

125(a)(1) of the Internal Revenue Code of 1939.

(c) *Municipal bonds.* In the case of a municipal bond (as defined in section 75(b)), basis shall be adjusted to the extent provided in section 75 or as provided in section 22(o) of the Internal Revenue Code of 1939, and the regulations thereunder.

(d) *Sale or exchange of residence.* Where the acquisition of a new residence results in the nonrecognition of any part of the gain on the sale, or exchange, or involuntary conversion of the old residence, the basis of the new residence shall be reduced by the amount of the gain not so recognized pursuant to section 1034(a), or section 112(n) of the Internal Revenue Code of 1939, and the regulations thereunder. See section 1034(e) and the regulations thereunder.

(e) *Loans from Commodity Credit Corporation.* In the case of property pledged to the Commodity Credit Corporation, the basis of such property shall be increased by the amount received as a loan from such corporation and treated by the taxpayer as income for the year in which received under section 77, or under section 123 of the Internal Revenue Code of 1939. The basis of such property shall be reduced to the extent of any deficiency on such loan with respect to which the taxpayer has been relieved from liability.

(f) *Deferred development and exploration expenses.* Expenditures for development and exploration of mines or mineral deposits treated as deferred expenses under sections 615 and 616, or under the corresponding provisions of prior income tax laws, are chargeable to capital account and shall be an adjustment to the basis of the property to which they relate. The basis so adjusted shall be reduced by the amount of such expenditures allowed as deductions which results in a reduction for any taxable year of the taxpayer's taxes under subtitle A (other than chapter 2 relating to tax on self-employment income) of the Code, or prior income, war-profits, or excess-profits tax laws, but not less than the amounts allowable under such provisions for the taxable year and prior years. This amount is considered as the *tax-benefit amount allowed* and shall be determined

in accordance with paragraph (e) of § 1.1016-3. For example, if a taxpayer purchases unexplored and undeveloped mining property for \$1,000,000 and at the close of the development stage has incurred exploration and development costs of \$9,000,000 treated as deferred expenses, the basis of such property at such time for computing gain or loss will be \$10,000,000. Assuming that the taxpayer in this example has operated the mine for several years and has deducted allowable percentage depletion in the amount of \$2,000,000 and has deducted allowable deferred exploration and development expenditures of \$2,000,000, the basis of the property in the taxpayer's hands for purposes of determining gain or loss from a sale will be \$6,000,000.

(g) *Sale of land with unharvested crop.* In the case of an unharvested crop which is sold, exchanged, or involuntarily converted with the land and which is considered as property used in the trade or business under section 1231, the basis of such crop shall be increased by the amount of the items which are attributable to the production of such crop and which are disallowed, under section 268, as deductions in computing taxable income. The basis of any other property shall be decreased by the amount of any such items which are attributable to such other property, notwithstanding any provisions of section 1016 or of this section to the contrary. For example, if the items attributable to the production of an unharvested crop consist only of fertilizer costing \$100 and \$50 depreciation on a tractor used only to cultivate such crop, and such items are disallowed under section 268, the adjustments to the basis of such crop shall include an increase of \$150 for such items and the adjustments to the basis of the tractor shall include a reduction of \$50 for depreciation.

(h) *Consent dividends.* (1) In the case of amounts specified in a shareholder's consent to which section 28 of the Internal Revenue Code of 1939 applies, the basis of the consent stock shall be increased to the extent provided in subsection (h) of such section.

(2) In the case of amounts specified in a shareholder's consent to be treated as a consent dividend to which section 565

applies, the basis of the consent stock shall be increased by the amount which, under section 565(c)(2), is treated as contributed to the capital of the corporation.

(i) *Stock in foreign personal holding company.* In the case of the stock of a United States shareholder in a foreign personal holding company, basis shall be adjusted to the extent provided in section 551(f) or corresponding provisions of prior income tax laws.

(j) *Research and experimental expenditures.* Research and experimental expenditures treated as deferred expenses under section 174(b) are chargeable to capital account and shall be an adjustment to the basis of the property to which they relate. The basis so adjusted shall be reduced by the amount of such expenditures allowed as deductions which results in a reduction for any taxable year of the taxpayer's taxes under subtitle A (other than chapter 2 relating to tax on self-employment income) of the Code, or prior income, war-profits, or excess-profits tax laws, but not less than the amounts allowable under such provisions for the taxable year and prior years. This amount is considered as the *tax-benefit amount allowed* and shall be determined in accordance with paragraph (e) of § 1.1016-3.

