

## Reg. Section 1.1038-1(g)(3)

### Reacquisitions of real property in satisfaction of indebtedness

#### (a) Scope of section 1038.

*(1) General rule on gain or loss.* If a sale of real property gives rise to indebtedness to the seller which is secured by the real property which is sold, and the seller of such property reacquires such property in a taxable year beginning after September 2, 1964, in partial or full satisfaction of such indebtedness, then, except as provided in paragraphs (b) and (f) of this section, no gain or loss shall result to the seller from such reacquisition. The treatment so provided is mandatory; however, see §1.1038-3 for an election to apply the provisions of this section to certain taxable years beginning after December 31, 1957. It is immaterial, for purposes of applying this subparagraph, whether the seller realized a gain or sustained a loss on the sale of the real property, or whether it can be ascertained at the time of the sale whether gain or loss occurs as a result of the sale. It is also immaterial what method of accounting the seller used in reporting gain or loss from the sale of the real property or whether at the time of reacquisition such property has depreciated or appreciated in value since the time of the original sale. Moreover, the character of the gain realized on the original sale of the property is immaterial for purposes of applying this subparagraph. The provisions of this section shall apply, except as provided in §1.1038-2, to the reacquisition of real property which was used by the seller as his principal residence and with respect to the sale of which an election under section 121 is in effect or with respect to the sale of which gain was not recognized under section 1034.

#### *(2) Sales giving rise to indebtedness.*

(i) Sale defined. For purposes of this section, it is not necessary for title to the property to have passed to the purchaser in order to have a sale. Ordinarily, a sale of property has occurred in a transaction in which title to the property has not passed to the purchaser, if the purchaser has a contractual right to retain possession of the property so long as he performs his obligations under the contract and to obtain title to the property upon the completion of the contract. However, a sale may have occurred even if the purchaser does not have the right to possession until he partially or fully satisfies the terms of the contract. For example, if S contracts to sell real property to P, and if S promises to convey title to P upon the completion of all of the payments due under the contract and to allow P to obtain possession of the property after 10 percent of the purchase price has been paid, there has been a sale on the date of the contract for purposes of this section. This section shall not apply to a disposition of real property which constituted an exchange of property or was treated as a sale under section 121(d)(4) or section 1034(i); nor shall it apply to a sale of stock in a cooperative housing corporation described in section 121(d)(3) or section 1034(f).

(ii) Secured indebtedness defined. An indebtedness to the seller is secured by the real property for purposes of this section whenever the seller has the right to take title or possession of the property or both if there is a default with respect to such indebtedness. A sale of real property may give rise to an indebtedness to the seller although the seller is limited in his recourse to the property for payment of the indebtedness in the case of a default.

*(3) Reacquisitions in partial or full satisfaction of indebtedness.*

(i) Purpose of reacquisition. This section applies only where the seller reacquires the real property in partial or full satisfaction of the indebtedness to him that arose from the sale of the real property and was secured by the property. That is, the reacquisition must be in furtherance of the seller's security rights in the property with respect to indebtedness to him that arose at the time of the sale. Accordingly, if the seller in reacquiring the real property does not pay consideration in addition to discharging the purchaser's indebtedness to him that arose from the sale and was secured by such property, this section shall apply to the reacquisition even though the purchaser has not defaulted in his obligations under the contract or such a default is not imminent. If in addition to discharging the purchaser's indebtedness to him that arose from the sale the seller pays consideration in reacquiring the real property, this section shall generally apply to the reacquisition if the reacquisition and the payment of additional consideration is provided for in the original contract for the sale of the property. This section generally shall apply to a reacquisition of real property if the seller reacquires the property either when the purchaser has defaulted in his obligations under the contract or when such a default is imminent. This section generally shall not apply to a reacquisition of real property where the seller pays consideration in addition to discharging the purchaser's indebtedness to him that arose from the sale if the reacquisition and payment of additional consideration was not provided for in the original contract for the sale of the property and if the purchaser has not defaulted in his obligations under the contract or such a default is not imminent. Thus, for example, if the purchaser is in arrears on the payment of interest or principal or has in any other way defaulted on his contract for the purchase of the property, or if the facts of the case indicate that the purchaser is unable satisfactorily to perform his obligations under the contract, and the seller reacquires the property from the purchaser in a transaction in which the seller pays consideration in addition to discharging the purchaser's indebtedness to him that arose from the sale and was secured by the property, this section shall apply to the reacquisition. Additional consideration paid by the seller includes money and other property paid or transferred by the seller. Also, the reacquisition by the seller of real property subject to an indebtedness (or the assumption, upon the reacquisition, of indebtedness) which arose subsequent to the original sale shall be considered as a payment by the seller of additional consideration. However, the reacquisition by the seller of real property subject to an indebtedness (or the assumption, upon the reacquisition, of an indebtedness) which arose prior to or arose out of the original sale shall not be considered as a payment by the seller of additional consideration.

