

# Mississippi State Tax Commission

## Gains – Dealings in Property

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### PURPOSE & SCOPE:

The primary purpose of this guide is to highlight major differences between federal and Mississippi income tax treatment involving the disposition of property.

### REFERENCES:

Miss. Code Ann. Section 27-7-15; Mississippi Administrative Code Title 35, Part III, Subpart 02, Chapter 03 (Gains derived from Dealings in Property)

### OVERVIEW:

A sale is a transfer of property for money and an exchange is a transfer of property for other property. While gain or loss is generally recognized in the year of sale, there are exceptions. Gain on the disposition of property may be deferred due to, among other reasons, replacement with like-kind property, transfer of the property to a controlled corporation, transfer in a corporate reorganization, or replacement of the property after an involuntary conversion.

Mississippi typically follows federal treatment on gains from dealings in property, but exceptions do exist.

#### **Capital v. Ordinary Gain Treatment:**

It is important to determine the type of gain or loss (i.e. capital v. non-capital) since a capital loss does not offset ordinary income except in the case of individuals.<sup>1</sup> In general, Mississippi follows the federal classification (i.e. capital v. non-capital) of assets. Two notable exceptions are commodities derivative financial instruments and certain contracts that constitute hedging transactions.<sup>2</sup> Miss. Code Ann. Section 27-7-99 provides a complete listing of non-capital assets.

#### **Gain & Loss: Deductions**

For federal tax purposes the tax rate applied to capital gains and losses varies depending on whether the gains and losses are long-term or short-term. Although Mississippi follows federal definitions when determining the amount of long-term and short-term gains and losses, Mississippi applies the same tax rates to all income whether ordinary or capital in nature. (*Miss. Code Ann. Section 27-7-5 & 27-7-101*).

#### **Capital Loss: Carryovers**

Mississippi follows current federal treatment in allowing a three (3) year carryback and five (5) year carryforward of a corporation's excess capital losses. The federal and Mississippi treatment are also the same for individuals. When capital losses exceed capital gains in a tax year, up to

\$3,000 (\$1,500 for married filing separate) of such excess capital loss may offset ordinary income with the rest being carried forward for as many years as needed.

*Example 1: During 2007, ABC corporation sold a piece of depreciated equipment (held for several years) for \$2,000 more than its original cost (basis), portfolio stock (held for six months) for \$1,000 more than its original cost (basis), and a piece of unimproved land (held for several years) for \$4,000 less than its original cost (basis). For the depreciable equipment which is an IRC Section 1245 asset, the amount of gain related to recapture of the depreciation expense is ordinary in nature. Only the true gain (increase from original cost basis) is capital in nature. Previously, ABC corporation had a taxable short-term capital gain of \$600 in 2004.*

*For federal and Mississippi tax purposes, the net long-term capital loss equals <\$2,000> (Gain from equipment minus loss from land) and the net short-term capital gain equals \$1,000 (gain on sale of stock). These two are netted resulting in a net long-term capital loss of <\$1,000>. Since ABC is a corporation, the loss is carried back three (3) years and in this case the long-term capital loss of <\$1,000> will offset the \$600 of short-term capital gain reported in 2004 resulting in a refund claim. The unused loss of <\$400> will be carried to 2005 and so on until the capital loss is either exhausted or expires.*

## DEFERRAL OF GAINS

### **Deferral of Gain: Involuntary conversion**

Mississippi follows the federal treatment of sales or exchanges of property involving involuntary conversions including the 5 year extended property acquisition period for the hurricane Katrina disaster area. (*Miss. Code Ann. Section 27-7-9(f)(6) references I.R.C. 1033*) In general, the replacement period is 2 years after the close of the tax year in which the disposition of the converted property occurs<sup>3</sup>.

A difference between Mississippi and federal treatment occurs when there is a conversion for public use. Mississippi law provides that gain shall not be recognized on property which is compulsorily or involuntarily converted for public use under Miss. Code Ann. Section 11-27-1 et. seq. or any federal law relating to the involuntary conversion of property for public use. In addition, gain is not recognized when property is voluntarily converted for public use after it becomes evident that eminent domain proceedings are probable. The owner's holding period of the converted property must be at least three years including the prior owner's holding period if the property was acquired by bequest, devise, gift, or inheritance.