(k) *Deductions disallowed in connection with disposal of coal or domestic iron ore.* Basis shall be adjusted by the amount of the deductions disallowed under section 272 with respect to the disposal of coal or domestic iron ore covered by section 631.

(l) *Expenditures attributable to grants or loans covered by section 621.* In the case of expenditures attributable to a grant or loan made to a taxpayer by the United States for the encouragement of exploration for, or development or mining of, critical and strategic minerals or metals, basis shall be adjusted to the extent provided in section 621, or in section 22(b)(15) of the Internal Revenue Code of 1939.

(m) *Trademark and trade name expenditures.* Trademark and trade name expenditures treated as deferred expenses under section 177 are chargeable to capital account and shall be an adjustment to the basis of the property to which they relate. The basis so ad-

justed shall be reduced by the amount of such expenditures allowed as deductions which results in a reduction for any taxable year of the taxpayer's taxes under subtitle A (other than chapter 2, relating to tax on self-employment income) of the Code, but not less than the amounts allowable under such section for the taxable year and prior years. This amount is considered as the *tax-benefit amount allowed* and shall be determined in accordance with paragraph (e) of § 1.1016-3.

(n) *Life insurance companies.* In the case of any evidence of indebtedness referred to in section 818(b), the basis shall be adjusted to the extent of the adjustments required under section 818(b) (or the corresponding provisions of prior income tax laws) for the taxable year and all prior taxable years. The basis of any such evidence of indebtedness shall be reduced by the amount of the adjustment required under section 818(b) (or the corresponding provision of prior income tax laws) on account of amortizable premium and shall be increased by the amount of the adjustment required under section 818(b) on account of accruable discounts.

(o) *Stock and indebtedness of electing small business corporation.* In the case of a shareholder of an electing small business corporation, as defined in section 1371(b), the basis of the shareholder's stock in such corporation, and the basis of any indebtedness of such corporation owing to the shareholder, shall be adjusted to the extent provided in §§ 1.1375-4, 1.1376-1, and 1.1376-2.

(p) *Gift tax paid on certain property acquired by gift.* Basis shall be adjusted by that amount of the gift tax paid in respect of property acquired by gift which, under section 1015(d), is an increase in the basis of such property.

(q) *Section 38 property.* In the case of property which is or has been section 38 property (as defined in section 48(a)), the basis shall be adjusted to the extent provided in section 48(g) and in section 203(a)(2) of the Revenue Act of 1964.

(r) *Stock in controlled foreign corporations and other property.* In the case of stock in controlled foreign corporations (or foreign corporations which were controlled foreign corporations)

and of property by reason of which a person is considered as owning such stock, the basis shall be adjusted to the extent provided in section 961.

(s) *Original issue discount.* In the case of certain corporate obligations issued at a discount after May 27, 1969, the basis shall be increased under section 1232(a)(3)(E) by the amount of original issue discount included in the holder's gross income pursuant to section 1232(a)(3).

(t) *Section 23 credit.* In the case of property with respect to which a credit has been allowed under section 23 or former section 44C (relating to residential energy credit), basis shall be adjusted as provided in paragraph (k) of § 1.23-3.

(u) *Gas guzzler tax.* In the case of an automobile upon which the gas guzzler tax was imposed, the basis shall be reduced as provided in section 1016 (d).

[T.D. 6500, 25 FR 11910, Nov. 26, 1960]

EDITORIAL NOTE: For FEDERAL REGISTER citations affecting § 1.1016-5, see the List of CFR Sections Affected in the Finding Aids section of this volume.

**§ 1.1016-6 Other applicable rules.**

(a) Adjustments must always be made to eliminate double deductions or their equivalent. Thus, in the case of the stock of a subsidiary company, the basis thereof must be properly adjusted for the amount of the subsidiary company's losses for the years in which consolidated returns were made.

(b) In determining basis, and adjustments to basis, the principles of estoppel apply, as elsewhere under the Code, and prior internal revenue laws.