(ii) Manner of reacquisition. For purposes of applying section 1038 and this section there must be a reacquisition by the seller of the real property itself, but the manner in which the seller so reduces the property to ownership or possession, as the case may be, shall generally be immaterial. Thus, the seller may reduce the real property to ownership or possession or both, as the case may require, by agreement or by process of law. The reduction of the real property to ownership or possession by agreement includes, where valid under local law, such methods as voluntary conveyance from the purchaser and abandonment to the seller. The reduction of the real property to ownership or possession by process of law includes foreclosure proceedings in which a competitive bid is entered, such as foreclosure by judicial sale or by power of sale contained in the loan agreement without recourse to the courts, as well as those types of foreclosure proceedings in which a competitive bid is not entered, such as strict foreclosure and foreclosure by entry and possession, by writ of entry, or by publication or notice.

*(4) Persons from whom real property may be reacquired.* The real property reacquired in satisfaction of the indebtedness need not be reacquired from the purchaser but may be reacquired from the purchaser's transferee or assignee, or from a trustee holding title to such property pending the purchaser's satisfaction of the terms of the contract, so long as the indebtedness that is partially or completely satisfied in the reacquisition of such property arose in the original sale of the property and was secured by the property so reacquired. In such a case, a reference in this section to the purchaser shall, where appropriate, include the purchaser's transferee or assignee. Thus, for example, this section will apply if the seller reacquires the property from a purchaser from the original purchaser and either the property is subject to, or the subsequent purchaser assumes, the liability to the seller on the indebtedness.

*(5) Reacquisitions not included.* This section shall not apply to reacquisitions of real property by mutual savings banks, domestic building and loan associations, and cooperative banks, described in section 593(a). However, for rules respecting the reacquisition of real property by such organizations, see §1.595-1.

**(b) Amount of gain resulting from a reacquisition.**

*(1) Determination of amount.*

(i) In general. As a result of a reacquisition to which paragraph (a) of this section applies gain shall be derived by the seller to the extent that the amount of money and the fair market value of other property (other than obligations of the purchaser arising with respect to the sale) which are received by the seller, prior to such reacquisition, with respect to the sale of the property exceed the amount of the gain derived by the seller on the sale of such property which is returned as income for periods prior to the reacquisition. However, the amount of gain so determined shall in no case exceed the amount determined under paragraph (c) of this section with respect to such reacquisition.

(ii) Amount of gain returned as income for prior periods. For purposes of this subparagraph and paragraph (c)(1) of this section, the amount of gain on the sale of the property which is returned as income for periods prior to the reacquisition of the real property does not include any amount of income determined under paragraph (f)(2) of this section which is considered to be received at the time of the reacquisition of the property. However, the amount of gain on the sale of the property which is returned as income for such periods does include gain on the sale resulting from payments received in the taxable year in which the date of reacquisition occurs if such payments are received prior to such reacquisition. The application of this subdivision may be illustrated by the following example:

*Example.* In 1965 S, who uses the calendar year as the taxable year, sells to P for \$10,000 real property which has an adjusted basis of \$3,000. S properly elects under section 453 to report the income from the sale on the installment method. In 1965 and 1966, S receives a total of \$4,000 on the contract. On May 15, 1967, S receives \$1,000 on the contract. Because of P's default, S reacquires the property on August 31, 1967. The gain on the sale which is returned as income for periods prior to the reacquisition is \$3,500 ( $\$5,000 \times \$7,000/\$10,000$ ).

