large as the adjusted sales price of his old residence, no gain is recognized on the sale of the old residence (see paragraph (b) of this section for definitions of *adjusted sales price*, *new residence*, and *old residence*). On the other hand, if the new residence costs the taxpayer less than the adjusted sales price of the old residence, gain is recognized to the extent of the difference. Thus, if an amount equal to or greater than the adjusted sales price of an old residence is invested in a new residence, according to the rules stated in section 1034, none of the gain (if any) realized from the sale shall be recognized. If an amount less than such adjusted sales price is so invested, gain shall be recognized, but only to the extent provided in section 1034. If there is

no investment in a new residence, section 1034 is inapplicable and all of the gain shall be recognized. Whenever, as a result of the application of section 1034, any or all of the gain realized on the sale of an old residence is not recognized, a corresponding reduction must be made in the basis of the new residence. The provisions of section 1034 are mandatory, so that the taxpayer cannot elect to have gain recognized under circumstances where this section is applicable. Section 1034 applies only to gains; losses are recognized or not recognized without regard to the provisions of this section. Section 1034 affects only the amount of gain recognized, and not the amount of gain realized (see also section 1001 and the regulations issued thereunder). Any gain realized upon disposition of other property in exchange for the new residence is not affected by section 1034. For special rules relating to the sale or exchange of a principal residence by a taxpayer who has attained age 65, see section 121 and paragraph (g) of § 1.121-5. For special rules relating to a case where real property with respect to the sale of which gain is not recognized under this section is reacquired by the seller in partial or full satisfaction of the indebtedness arising from such sale and resold by him within 1 year after the date of such reacquisition, see § 1.1038-2.

(b) *Definitions.* The following definitions of frequently used terms are applicable for purposes of section 1034 (other definitions and detailed explanations appear in subsequent paragraphs of this regulation):

(1) *Old residence* means property used by the taxpayer as his principal residence which is the subject of a sale by him after December 31, 1953 (section 1034(a); for detailed explanation see paragraph (c)(3) of this section).

(2) *New residence* means property used by the taxpayer as his principal residence which is the subject of a purchase by him (section 1034(a); for detailed explanation and limitations see paragraphs (c)(3) and (d)(1) of this section).

(3) *Adjusted sales price* means the amount realized reduced by the fixing-up expenses (section 1034(b)(1); for special rule applicable in some cases to

husband and wife, see paragraph (f) of this section).

(4) *Amount realized* is to be computed by subtracting,

(i) The amount of the items which, in determining the gain from the sale of the old residence, are properly an offset against the consideration received upon the sale (such as commissions and expenses of advertising the property for sale, of preparing the deed, and of other legal services in connection with the sale); from

(ii) The amount of the consideration so received, determined (in accordance with section 1001(b) and regulations issued thereunder) by adding to the sum of any money so received, the fair market value of the property (other than money) so received. If, as part of the consideration for the sale, the purchaser either assumes a liability of the taxpayer or acquires the old residence subject to a liability (whether or not the taxpayer is personally liable on the debt), such assumption or acquisition, in the amount of the liability, shall be treated as money received by the taxpayer in computing the *amount realized*.

(5) *Gain realized* is the excess (if any) of the amount realized over the adjusted basis of the old residence (see also section 1001(a) and regulations issued thereunder).

(6) *Fixing-up expenses* means the aggregate of the expenses for work performed (in any taxable year, whether beginning before, on, or after January 1, 1954) on the old residence in order to assist in its sale, provided that such expenses (i) are incurred for work performed during the 90-day period ending on the day on which the contract to sell the old residence is entered into; and (ii) are paid on or before the 30th day after the date of the sale of the old residence; and (iii) are neither (a) allowable as deductions in computing taxable income under section 63(a), nor (b) taken into account in computing the amount realized from the sale of the old residence (section 1034(b) (2) and (3)). *Fixing-up expenses* does not include expenditures which are properly chargeable to capital account and which would, therefore, constitute adjustments to the basis of the old residence (see section 1016 and regulations issued thereunder).