**§ 1.1016-7 Adjusted basis; cancellation of indebtedness under Bankruptcy Act.**

(a) In addition to the adjustments provided in section 1016, further adjustment is required in the case of a cancellation or deduction of indebtedness in any proceeding under chapters X, XI, or XII of the Bankruptcy Act (11 U.S.C. chapter 10, 11, and 12) and corresponding provisions of prior law. For exceptions to the above rule see sections 372, 373, 374, and 1018. Furthermore, no such further adjustment will be made in the case of a *wage earner* as that term is defined in section 606(8) of

the Bankruptcy Act (11 U.S.C. 1006 (8)). The further adjustments required by this section shall be made in the following manner and order:

(1) In the case of indebtedness incurred to purchase specific property (other than inventory or notes or accounts receivable whether or not a lien is placed against such property securing the payment of all or part of such indebtedness, which indebtedness shall have been canceled or reduced in any such proceeding, the cost or other basis of such property shall be decreased (but not below its fair market value) by the amount by which the indebtedness so incurred with respect to such property shall have been canceled or reduced;

(2) In the case of specific property (other than inventory or notes or accounts receivable) against which, at the time of the cancellation or reduction of the indebtedness, there is a lien (other than a lien securing indebtedness incurred to purchase such property) the cost or other basis of such property shall be decreased (but not below its fair market value) by the amount by which the indebtedness secured by such lien shall have been canceled or reduced;

(3) Any excess of the total amount by which the indebtedness shall have been so canceled or reduced in such proceeding over the sum of the adjustments made under subparagraphs (1) and (2) of this paragraph shall next be applied to reduce the cost or other basis of the property of the debtor (other than inventory and notes and accounts receivable, but including property covered by such subparagraphs) as follows: The cost or other basis of each unit of property shall be decreased (but not below its fair market value) in an amount equal to such proportion of such excess as the adjusted basis (after adjustment under subparagraphs (1) and (2) of this paragraph) of each such unit of property bears to the sum of the adjusted bases (after adjustment under such subparagraphs) of all the property of the debtor other than inventory and notes and accounts receivable;

(4) Any excess of the total amount by which such indebtedness shall have been so canceled or reduced over the sum of the adjustments made under subparagraphs (1), (2), and (3), of this

paragraph shall next be applied to reduce the cost or other basis of any units of property covered by such subparagraphs which have a remaining basis (after adjustment under such subparagraphs) greater than their fair market value, as follows: the cost or other basis of each such unit of property shall be decreased (but not below its fair market value) in an amount equal to such proportion of such excess as the remaining basis of each such unit bears to the sum of the remaining basis of such units. The process shall be repeated until the cost or other basis of each unit of the property covered by subparagraphs (1), (2), and (3) of this paragraph is reduced to its fair market value or the amount by which the indebtedness shall have been canceled or reduced is exhausted, taking into account in the successive steps only those units of property having, after the preceding adjustment, a remaining basis greater than their fair market value; and

(5) Any excess of the total amount by which the indebtedness shall have been so canceled or reduced over the sum of the adjustments made under subparagraphs (1), (2), (3), and (4) of this paragraph shall next be applied to reduce the cost or other basis of inventory and notes and accounts receivable as follows: the cost or other basis of inventory or notes or accounts receivable, as the case may be, shall be decreased (but not below its fair market value) in an amount equal to such proportion of such excess as the adjusted basis of inventory, notes receivable or accounts receivable, as the case may be, bears to the sum of the adjusted bases of such inventory and notes and accounts receivable. The process shall be repeated until the adjusted bases of inventory, notes receivable, and accounts receivable are reduced to their fair market value or the amount by which the indebtedness shall have been canceled or reduced is exhausted, taking into account in the successive steps only those units of property having, after the preceding adjustment, a remaining basis greater than their fair market value.