*(2) Amount of money and other property received with respect to the sale.*

(i) In general. Amounts of money and other property received by the seller with respect to the sale of the property include payments made by the purchaser for the seller's benefit, as well as payments made and other property transferred directly to the seller. If the purchaser of the real property makes payments on a mortgage or other indebtedness to which the property is subject at the time of the sale of such property to him, or on which the seller was personally liable at the time of such sale, such payments are considered amounts received by the seller with respect to the sale. However, if after the sale the purchaser borrows money and uses the property as security for the loan, payments by the purchaser in satisfaction of the indebtedness are not considered as amounts received by the seller with respect to the sale, although the seller does in fact receive some indirect benefit when the purchaser makes such payments.

(ii) Payments by purchaser at time of reacquisition. All payments made by the purchaser at the time of the reacquisition of the real property that are with respect to the original sale of the property shall be treated, for purposes of subparagraph (1) of this paragraph, by the seller as having been received prior to the reacquisition with respect to such sale. For example, if the purchaser, at the time of the reacquisition by the seller, pays money or other property to the seller in partial or complete satisfaction of the purchaser's indebtedness on the original sale, the seller shall treat such amounts as having been received prior to the reacquisition with respect to the sale.

(iii) Interest received. For purposes of this subparagraph and paragraph (c)(1) of this section any amounts received by the seller as interest, stated or unstated, are excluded from the computation of gain on the sale of the property and are not considered amounts of money or other property received with respect to the sale.

(iv) Amounts received on sale of purchaser's indebtedness. Money or other property received by the seller on the sale of the purchaser's indebtedness that arose at the time of the sale of the real property are amounts received by the seller with respect to the sale of such real property, except that the amounts so received from the sale of such indebtedness shall be reduced by the amount of money and the fair market value of other property paid or transferred by the seller, before the reacquisition of the real property, to reacquire such indebtedness. For example, if S sells real property to P for \$25,000, and under the contract receives \$10,000 down and a note from P for \$15,000, S would receive \$22,000 with respect to the sale if he were to discount the note for \$12,000. If before the reacquisition of the real property S were to reacquire the discounted note for \$8,000, he would receive \$14,000 with respect to the sale.

*(3) Obligations of the purchaser arising with respect to the sale.* The term "obligations of the purchaser arising with respect to the sale" of the real property includes, for purposes of subparagraph (1) of this paragraph, only that indebtedness on which the purchaser is liable to the seller and which arises out of the sale of such property. Thus, the term does not include any indebtedness in respect of the property that the seller owes to a third person which the purchaser assumes, or to which the property is subject, at the time of the sale of the property to the purchaser. Nor does the term include any indebtedness on which the purchaser is liable to the seller if such indebtedness arises subsequent to the sale of such property.

**(c) Limitation upon amount of gain.**

*(1) In general.* Except as provided by subparagraph (2) of this paragraph, the amount of gain on a reacquisition of real property, as determined under paragraph (b) of this section, shall in no case exceed-

- (i) The amount by which the price at which the real property was sold exceeded its adjusted basis at the time of the sale, as determined under §1.1011-1, reduced by
- (ii) The amount of gain on the sale of such real property which is returned as income for periods prior to the reacquisition, and by
- (iii) The amount of money and the fair market value of other property (other than obligations of the purchaser to the seller which are secured by the real property) paid or transferred by the seller in connection with the reacquisition of such real property.

*(2) Cases where limitation does not apply.* The limitation provided by subparagraph (1) of this paragraph shall not apply in a case where the selling price of property is indefinite in amount and cannot be ascertained at the time of the reacquisition of such property, as, for example, where the selling price is stated as a percentage of the profits to be realized from the development of the property which is sold. Moreover, the limitation so provided shall not apply to a reacquisition of real property occurring in a taxable year beginning before September 3, 1964, to which the provisions of this section are applied pursuant to an election under §1.1038-3.