(7) *Cost of purchasing the new residence* means the total of all amounts which are attributable to the acquisition, construction, reconstruction, and improvements constituting capital expenditures, made during the period beginning 18 months (one year in the case of a sale of an old residence prior to January 1, 1975) before the date of sale of the old residence and ending either (i) 18 months (one year in the case of a sale of an old residence prior to January 1, 1975) after such date in the case of a new residence purchased but not constructed by the taxpayer, or (ii) two years (18 months in the case of a sale of an old residence prior to January 1, 1975) after such date in the case of a new residence the construction of which was commenced by the taxpayer before the expiration of 18 months (one year in the case of a sale of an old residence prior to January 1, 1975) after such date (section 1034(a), (c)(2) and (c)(5); for detailed explanation, see paragraph (c)(4) of this section; for special rule applicable in some cases to husband and wife, see paragraph (f) of this section; see also paragraph (b)(9) of this section for definition of *purchase*).

(8) *Sale* (of a residence) means a sale or an exchange (of a residence) for other property which occurs after December 31, 1953, an involuntary conversion (of a residence) which occurs after December 31, 1950, and before January 1, 1954, or certain involuntary conversions where the disposition of the property occurs after December 31, 1957, in respect of which a proper election is made under section 1034(i)(2) (see sections 1034(c)(1), 1034(i)(1)(A), and 1034(i)(2); for detailed explanation concerning involuntary conversions, see paragraph (h) of this section).

(9) *Purchase* (of a residence) means a purchase or an acquisition (of a residence) on the exchange of property or the partial or total construction or reconstruction (of a residence) by the taxpayer (section 1034(c) (1) and (2)). However, the mere improvement of a residence, not amounting to reconstruction, does not constitute *purchase* of a residence.

(c) *Rules for application of section 1034—(1) General rule; limitations on applicability.* Gain realized from the sale (after December 31, 1953) of an old resi-

dence will be recognized only to the extent that the taxpayer's adjusted sales price of the old residence exceeds the taxpayer's cost of purchasing the new residence, provided that the taxpayer either (i) within a period beginning 18 months (one year in the case of a sale of an old residence prior to January 1, 1975) before the date of such sale and ending 18 months (one year in the case of a sale of an old residence prior to January 1, 1975) after such date purchases property and uses it as his principal residence, or (ii) within a period beginning 18 months (one year in the case of a sale of an old residence prior to January 1, 1975) before the date of such sale and ending two years (18 months in the case of a sale of an old residence prior to January 1, 1975) after such date uses as his principal residence a new residence the construction of which was commenced by him at any time before the expiration of 18 months (one year in the case of a sale of an old residence prior to January 1, 1975) after the date of the sale of the old residence (section 1034 (a) and (c)(5); for detailed explanation of use as *principal residence* see subparagraph (3) of this paragraph). The rule stated in the preceding sentence applies to a new residence purchased by the taxpayer before the date of sale of the old residence provided the new residence is still owned by him on such date (section 1034(c)(3)). Whether the construction of a new residence was commenced by the taxpayer before the expiration of 18 months (one year in the case of a sale of an old residence prior to January 1, 1975) after the date of the sale of the old residence will depend upon the facts and circumstances of each case. Section 1034 is not applicable to the sale of a residence if within the previous 18 months (previous year in the case of a sale of an old residence prior to January 1, 1975) the taxpayer made another sale of residential property on which gain was realized but not recognized (section 1034(d)). For further details concerning limitations on the application of section 1034, see paragraph (d) of this section.

(2) *Computation and examples.* In applying the general rule stated in subparagraph (1) of this paragraph, the taxpayer should first subtract the commissions and other selling expenses

from the selling price of his old residence, to determine the amount realized. A comparison of the amount realized with the cost or other basis of the old residence will then indicate whether there is any gain realized on the sale. Unless the amount realized is greater than the cost or other basis, no gain is realized and section 1034 does not apply. If the amount realized exceeds the cost or other basis, the amount of such excess constitutes the gain realized. The amount realized should then be reduced by the fixing-up expenses (if any), to determine the adjusted sales price. A comparison of the adjusted sales price of the old residence with the cost of purchasing the new residence will indicate how much (if any) of the realized gain is to be recognized. If the cost of purchasing the new residence is the same as, or greater than, the adjusted sales price of the old residence, then none of the realized gain is to be recognized. On the other hand, if the cost of purchasing the new residence is smaller than the adjusted sales price of the old residence, the gain realized, all of the gain realized is to be recognized to the extent of the difference. It should be noted that any amount of gain realized but not recognized is to be applied as a downward adjustment to the basis of the new residence (for details see paragraph (e) of this section.) The application of the general rule stated above may be illustrated by the following examples:

Example 1. A taxpayer decides to sell his residence, which has a basis of \$17,500. To make it more attractive to buyers, he paints the outside at a cost of \$300 in April, 1954. He pays for the painting when the work is finished. In May, 1954, he sells the house for \$20,000. Brokers' commissions and other selling expenses are \$1,000. In October, 1954, the taxpayer buys a new residence for \$18,000. The amount realized, the gain realized, the adjusted sales price, and the gain to be recognized are computed as follows:

Selling price	\$20,000
Less: Commissions and other selling expenses	1,000
Amount realized	19,000
Less: Basis	17,500
Gain realized	1,500
Amount realized	19,000
Less: Fixing-up expenses	300
Adjusted sales price	18,700

Cost of purchasing new residence	18,000
Gain recognized	700
Gain realized but not recognized	800
Adjusted basis of new residence (see paragraph (e) of this section)	17,200

Example 2. The facts are the same as in example (1), except that the selling price of the old residence is \$18,500. The computations are as follows:

Selling price	\$18,500
Less: Commissions and other selling expenses	1,000
Amount realized	17,500
Less: Basis	17,500
Gain realized	0

NOTE: Since no gain is realized, section 1034 is inapplicable; it is, therefore, unnecessary to compute the adjusted sales price of the old residence and compare it with the cost of purchasing the new residence. No adjustment to the basis of the new residence is to be made.

Example 3. The facts are the same as in example (1), except that the cost of purchasing the new residence is \$17,000. The computations are as follows:

Selling price	\$20,000
Less: Commissions and other selling expenses	1,000
Amount realized	19,000
Less: Basis	17,500
Gain realized	1,500
Amount realized	19,000
Less: Fixing-up expenses	300
Adjusted sales price	18,700
Cost of purchasing the new residence	17,000
Gain recognized	1,500

NOTE: Since the adjusted sales price of the old residence exceeds the cost of purchasing the new residence by \$1,700, which is more than the gain realized, all of the gain realized is recognized. No adjustment to the basis of the new residence is to be made.

Gain realized but not recognized	\$0
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Example 4. The facts are the same as in example (1), except that the fixing-up expenses are \$1,100. The computations are as follows:

Selling price	\$20,000
Less: Commissions and other selling expenses	1,000
Amount realized	19,000
Less: Basis	17,500
Gain realized	1,500
Amount realized	19,000
Less: Fixing-up expenses	1,100
Adjusted sales price	17,900
Cost of purchasing the new residence	18,000
Gain recognized	0

NOTE: Since the cost of purchasing the new residence exceeds the adjusted sales price, none of the gain realized is recognized.

Gain realized but not recognized	\$1,500
Adjusted basis of new residence (see paragraph (e) of this section)	16,500

(3) *Property used by the taxpayer as his principal residence.* (i) Whether or not property is used by the taxpayer as his residence, and whether or not property is used by the taxpayer as his principal residence (in the case of a taxpayer using more than one property as a residence), depends upon all the facts and circumstances in each case, including the good faith of the taxpayer. The mere fact that property is, or has been, rented is not determinative that such property is not used by the taxpayer as his principal residence. For example, if the taxpayer purchases his new residence before he sells his old residence, the fact that he temporarily rents out the new residence during the period before he vacates the old residence may not, in the light of all the facts and circumstances in the case, prevent the new residence from being considered as property used by the taxpayer as his principal residence. Property used by the taxpayer as his principal residence may include a houseboat, a house trailer, or stock held by a tenant-stockholder in a cooperative housing corporation (as those terms are defined in section 216(b) (1) and (2)), if the dwelling which the taxpayer is entitled to occupy as such stockholder is used by him as his principal residence (section 1034(f)). Property used by the taxpayer as his principal residence does not include personal property such as a piece of furniture, a radio, etc., which, in accordance with the applicable local law, is not a fixture.