### **Deferral of Gain: Like-Kind Exchanges**

Mississippi follows the federal treatment of deferring gain on like-kind exchanges of property (*I.R.C. Section 1031*).

### **Deferral of Gain: Installment Sales**

Mississippi does not follow the federal installment method of recognizing gain on the casual sales of property. Gain or profit from installment sales is recognized (i.e. included in taxable income) for Mississippi tax purposes in the year of sale even though the gain may not be recognized for federal tax purposes.

*Example 2: ABC corporation, a software producer, sold a piece of land in Lowndes county during the tax year. The tax basis and realized gain, \$100,000, in the property is the same for*

*both state and federal tax purposes. The total sales price is \$120,000 to be received over four years in equal installments starting with the year of sale. For federal tax purposes \$25,000 of gain is recognized each year a payment is received, but for Mississippi the total gain of \$100,000 is recognized in the year of sale.*

While gain is recognized in full in the year of sale, the Mississippi tax on such gain is deferred in the same manner as the recognition of gain is deferred for federal tax purposes under I.R.C. Section 453. Deferred tax payments are required to be made as installment payments are received.

*Example 3: ABC corporation, a software producer, sold a piece of land in Lowndes county during the tax year. The tax basis was \$20,000 and the realized gain was \$100,000 for both state and federal tax purposes. The total sales price is \$120,000 to be received over four years in equal installments starting with the year of sale. In addition, ABC corporation had \$80,000 of ordinary income in the year of sale.*

*ABC corporation's taxable income in the year of sale is \$180,000 resulting in a total tax liability of \$8,850. However, since the tax payment on the installment sale is deferred, the required tax payment for the year is \$5,100 (tax on \$105,000).*

Although the tax on the gain may be deferred, a multi-state taxpayer's apportionment ratio for the year of sale should be used to determine the Mississippi gain regardless of when the tax is actually paid.

While tax on the gain may be deferred initially, such deferral is lost if the installment note or other right to the proceeds is sold, contributed, transferred or disposed of in any manner and for any purpose by the original note holder or if the original note holder is merged, liquidated, dissolved or withdrawn from this state.

*Example 4: Assume the same facts as in example 3 except that ABC corporation distributed the note to its shareholder in the year after sale. In this situation the remainder of the tax on the installment sale, \$3,750 (tax due in the year of sale, \$8850, less the tax paid, \$5,100) becomes due and payable in the tax year the note was distributed.*

### **Election to defer payment of tax for an installment sale**

If the taxpayer has elected out or is precluded from using the installment method (I.R.C. Section 453), or is otherwise required to recognize gain for federal tax purposes, then there will not be a deferral of Mississippi income taxes. A taxpayer may also elect out of the Mississippi tax deferral by paying all taxes for the period in question. Otherwise, the taxpayer will be considered to have made an election to defer the payment of Mississippi income taxes.

If the installment sale is reported by an S corporation, partnership, or other flow-through entity, the election will be automatic for all shareholders, partners, etc. An election out of deferring the tax payment can be made on an individual shareholder, partner, or member basis.

### **Exclusion of Gain: Personal Residence**

Mississippi follows the federal treatment on the disposition of a personal residence. Subject to qualifications, a person may exclude up to \$500,000 (\$250,000 for married filing separate status) of gain on the sale of a personal residence.

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<sup>1</sup> Individuals are allowed to offset up to \$3,000 (\$1,500 for married filing separate) of capital losses per year against ordinary income.

<sup>2</sup> For federal tax purposes the income or loss from such contracts is ordinary in nature, but for Mississippi the income or loss is capital in nature. As such, Mississippi code does not provide ordinary gain treatment for dealers using mark-to-market accounting for commodities derivative financial instruments. However, commodities derivative financial instruments do not include regulated exchange I.R.C. Section 1256 contracts where the value or settlement price is calculated in reference to a specific index.

<sup>3</sup> Federal code provides other limited exceptions to the two year qualifying period. Since Mississippi has adopted I.R.C. Section 1033, these exceptions would apply for state purposes as well.