*(3) Determination of sales price.* The price at which the real property was sold shall be, for purposes of subparagraph (1) of this paragraph, the gross sales price reduced by the selling commissions, legal fees, and other expenses incident to the sale of such property which are properly taken into account in determining gain or loss on the sale. For example, the amount of selling commissions paid by a nondealer will be deducted from the gross sales price in determining the price at which the real property was sold; on the other hand, selling commissions paid by a real estate dealer will be deducted as a business expense. Examples of other expenses incident to the sale of the property are expenses for appraisal fees, advertising expense, cost of preparing maps, recording fees, and documentary stamp taxes. Payments on indebtedness to the seller which are for interest, stated or unstated, are not included in determining the price at which the property was sold. See paragraph (b)(2)(iii) of this section.

*(4) Determination of amounts paid or transferred in connection with a reacquisition.*

(i) In general. Amounts of money or property paid or transferred by the seller of the real property in connection with the reacquisition of such property include payments of money, or transfers of property, to persons from whom the real property is reacquired as well as to other persons. Payments or transfers in connection with the reacquisition of the property do not include money or property paid or transferred by the seller to reacquire obligations of the purchaser to the seller which were received by the seller with respect to the sale of the property or which arose subsequent to the sale. Amounts of money or property paid or transferred by the seller in connection with the reacquisition of the property include payments or transfers for such items as court costs and fees for services of an attorney, master, trustee, or auctioneer, or for publication, acquiring title, clearing liens, or filing and recording.

(ii) Assumption of indebtedness. The assumption by the seller, upon reacquisition of the real property, of any indebtedness to another person which at such time is secured by such property will be considered a payment of money by the seller in connection with the reacquisition. Also, if at the time of reacquisition such property is subject to an indebtedness which is not an indebtedness of the purchaser to the seller, the seller shall be considered to have paid money, in an amount equal to such indebtedness, in connection with the reacquisition of the property. Thus, for example, if at the time of the sale the purchaser executes in connection with the sale a first mortgage to a bank and a second mortgage to the seller and at the time of reacquisition the seller reacquires the property subject to the first mortgage which he does not assume, the seller will be considered to have paid money, in an amount equal to the unpaid amount of the first mortgage, in connection with the reacquisition.

**(d) Character of gain resulting from a reacquisition.** Paragraphs (b) and (c) of this section set forth the extent to which gain shall be derived from a reacquisition to which paragraph (a) of this section applies, but the rule provided by section 1038 and this section do not affect the character of the gain so derived. The character of the gain resulting from such a reacquisition is determined on the basis of whether the gain on the original sale was returned on the installment method or, if

not, on the basis of whether title to the real property was transferred to the purchaser; and, if title was transferred to the purchaser in a deferred-payment sale, whether the reconveyance of the property to the seller was voluntary. For example, if the gain on the original sale of the reacquired property was returned on the installment method, the character of the gain on reacquisition by the seller shall be determined in accordance with the rules provided in paragraph (a) of §1.453-9. If the original sale was not on the installment method but was a deferred-payment sale, as described in §1.453-6(a), where title to the real property was transferred to the purchaser and the seller accepts a voluntary reconveyance of the property, the gain on the reacquisition shall be ordinary income; however, if the obligations satisfied are securities (as defined in section 165(g)(2)(C)), any gains resulting from the reacquisition is capital gain subject to the provisions of subchapter P of chapter 1 of the Code.

**(e) Recognition of gain.** The entire amount of the gain determined under paragraphs (b) and (c) of this section with respect to a reacquisition to which paragraph (a) of this section applies shall be recognized notwithstanding any other provision of subtitle A (relating to income taxes) of the Code.