(ii) Where part of a property is used by the taxpayer as his principal residence and part is used for other purposes, an allocation must be made to determine the application of this section. If the old residence is used only partially for residential purposes, only that part of the gain allocable to the residential portion is not to be recognized under this section and only an amount allocable to the selling price of such portion need be invested in the new residence in order to have the gain allocable to such portion not recog-

nized under this section. If the new residence is used only partially for residential purposes only so much of its cost as is allocable to the residential portion may be counted as the cost of purchasing the new residence.

(4) *Cost of purchasing new residence.* (i) The taxpayer's cost of purchasing the new residence includes not only cash but also any indebtedness to which the property purchased is subject at the time of purchase whether or not assumed by the taxpayer (including purchase-money mortgages, etc.) and the face amount of any liabilities of the taxpayer which are part of the consideration for the purchase. Commissions and other purchasing expenses paid or incurred by the taxpayer on the purchase of the new residence are to be included in determining such cost. In the case of an acquisition of a residence upon an exchange which is considered as a *purchase* under this section, the fair market value of the new residence on the date of the exchange shall be considered as the taxpayer's cost of purchasing the new residence. Where any part of the new residence is acquired by the taxpayer other than by *purchase*, the value of such part is not to be included in determining the taxpayer's cost of the new residence (see paragraph (b)(9) of this section for definition of *purchase*). For example, if the taxpayer acquires a residence by gift or inheritance, and spends \$20,000 in reconstructing such residence, only such \$20,000 may be treated as his cost of purchasing the new residence.

(ii) The taxpayer's cost of purchasing the new residence includes only so much of such cost as is attributable to acquisition, construction, reconstruction, or improvements made within the period of three years or 42 months (two years or 30 months in the case of a sale of an old residence prior to January 1, 1975), as the case may be, in which the purchase and use of the new residence must be made in order to have gain on the sale of the old residence not recognized under this section. Thus, if the construction of the new residence is begun three years before the date of sale of the old residence and completed on the date of sale of the old residence, only that portion of the cost which is attributable to the last 18 months (last

year in the case of a sale of an old residence prior to January 1, 1975) of such construction constitutes the taxpayer's cost of purchasing the new residence, for purposes of section 1034. Furthermore, the taxpayer's cost of purchasing the new residence includes only such amounts as are properly chargeable to capital account rather than to current expense. As to what constitutes capital expenditures, see section 263.

(iii) The provisions of this subparagraph may be illustrated by the following example:

Example: M began the construction of a new residence on January 15, 1974, and completed it on October 14, 1974. The cost of \$45,000 was incurred ratably over the 9-month period of construction. On December 14, 1975, M sold his old residence and realized a gain. In determining the extent to which the realized gain is not to be recognized under section 1034, M's cost of constructing the new residence shall include only the \$20,000 which was attributable to the June 15—October 14, 1974, period (4 months at \$5,000). The \$25,000 balance of the cost of constructing the new residence was not attributable to the period beginning 18 months before the date of the sale of the old residence and ending two years after such date and, under section 1034, is not properly a part of M's cost of constructing the new residence.

(d) *Limitations on application of section 1034.* (1) If a residence is purchased by the taxpayer prior to the date of the sale of the old residence, the purchased residence shall, in no event, be treated as a new residence if such purchased residence is sold or otherwise disposed of by him prior to the date of the sale of the old residence (section 1034(c)(3)). And, if the taxpayer, during the period within which the purchase and use of the new residence must be made in order to have any gain on the sale of the old residence not recognized under this section, purchases more than one property which is used by him as his principal residence during the 18 months (or two years in the case of the construction of the new residence) succeeding the date of the sale of the old residence, only the last of such properties shall be considered a new residence (section 1034(c)(4)). In the case of a sale of an old residence prior to January 1, 1975, the period of 18 months (or two years) referred to in the preceding sentence shall be one year (or 18

months). If within 18 months (one year in the case of a sale of an old residence prior to January 1, 1975) before the date of the sale of the old residence, the taxpayer sold other property used by him as his principal residence at a gain, and any part of such gain was not recognized under this section or section 112(n) of the Internal Revenue Code of 1939, this section shall not apply with respect to the sale of the old residence (section 1034(d)).

