



Eminent Domain Taxation Information

| | If the proceeds are for ... | ... then the tax treatment is |
|---|---|--|
| (1) How are eminent domain payments taxed? | (a) principal or vacation residence | Long-term capital gain if held for more than 1 year (23.8% federal, up to 12.3% California) |
| | (b) property used for agriculture, investment, or business, and buildings | Long-term capital gain if held for more than 1 year (23.8% federal (28.8% to extent of “recapture” of prior depreciation), up to 12.3% California) |
| | (c) depreciable other property (fences, orchard trees, etc.) | Ordinary income to extent of “recapture” of prior depreciation (up to 37% federal, 12.3% California) |
| | (d) annual crops (nuts/ fruit on trees, “in ground”, etc.) | Ordinary income as if owner had harvested and sold the crops (up to 37% federal, 12.3% California) |
| | (e) relocation expenses | Not taxable |
| (2) Can I exclude (or at least defer) taxable gains or income in “(1)(a)” through “(1)(d)” above? | (a) In “(1)(a)” above, you may be able to exclude up to \$500,000 of gain for a principal residence (but not a vacation home) depending on how long you occupied it under Internal Revenue Code (“Code”) section 121 (https://www.law.cornell.edu/uscode/text/26/121) | |
| | (b) In “(1)(b)” and “(1)(c)” above, you may be able to defer tax under Code section 1033 (https://www.law.cornell.edu/uscode/text/26/1033) if you use the eminent domain proceeds to purchase replacement property used for business or investment, or “similar in use” to the property condemned, within 2 years after the year in which you received the proceeds (though you can ask the IRS for one and perhaps even two 1-year extensions) | |
| | (c) In “(1)(a)” or “(1)(d)” above, you may be able to defer tax under Code section 1033 if you use the eminent domain proceeds to purchase property “similar in use” to the property condemned | |
| (3) What if part of my property is condemned, and I receive additional “severance” damages for the diminution in value of the rest? | Under IRS Revenue Ruling 83-49 (https://www.exeterco.com/1031_exchange_revenue_ruling_83_49), you would allocate your “basis” in the overall property (i.e., original purchase cost, plus additional investment, less depreciation) to the parcel you keep and the parcel you don’t keep based on their relative fair market values; reduce the basis allocated to the property you keep (but not below zero) by the severance damages; and treat any remaining severance damages as gain. You can defer this gain under Code section 1033, under the same principles as in “(2)(b)” and “(2)(c)” above. (Revenue Ruling 83-49 gives an example of how this calculation works.) | |
| (4) Can I keep my lower assessed value for California property tax purposes from the property I lost if I acquire replacement property?? | Generally yes, provided you apply to the assessor’s office of the county where your replacement property is located and the replacement property is “similar in size, utility, and function” to the property taken. “[S]imilar in size” for this purpose means that the value of the replacement property is no more than 1.2 times the value of the property taken. For more information see California Board of Equalization (“BOE”) Rule 462.500 (available at https://www.boe.ca.gov/proptaxes/pdf/rules/Rule462_500.pdf) and sample BOE Form 68 Claim for Base Year Value Transfer – Acquisition by Public Entity (each county will have its own form) (available at https://www.boe.ca.gov/proptaxes/pdf/sample_boe68.pdf) | |

The information provided is not legal advice, but rather is only intended as a general overview of some of the key points relating to tax treatment of proceeds and deferrals in eminent domain situations. Someone seeking legal advice on these matters should consult his/her attorney or tax advisor for guidance on his/her particular facts and circumstances.

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