(b) For the purposes of this section:

(1) Basis shall be determined as of the dates of entry of the order confirming

the plan, composition, or arrangement under which such indebtedness shall have been canceled or reduced;

(2) Except where the context otherwise requires, property means all of the debtor's property, other than money;

(3) No adjustment shall be made by virtue of the cancellation or reduction of any accrued interest unpaid which shall not have resulted in a tax benefit in any income tax return;

(4) The phrase *indebtedness incurred to purchase* includes (i) indebtedness for money borrowed and applied in the purchase of property and (ii) an existing indebtedness secured by a lien against the property which the debtor, as purchaser of such property, has assumed to pay; and

(5) The term *fair market value* has reference to such value as of the date of entry of the order confirming the plan, composition, or arrangement under which such indebtedness shall have been canceled or reduced.

(c) Any determination of value in a proceeding under the Bankruptcy Act (11 U.S.C. 1 et seq.), shall not constitute a determination of fair market value for the purpose of this section.

(d) The basis of any of the debtor's property which shall have been transferred to a person required to use the debtor's basis in whole or in part shall be determined in accordance with the provisions of this section.

**§ 1.1016-8 Adjusted basis; cancellation of indebtedness; special cases.**

If the taxpayer and the Commissioner agree, the basis of the taxpayer's property may be adjusted in a manner different from that set forth in § 1.1016-7. Variations from such rule may, for example involve adjusting the basis of any part of the taxpayer's property or adjusting the basis of all the taxpayer's property, according to a fixed allocation. Agreement between the taxpayer and the Commissioner as to any variation from such general rule shall be effected only by a closing agreement entered into under the provisions of section 7121.

**§ 1.1016-9 Adjusted basis; mutual savings banks, building and loan associations, and cooperative banks.**

(a) The adjustments to the cost or other basis of property provided in section 1016 and §§ 1.1016-1 to 1.1016-8, inclusive, are applicable in the case of a mutual savings bank not having capital stock represented by shares, a domestic building and loan association, and a cooperative bank without capital stock organized and operated for mutual purposes and without profit, although such institutions were exempt from tax for taxable years beginning before January 1, 1952. Proper adjustment must be made under section 1016 for the entire period since the acquisition of property. Thus, adjustment to basis must be made for depreciation sustained for all prior taxable years although such institution may have been exempt from tax during such years. Similarly, in the case of tax-exempt and partially taxable bonds purchased at a premium and subject to amortization under section 171, proper adjustment to basis must be made to reflect amortization with respect to such premium from the date of acquisition of the bond (or in the case of bonds not issued with interest coupons, or in registered form, from the date such bonds are subject to amortization under section 171).

(b) The application of paragraph (a) of this section may be illustrated by the following example:

*Example.* On January 1, 1954, Z, a mutual savings bank, which keeps its books on a calendar year basis, owns a tax-exempt \$1,000 noncallable bond maturing on January 1, 1964. Such bond was acquired by Z on January 1, 1934, for \$1,300. It was sold by Z on December 31, 1954, for \$1,250. The yearly rate of amortization of the premium, determined by dividing the total premium of \$300 by the life of the bond (30 years) is \$10. Z realizes a gain of \$80 from such sale computed as follows:

(1) Cost of bond .....	\$1,300
(2) Amount of bond premium attributable to years 1942 through 1951, during which Z was exempt from tax (\$10 times 10 years) .....	\$100
(3) Amount of bond premium amortized from Jan. 1, 1952, through Dec. 31, 1954 (\$10 times 3 years) .....	30
(4) Total amount of adjustments to basis (aggregate of (2) and (3)) .....	130

(5) Adjusted basis of bond at close of 1954 ((1) reduced by (4)) .....

1,170

(6) Gain realized upon sale—excess of sale price over adjusted basis (\$1,250 minus \$1,170) .....

80

The basis of a fully taxable bond purchased at a premium shall be adjusted from the date to which the election applies to amortize such premium in accordance with the provisions of section 171, except that no adjustment shall be allowable for such portion of the premium attributable to the period prior to the election.

(c) In the case of a mortgage (not within the definition of section 171(d)) purchased, acquired, or originated at a premium, where the principal of such mortgage is payable in installments, adjustments to the basis of the premium must be made for all taxable years (whether or not the institution was exempt from tax during such years) in which installment payments are received. Such adjustments may be made on an individual mortgage basis or on a composite basis by reference to the average period of payments of the mortgage loans of such institution. For the purpose of this adjustment, the term *premium* includes the excess of the acquisition value of the mortgage over its maturity value. The acquisition value of the mortgage is the cost including buying commissions, attorneys' fees, or brokerage fees, but such value does not include amounts paid for accrued interest. For the method of amortization in the case of corporate mortgages purchased, acquired, or originated at a premium, see paragraph (e) of § 1.171-2.