(2) The following example will illustrate the rules of subparagraph (1) of this paragraph:

Example: A taxpayer sells his old residence on January 15, 1954, and purchases another residence on February 15, 1954. On March 15, 1954, he sells the residence which he bought on February 15, 1954, and purchases another residence on April 15, 1954. The gain on the sale of the old residence on January 15, 1954, will not be recognized except to the extent to which the taxpayer's adjusted sales price of the old residence exceeds the cost of purchasing the residence which he purchased on April 15, 1954. Gain on the sale of the residence which was bought on February 15, 1954, and sold on March 15, 1954, will be recognized.

(e) *Basis of new residence.* (1) Where the purchase of a new residence results, under this section, in the nonrecognition of any part of the gain realized upon the sale of an old residence, then, in determining the adjusted basis of the new residence as of any time following the sale of the old residence, the adjustments to basis shall include a reduction by an amount equal to the amount of the gain which was not recognized upon the sale of the old residence (section 1034(e); for special rule applicable in some cases to husband and wife, see paragraph (f) of this section). Such a reduction is not to be made for the purpose of determining the adjusted basis of the new residence as of any time preceding the sale of the old residence. For the purpose of this determination, the amount of the gain not recognized under this section upon the sale of the old residence includes only so much of the gain as is not recognized because of the taxpayer's cost, up to the date of the determination of the adjusted basis, of purchasing the new residence.

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(2) The following example will illustrate the rule of subparagraph (1) of this paragraph:

Example: On January 1, 1954, the taxpayer buys a new residence for \$10,000. On March 1, 1954, he sells for an adjusted sales price of \$15,000 his old residence, which has an adjusted basis to him of \$5,000 (no fixing-up expenses are involved, so that \$15,000 is the amount realized as well as the adjusted sales price). Between April 1 and April 15 a wing is constructed on the new house at a cost of \$5,000. Between May 1 and May 15 a garage is constructed at a cost of \$2,000. The adjusted basis of the new residence is \$10,000 during January and February, \$5,000 during March, \$5,000 following the completion of the construction in April, and \$7,000 following the completion of the construction in May. Since the old residence was not sold until March 1, no adjustment to the basis of the new residence is made during January and February. Computations for March, April, and May are as follows:

Amount realized on sale of old residence	\$15,000
Less: Adjusted basis of old residence	5,000
Gain realized on sale of old residence ..	10,000
<i>March 1, 1954</i>	
Adjusted sales price of old residence ...	15,000
Less: Cost of purchasing new residence	10,000
Gain recognized	5,000
Gain realized but not recognized	5,000
Cost of purchasing new residence	10,000
Less: Gain realized but not recognized	5,000
Adjusted basis of new residence	5,000
<i>April 15, 1954</i>	
Gain realized on sale of old residence ..	10,000
Adjusted sales price of old residence ...	15,000
Less: Cost of purchasing new residence	15,000
Gain recognized	0
Gain realized but not recognized	10,000
Cost of purchasing new residence	15,000
Less: Gain realized but not recognized	10,000
Adjusted basis of new residence	5,000
<i>May 15, 1954</i>	
Gain realized on sale of old residence ..	10,000
Adjusted sales price of old residence ...	15,000
Less: Cost of purchasing new residence	17,000
Gain recognized	0
Gain realized but not recognized	10,000
Cost of purchasing new residence	17,000
Less: Gain realized but not recognized	10,000
Adjusted basis of new residence	7,000

(f) *Husband and wife.* (1) If the taxpayer and his spouse file the consent referred to in this paragraph, then the taxpayer's adjusted sales price of the old residence shall mean the taxpayer's, or the taxpayer's and his spouse's, adjusted sales price of the old residence, and the taxpayer's cost of purchasing the new residence shall mean the cost to the taxpayer, or to his spouse, or to both of them, of purchasing the new residence, whether such new residence is held by the taxpayer, or his spouse, or both (section 1034(g)). Such consent may be filed only if the old residence and the new residence are each used by the taxpayer and his same spouse as their principal residence. If the taxpayer and his spouse do not file such a consent, the recognition of gain upon sale of the old residence shall be determined under this section without regard to the foregoing.