**(f) Special rules applicable to worthless indebtedness.**

*(1) Worthlessness resulting from reacquisition.* No debt of the purchaser to the seller which was secured by the reacquired real property shall be considered as becoming worthless or partially worthless as a result of a reacquisition of such real property to which paragraph (a) of this section applies. Accordingly, no deduction for a bad debt and no charge against a reserve for bad debts shall be allowed, as a result of the reacquisition, in order to reflect the noncollectibility of any indebtedness of the purchaser to the seller which at the time of reacquisition was secured by such real property.

*(2) Indebtedness treated as worthless prior to reacquisition.*

(i) Prior taxable years. If for any taxable year ending before the taxable year in which occurs a reacquisition of real property to which paragraph (a) of this section applies the seller of such property has treated any indebtedness of the purchaser which is secured by such property as having become worthless or partially worthless by taking a bad debt deduction under section 166(a), he shall be considered as receiving, at the time of such reacquisition, income in an amount equal to the amount of such indebtedness previously treated by him as having become worthless. The amount so treated as income received shall be treated as a recovery of a bad debt previously deducted as worthless or partially worthless. Accordingly, the amount of such income shall be excluded from gross income, as provided in §1.111-1, to the extent of the "recovery exclusion" with respect to such item. For purposes of §1.111-1, if the indebtedness was treated as partially worthless in a prior taxable year, the amount treated under this subparagraph as a recovery shall be considered to be with respect to the part of the indebtedness that was previously deducted as worthless. The seller shall not be considered to have treated an indebtedness as worthless in any taxable year for which he took the standard deduction under section 141 or paid the tax imposed by section 3 if a deduction in respect of such indebtedness was not allowed in determining adjusted gross income for such year under section 62.

(ii) Current taxable year. No deduction shall be allowed under section 166(a), for the taxable year in which occurs a reacquisition of real property to which paragraph (a) of this section applies, in respect of any indebtedness of the purchaser secured by such property which has been treated by the seller as having become worthless or partially worthless in such taxable year but prior to the date of such reacquisition.

(3)*Basis adjustment.* The basis of any indebtedness described in subparagraph (2)(i) of this paragraph shall be increased (as of the date of the reacquisition) by an amount equal to the amount which, under such subparagraph of this paragraph, is treated as income received by the seller with respect to such indebtedness, but only to the extent the amount so treated as received is not excluded from gross income by reason of the application of §1.111-1.

**(g) Rules for determining gain or loss on disposition of reacquired property.**

(1)*Basis of reacquired real property.* The basis of any real property acquired in a reacquisition to which paragraph (a) of this section applies shall be the sum of the following amounts, determined as of the date of such reacquisition:

(i) The amount of the adjusted basis, determined under sections 453 and 1011, and the regulations thereunder, of all indebtedness of the purchaser to the seller which at the time of reacquisition was secured by such property, including any increase by reason of paragraph (f)(3) of this section,

(ii) The amount of gain determined under paragraphs (b) and (c) of this section with respect to such reacquisition, and

(iii) The amount of money and the fair market value of other property (other than obligations of the purchaser to the seller which are secured by the real property) paid or transferred by the seller in connection with the reacquisition of such real property, determined as provided in paragraph (c) of this section even though such paragraph does not apply to the reacquisition.

(2)*Basis of undischarged indebtedness.* The basis of any indebtedness of the purchaser to the seller which was secured by the reacquired real property described in subparagraph (1) of this paragraph, to the extent that such indebtedness is not discharged upon the reacquisition of such property, shall be zero. Therefore, to the extent not discharged upon the reacquisition of the real property, indebtedness on the original obligation of the purchaser, a substituted obligation of the purchaser, a deficiency judgment entered in a court of law into which the purchaser's obligation has merged, or any other obligation of the purchaser to the seller, shall be zero if such indebtedness constitutes an indebtedness to the seller which was secured by such property.