**§ 1.1016-10 Substituted basis.**

(a) Whenever it appears that the basis of property in the hands of the taxpayer is a substituted basis, as defined in section 1016(b), the adjustments indicated in §§ 1.1016-1 to 1.1016-6, inclusive, shall be made after first making in respect of such substituted basis proper adjustments of a similar nature in respect of the period during which the property was held by the transferor, donor, or grantor, or during which the other property was held by the person for whom the basis is to be determined. In addition, whenever it appears that the basis of property in the hands of the taxpayer is a substituted basis, as defined in section

1016(b)(1), the adjustments indicated in §§ 1.1016-7 to 1.1016-9, inclusive, and in section 1017 shall also be made, whenever necessary, after first making in respect of such substituted basis a proper adjustment of a similar nature in respect of the period during which the property was held by the transferor, donor, or grantor. Similar rules shall also be applied in the case of a series of substituted bases.

(b) The application of this section may be illustrated by the following example:

*Example.* A, who makes his returns upon the calendar year basis, in 1935 purchased the X Building and subsequently gave it to his son B. B exchanged the X Building for the Y Building in a tax-free exchange, and then gave the Y Building to his wife C. C, in determining the gain from the sale or disposition of the Y Building in 1954, is required to reduce the basis of the building by deductions for depreciation which were successively allowed (but not less than the amount allowable) to A and B upon the X Building and to B upon the Y Building, in addition to the deductions for depreciation allowed (but not less than the amount allowable) to herself during her ownership of the Y Building.

**§ 1.1017-1 Adjusted basis; discharge of indebtedness; general rule.**

(a) In addition to the adjustments provided in section 1016 and the regulations thereunder which are required to be made with respect to the cost or other basis of property, and except as otherwise provided in section 372(a), 373(b)(2), or 1018, a further adjustment shall be made in any case in which there shall have been an exclusion from gross income under section 108(a) on account of a discharge of indebtedness during the taxable year. Such further adjustments shall, except as otherwise provided in § 1.1017-2, be made in the following manner and order (but in the case of an individual, subparagraphs (1) to (4), inclusive, of this paragraph, shall apply only to property used in any trade or business of such individual):

(1) In the case of indebtedness incurred to purchase specific property (other than inventory or notes or accounts receivable), whether or not a lien is placed against such property securing the payment of all or part of such indebtedness, which indebtedness

shall have been discharged, the cost or other basis of such property shall be decreased by an amount equal to the amount excluded from gross income under section 108(a) and attributable to the discharge of the indebtedness so incurred with respect to such property;

(2) In the case of specific property (other than inventory or notes or accounts receivable) against which, at the time of the discharge of the indebtedness, there is a lien (other than a lien securing indebtedness incurred to purchase such property), the cost or other basis of such property shall be decreased by an amount equal to the amount excluded from gross income under section 108(a) and attributable to the discharge of the indebtedness secured by such lien;

(3) Any excess of the total amount excluded from gross income under section 108(a) over the sum of the adjustments made under subparagraphs (1) and (2) of this paragraph shall next be applied to reduce the cost or other basis of all the property of the debtor (other than inventory and notes and accounts receivable) as follows: The cost or other basis of each unit of property shall be decreased in an amount equal to such proportion of such excess as the adjusted basis (without reference to this section) of each such unit of property bears to the sum of adjusted bases (without reference to this section) of all the property of the debtor other than inventory and notes and accounts receivable;

(4) Any excess of the total amount excluded from gross income under section 108(a) over the sum of the adjustments made under subparagraphs (1), (2), and (3) of this paragraph shall next be applied to reduce the cost or other basis of inventory and notes and accounts receivable, as follows: The cost or other basis of inventory or notes or accounts receivable, as the case may be, shall be decreased in an amount equal to such proportion of such excess as the adjusted basis of inventory, notes receivable or accounts receivable, as the case may be, bears to the sum of the adjusted bases of such inventory and notes and accounts receivable;

(5) In the case of an individual, any excess of the total amount excluded