(2) The consent referred to in subparagraph (1) of this paragraph is a consent by the taxpayer and his spouse to have the basis of the interest of either of them in the new residence reduced from what it would have been but for the filing of such consent by an amount by which the gain of either of them on the sale of his interest in the old residence is not recognized solely by reason of the filing of such consent. Such reduction in basis is applicable to the basis of the new residence, whether such basis is that of the husband, of the wife, or divided between them. If the basis is divided between the husband and wife, the reduction in basis shall be divided between them in the same proportion as the basis (determined without regard to such reduction) is divided. Such consent shall be filed with the district director with whom the taxpayer filed the return for the taxable year or years in which the gain from the sale of the old residence was realized.

(3) The following examples will illustrate the application of this rule:

Example 1. A taxpayer, in 1954, sells for an adjusted sales price of \$10,000 the principal residence of himself and his wife, which he owns individually and which has an adjusted basis to him of \$5,000 (no fixing-up expenses are involved, so that \$10,000 is the amount realized as well as the adjusted sales price). Within a year after such sale he and his wife contribute \$5,000 each from their separate

funds for the purchase of their new principal residence which they hold as tenants in common, each owning an undivided one-half interest therein. If the taxpayer and his wife file the required consent, the gain of \$5,000 upon the sale of the old residence will not be recognized to the taxpayer, and the adjusted basis of the taxpayer's interest in the new residence will be \$2,500 and the adjusted basis of his wife's interest in such property will be \$2,500.

Example 2. A taxpayer and his wife, in 1954, sell for an adjusted sales price of \$10,000 their principal residence, which they own as joint tenants and which has an adjusted basis of \$2,500 to each of them (\$5,000 together) (no fixing-up expenses are involved, so that \$10,000 is the *amount realized* as well as the *adjusted sales price*). Within a year after such sale, the wife spends \$10,000 of her own funds in the purchase of a principal residence for herself and the taxpayer and takes title in her name only. If the taxpayer and his wife file the required consent, the adjusted basis to the wife of the new residence will be \$5,000, and the gain of the taxpayer will be \$2,500 upon the sale of the old residence will not be recognized. The wife, as a taxpayer herself, will have her gain of \$2,500 on the sale of the old residence not recognized under the general rule.

(g) *Members of Armed Forces.* (1) Section 1034(h) provides a special rule for members of the Armed Forces with respect to the period after the sale of the old residence within which the acquisition of a new residence may result in a non-recognition of gain on such sale. The running of the period of 18 months (one year in the case of a sale of an old residence prior to January 1, 1975) after the sale of the old residence in the case of the purchase of a new residence, or the period of two years (18 months in the case of a sale of an old residence prior to January 12, 1975) after such sale in the case of the construction of a new residence, is suspended during any time that the taxpayer serves on extended active duty with the Armed Forces of the United States. (This paragraph applies to time served on extended active duty prior to July 1, 1973, only if such extended active duty occurred during an induction period as defined in section 112(c)(5) as in effect prior to July 1, 1973.) However, in no event may such suspension extend for more than four years after the date of the sale of the old residence the period within which the purchase or construction of a new residence may result in a

nonrecognition of gain. For example, if the taxpayer is on extended active duty with the Army from January 1, 1975, to June 30, 1976, and if he sold his old residence on January 10, 1975, the latest date on which the taxpayer may use a new residence constructed by him and have any part of the gain on the sale of his old residence not recognized under this section is June 30, 1978 (the date two years following the taxpayer's termination of active duty). However, if this taxpayer were on extended active duty with the Army from January 1, 1975, to December 31, 1978, the latest date on which he might use a new residence constructed by him and have any part of the gain on the sale of his old residence not recognized under this section would be January 10, 1979 (the date four years following the date of the sale of the old residence).