(3)*Holding period of reacquired property.* Since the reacquisition described in subparagraph (1) of this paragraph is in a sense considered a nullification of the original sale of the real property, for purposes of determining gain or loss on a disposition of such property after its reacquisition the period for which the seller has held the real property at

the time of such disposition shall include the period for which such property is held by him prior to the original sale. However, the holding period shall not include the period of time commencing with the date following the date on which the property is originally sold to the purchaser and ending with the date on which the property is reacquired by the seller. The period for which the property was held by the seller prior to the original sale shall be determined as provided in §1.1223-1. For example, if under paragraph (a) of §1.223-1 real property, which was acquired as the result of an involuntary conversion, has been held for five months on January 1, 1965, the date of its sale, and such property is reacquired on July 2, 1965, and resold on July 3, 1965, the seller will be considered to have held such property for five months and one day for purposes of this subparagraph.

**(h) Illustrations.** The application of this section may be illustrated by the following examples in which it is assumed that the reacquisition is in satisfaction of secured indebtedness arising out of the sale of the real property:

*Example (1).* (a) S purchases real property for \$20 and sells it to P for \$100, the property not being mortgaged at the time of sale. Under the contract P pays \$10 down and executes a note for \$90, with stated interest at 6 percent, to be paid in nine annual installments. S properly elects to report the gain on the installment method. After the second \$10 annual payment P defaults and S accepts a voluntary reconveyance of the property in complete satisfaction of the indebtedness. S pays \$5 in connection with the reacquisition of the property. The fair market value of the property at the time of the reacquisition is \$110.

(b) The gain derived by S on the reacquisition of the property is \$6, determined as follows:

Gain before application of limitation:

Money with respect to the sale received by S prior to the reacquisition	\$30
Less: Gain returned by S as income for periods prior to the reacquisition ( $\$30 \times [(\$100 - \$20)/\$100]$ )	24
Gain before application of limitation	6

Limitation on amount of gain:

Sales price of real property	100
Less:	

Adjusted basis of the property at the time of sale	\$20	
Gain returned by S as income for periods prior to the reacquisition	24	
Amount of money paid by S in connection with the reacquisition	5	49
Limitation on amount of gain		51
		6
Gain resulting from the reacquisition of the property		

(c) The basis of the reacquired real property at the date of the reacquisition is \$25, determined as follows:

Adjusted basis of P's indebtedness to S ( $\$70 - [\$70 \times \$80/\$100]$ )	\$14
Gain resulting from the reacquisition of the property	6
Amount of money paid by S in connection with the reacquisition	5
Basis of reacquired property	25

*Example (2).*(a) The facts are the same as in example (1) except that S purchased the property for \$80.

(b) The gain derived by S on the reacquisition of the property is \$9, determined as follows:

Gain before application of limitation:

Money with respect to the sale received by S prior to the reacquisition	\$30
Less: Gain returned by S as income for periods prior to the reacquisition ( $\$30 \times [(\$100 - \$80)/\$100]$ )	6
Gain before application of limitation	24

Limitation on amount of gain:

Sales price of real property	100	
Less:		
Adjusted basis of the property at the time of sale	\$80	
Gain returned by S as income for periods prior to the reacquisition	6	
Amount of money paid by S in connection with the reacquisition	5	91
Limitation on amount of gain	9	
	9	
Gain resulting from the reacquisition of the property		

(c) The basis of the reacquired real property at the date of the acquisition is \$70, determined as follows:

Adjusted basis of P's indebtedness to S ( $\$70 - [\$70 \times \$20/\$100]$ )	\$56
Gain resulting from the reacquisition of the property	9
Amount of money paid by S in connection with the reacquisition	5
Basis of reacquired property	70

*Example (3).*(a) S purchases real property for \$70 and sells it to P for \$100, the property not being mortgaged at the time of sale. Under the contract P pays \$10 down and executes a note for \$90, with stated interest at 6 percent, to be paid in nine annual installments. S properly elects to report the gain on the installment method. After the first \$10 annual payment P defaults and S accepts a voluntary reconveyance of the property in complete satisfaction of the indebtedness. S pays \$5 in connection with the reacquisition of the property. The fair market value of the property at the time of the reacquisition is \$50.