(2) This suspension covers not only the Armed Forces service of the taxpayer but if the taxpayer and his same spouse used both the old and the new residences as their principal residence, then the extension applies in like manner to the time the taxpayer's spouse is on extended active duty with the Armed Forces of the United States.

(3) The time during which the running of the period is suspended is part of such period. Thus, construction costs during such time are includible in the cost of purchasing the new residence under paragraph (c)(4) of this section.

(4) The running of the period of 18 months (or two years) after the date of sale of the old residence referred to in section 1034(c)(4) and in paragraph (d) of this section is not suspended. The running of the 18-month period prior to the date of the sale of the old residence within which the new residence may be purchased in order to have gain on the sale of the old residence not recognized under this section is also not suspended. In the case of a sale of an old residence prior to January 1, 1975, the periods of 18 months (or two years) referred to in each of the two preceding sentences shall be one year (or 18 months).

(5) The term *extended active duty* means any period of active duty which is served pursuant to a call or order to such duty for a period in excess of 90

days or for an indefinite period. If the call or order is for a period of more than 90 days, it is immaterial that the time served pursuant to such call or order is less than 90 days, if the reason for such shorter period of service occurs after the beginning of such duty. As to what constitutes active service as a member of the Armed Forces of the United States, see paragraph (i) of § 1.112-1. As to who are members of the Armed Forces of the United States, see section 7701(a)(15), and the regulations in part 301 of this chapter (Regulations on Procedure and Administration).

(h) *Special rules for involuntary conversions*—(1) *In general.* Except as provided in subparagraph (2) of this paragraph, section 1034 is inapplicable to involuntary conversions of personal residences occurring after December 31, 1953 (section 1034(i)(1)(B)). For purposes of section 1034, an involuntary conversion of a personal residence occurring after December 31, 1950, and before January 1, 1954, is treated as a sale of such residence (section 1034(i)(1)(A); see paragraph (b)(8) of this section). For purposes of this paragraph, an involuntary conversion is defined, as the destruction in whole or in part, theft, seizure, requisition, or condemnation of property, or the sale or exchange of property under threat or imminence thereof. See section 1033 and § 1.1033(a)-3 for treatment of residences involuntarily converted after December 31, 1953.

(2) *Election to treat condemnation of personal residence as sale.* (i) Section 1034(i)(2) provides a special rule which permits a taxpayer to elect to treat the seizure, requisition, or condemnation of his principal residence, or the sale or exchange of such residence under threat or imminence thereof, if occurring after December 31, 1957, as the sale of such residence for purposes of section 1034 (relating to sale or exchange of residence). A taxpayer may thus elect to have section 1034 apply, rather than section 1033 (relating to involuntary conversions), in determining the amount of gain realized on the disposition of his old residence that will not be recognized and the extent to which the basis of his new residence acquired in lieu thereof shall be reduced. Once made, the election shall be irrevocable.

(ii) If the taxpayer elects to be governed by the provisions of section 1034, section 1033 will have no application. Thus, a taxpayer who elects under section 1034(i)(2) to treat the seizure, requisition, or condemnation of his principal residence (but not the destruction), or the sale or exchange of such residence under threat or imminence thereof, as a sale for the purpose of section 1034 must satisfy the requirements of section 1034 and this section. For example, under section 1034 a taxpayer generally must replace his old residence with a new residence which he uses as his principal residence, within a period beginning 18 months (one year in the case of a sale of an old residence prior to January 1, 1975) before the date of disposition of his old residence, and ending 18 months (one year in the case of a sale of an old residence prior to January 1, 1975) after such date. However, in the case of a new residence the construction of which was commenced by the taxpayer within such period, the replacement period shall not expire until 2 years (18 months in the case of a sale of an old residence prior to January 1, 1975) after the date of disposition of the old residence.