(b) The gain derived by S on the reacquisition of the property is \$14, determined as follows:

Gain before application of limitation:

Money with respect to the sale received by S prior to the reacquisition	\$20
Less: Gain returned by S as income for periods prior to the reacquisition ( $\$20 \times [(\$100 - \$70)/\$100]$ )	6
Gain before application of limitation	14

Limitation on amount of gain:

Sales price of real property		100
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Less:

Adjusted basis of the property at time of sale	\$70	
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Gain returned by S as income for periods prior to the reacquisition	6	
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Amount paid by S in connection with the reacquisition	5	81
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Limitation on amount of gain		19
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Gain resulting from the reacquisition of the property		14
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(c) The basis of the reacquired real property at the date of the reacquisition is \$75, determined as follows:

Adjusted basis of P's indebtedness to S ( $\$80 - [\$80 \times \$30/\$100]$ )	\$56
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Gain resulting from the reacquisition of the property	14
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Amount of money paid by S in connection with the reacquisition	\$5
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Basis of reacquired property	75
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*Example (4).*(a) S purchases real property for \$20 and sells it to P for \$100, the property not being mortgaged at the time of sale. Under the contract P pays \$10 down and executes a note for \$90, with stated interest at 6 percent, to be paid in nine annual installments. S properly elects to report gain on the installment method. After the second \$10 annual payment P defaults and S accepts from P in complete satisfaction of the indebtedness a voluntary reconveyance of the property plus cash in the amount of \$20. S does not pay any amount in connection with the reacquisition of the property. The fair market value of the property at the time of the reacquisition is \$30.

(b) The gain derived by S on the reacquisition of the property is \$10, determined as follows:

Gain before application of the limitation:

Money with respect to the sale received by S prior to the reacquisition ( $\$30 + \$20$ ) \$50

Less: Gain returned by S as income for periods prior to the reacquisition ( $\$50 \times [(\$100 - \$20)/\$100]$ ) 40

Gain before application of limitation 10

Limitation on amount of gain:

Sales price of real property 100

Less:

Adjusted basis of the property at time of sale \$20

Gain returned by S as income for periods prior to the reacquisition 40 60

Limitation on amount of gain 40

Gain resulting from the reacquisition of the property 10

(c) The basis of the reacquired real property at the date of the reacquisition is \$20, determined as follows:

Adjusted basis of P's indebtedness to S ( $\$50 - [\$50 \times \$80/\$100]$ )	\$10
Gain resulting from the reacquisition of the property	10
Basis of reacquired property	20

*Example (5).*(a) S purchases real property for \$80 and sells it to P for \$100, the property not being mortgaged at the time of sale. Under the contract P pays \$10 down and executes a note for \$90, with stated interest at 6 percent, to be paid in nine annual installments. At the time of sale P's note has a fair market value of \$90. S does not elect to report the gain on the installment method but treats the transaction as a deferred-payment sale. After the third \$10 annual payment P defaults and S forecloses. Under the foreclosure sale S bids in the property at \$70, cancels P's obligation of \$60, and pays \$10 to P. There are no other amounts paid by S in connection with the reacquisition of the property. The fair market value of the property at the time of the reacquisition is \$70.

(b) The gain derived by S on the reacquisition of the property is \$0, determined as follows:

Gain before application of the limitation:

Money with respect to the sale received by S prior to the reacquisition	\$40
Less: Gain returned by S as income for periods prior to the reacquisition ( $[\$10 + \$90] - \$80$ )	20
Gain before application of limitation	20

Limitation on amount of gain:

Sales price of real property		\$100
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Less:

Adjusted basis of the property at time	\$80	
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Gain return by S as income for periods prior to the reacquisition	20	
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Amount of money paid by S in connection with the reacquisition	10	110
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Limitation on amount of gain (not to be less than zero)		0
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0

Gain resulting from the reacquisition of the property

(c) The basis of the reacquired real property at the date of the reacquisition is \$70, determined as follows:

Adjusted basis of P's indebtedness to S (face value at time of reacquisition)	\$60
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Gain resulting from the reacquisition of the property	0
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Amount of money paid by S in connection with the reacquisition	10
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Basis of reacquired property	70
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