(iii) *Time and manner of making election.* The election under section 1034(i)(2) shall be made in a statement attached to the taxpayer's income tax return, when filed, for the taxable year during which the disposition of his old residence occurs. The statement shall indicate that the taxpayer elects under section 1034(i)(2) to treat the disposition of his old residence as a sale for purposes of section 1034, and shall also show—

- (a) The basis of the old residence;
- (b) The date of its disposition;
- (c) The adjusted sales price of the old residence, if known; and
- (d) The purchase price, date of purchase, and date of occupancy of the new residence if it has been acquired prior to the time of making the election.

(i) *Statute of limitations.* (1) Whenever a taxpayer sells property used as his principal residence at a gain, the statutory period prescribed in section 6501(a) for the assessment of a deficiency attributable to any part of such gain shall not expire prior to the expiration

of three years from the date of receipt, by the district director with whom the return was filed for the taxable year or years in which the gain from the sale of the old residence was realized (section 1034(j)), of a written notice from the taxpayer of—

(i) The taxpayer's cost of purchasing the new residence which the taxpayer claims result in nonrecognition of any part of such gain.

(ii) The taxpayer's intention not to purchase a new residence within the period when such a purchase will result in nonrecognition of any part of such gain, or

(iii) The taxpayer's failure to make such a purchase within such period.

Any gain from the sale of the old residence which is required to be recognized shall be included in gross income for the taxable year or years in which such gain was realized. Any deficiency attributable to any portion of such gain may be assessed before the expiration of the 3-year period described in this paragraph, notwithstanding the provisions of any law or rule of law which might otherwise bar such assessment.

(2) The notification required by the preceding subparagraph shall contain all pertinent details in connection with the sale of the old residence and, where applicable, the purchase price of the new residence. The notification shall be in the form of a written statement and shall be accompanied, where appropriate, by an amended return for the year in which the gain from the sale of the old residence was realized, in order to reflect the inclusion in gross income for that year of gain required to be recognized in connection with such sale.

(j) *Effective date.* Pursuant to section 7851(a)(1)(C), paragraphs (a), (b), (c), (d), (f), (g), and (i) of this section apply in the case of any *sale* (as defined in paragraph (b)(8) of this section) made after December 31, 1953, although such sale may occur in a taxable year subject to the Internal Revenue Code of 1939. Similarly, the rule in paragraph (h) of this section that involuntary conversions of personal residences are not to be treated as sales for purposes of section 1034 but are governed by section 1033 applies to any such involuntary conversion made after December 31,

1953, although such involuntary conversion may occur in a taxable year subject to the Internal Revenue Code of 1939. The rule in paragraph (e) of this section requiring an adjustment to the basis of a new residence, the purchase of which results (under section 1034, or section 112(n) of the Internal Revenue Code of 1939) in the nonrecognition of gain on the sale of an old residence, applies in determining the adjusted basis of the new residence at any time following such sale, although such sale may occur in a taxable year subject to the Internal Revenue Code of 1939.

[T.D. 6500, 25 FR 11910, Nov. 26, 1960, as amended by T.D. 6916, 32 FR 5924, Apr. 13, 1967; 32 FR 6971, May 6, 1967; T.D. 7404, 41 FR 6758, Feb. 13, 1976; T.D. 7625, 44 FR 31013, May 30, 1979]

§ 1.1035-1 Certain exchanges of insurance policies.

Under the provisions of section 1035 no gain or loss is recognized on the exchange of:

(a) A contract of life insurance for another contract of life insurance or for an endowment or annuity contract (section 1035(a)(1));

(b) A contract of endowment insurance for another contract of endowment insurance providing for regular payments beginning at a date not later than the date payments would have begun under the contract exchanged, or an annuity contract (section 1035(a)(2)); or

(c) An annuity contract for another annuity contract (section 1035(a)(3)), but section 1035 does not apply to such exchanges if the policies exchanged do not relate to the same insured. The exchange, without recognition of gain or loss, of an annuity contract for another annuity contract under section 1035(a)(3) is limited to cases where the same person or persons are the obligee or obligees under the contract received in exchange as under the original contract. This section and section 1035 do not apply to transactions involving the exchange of an endowment contract or annuity contract for a life insurance contract, nor an annuity contract for an endowment contract. In the case of such exchanges, any gain or loss shall be recognized. In the case of exchanges which would be governed by section