

he makes no other charitable contributions. If C had sold the property at its fair market value at the time of its contribution, it is assumed that under section 1245 \$4,000 of the gain of \$6,000 (\$10,000 value - \$4,000 adjusted basis) would have been treated as ordinary income. Thus, there would have been long-term capital gain of \$2,000. It is also assumed that the church does not put the property to an unrelated use, as defined in paragraph (b)(3) of §1.170A-4. Under paragraph (b) of this section the adjusted basis for determining gain on the bargain sale is \$1,600 (\$4,000 adjusted basis × \$4,000 amount realized / \$10,000 value of property). Accordingly, C has a recognized gain of \$2,400 (\$4,000 amount realized - \$1,600 adjusted basis) on the bargain sale, consisting of ordinary income of \$1,600 (\$4,000 ordinary income × \$4,000 amount realized / \$10,000 value of property) and of long-term capital gain of \$800 (\$2,000 long-term gain × \$4,000 amount realized / \$10,000 value of property). After applying section 1011(b) and paragraphs (a) and (c)(2)(i) of §1.170A-4, C is allowed a charitable contributions deduction for 1970 of \$3,600 (\$6,000 gift - [\$4,000 ordinary income × \$6,000 value of gift / \$10,000 value of property]).

*Example 8.* (a) On January 1, 1970, A, a male of age 65, transfers capital assets consisting of securities held for more than 6 months to a church in exchange for a promise by the church to pay A a nonassignable annuity of \$5,000 per year for life. The annuity is payable monthly with the first payment to be made on February 1, 1970. A's contribution base for 1970, as defined in section 170(b)(1)(F), is \$200,000, and during that year he makes no other charitable contributions. On the date of transfer the securities have a fair market value of \$100,000 and an adjusted basis to A of \$20,000.

(b) The present value of the right of a male age 65 to receive a life annuity of \$5,000 per annum, payable in equal installments at the end of each monthly period, is \$59,755 (\$5,000 × [1.469 + 0.482]), determined in accordance with section 101(b) of the Code, paragraph (e)(1)(iii)(b)(2) of §1.101-2, and section 3 of Rev. Rul. 62-216, C.B. 1962-2, 30. Thus, A makes a charitable contribution to the church of \$40,245 (\$100,000 - \$59,755). See Rev. Rul. 84-162, 1984-2 C.B. 200, for transfers for which the valuation date falls after November 23, 1984. (See §601.601(d)(2)(ii)(b) of this chapter). For the applicable valuation tables in connection therewith, see §20.2031-7(d)(6) of this chapter. See, however, §1.7520-3(b) (relating to exceptions to the use of standard actuarial factors in certain circumstances).

(c) Under paragraph (b) of this section, the adjusted basis for determining gain on the bargain sale is \$11,951 (\$20,000 × \$59,755 / \$100,000). Accordingly, A has a recognized long-term capital gain of \$47,804 (\$59,755 - \$11,951) on the bargain sale. Such gain is to be reported by A ratably over the period of

years measured by the expected return multiple under the contract, but only from that portion of the annual payments which is a return of his investment in the contract under section 72 of the Code. For such purposes, the investment in the contract is \$59,755, that is, the present value of the annuity.

(d) The computation and application of the exclusion ratio, the gain, and the ordinary annuity income are as follows, determined by using the expected return multiple of 15.0 applicable under table I of §1.72-9:

A's expected return (annual payments of \$5,000 × 15) .....	\$75,000.00
Exclusion ratio (\$59,755 investment in contract divided by expected return of \$75,000) .....	79.7%
Annual exclusion (annual payments of \$5,000 × 79.7%) .....	\$3,985.00
Ordinary annuity income (\$5,000 - \$3,985) .....	\$1,015.00
Long-term capital gain per year (\$47,804/15) with respect to the annual exclusion .....	\$3,186.93

(e) The exclusion ratio of 79.7 percent applies throughout the life of the contract. During the first 15 years of the annuity, A is required to report ordinary income of \$1,015 and long-term capital gain of \$3,186.93 with respect to the annuity payments he receives. After the total long-term capital gain of \$47,804 has been reported by A, he is required to report only ordinary income of \$1,015.00 per annum with respect to the annuity payments he receives.

(d) *Effective date.* This section applies only to sales and exchanges made after December 19, 1969.

(e) *Cross reference.* For rules relating to the treatment of liabilities on the sale or other disposition or encumbered property, see §1.1001-2.

[T.D. 7207, 37 FR 20798, Oct. 5, 1972, as amended by T.D. 7741, 45 FR 81745, Dec. 12, 1980; T.D. 8176, 53 FR 5570, Feb. 25, 1988; 53 FR 11002, Apr. 4, 1988; T.D. 8540, 59 FR 30148, June 10, 1994]

### § 1.1012-1 Basis of property.

(a) *General rule.* In general, the basis of property is the cost thereof. The cost is the amount paid for such property in cash or other property. This general rule is subject to exceptions stated in subchapter O (relating to gain or loss on the disposition of property), subchapter C (relating to corporate distributions and adjustments), subchapter K (relating to partners and partnerships), and subchapter P (relating to capital gains and losses), chapter 1 of the code.

(b) *Real estate taxes as part of cost.* In computing the cost of real property,

the purchaser shall not take into account any amount paid to the seller as reimbursement for real property taxes which are treated under section 164(d) as imposed upon the purchaser. This rule applies whether or not the contract of sale calls for the purchaser to reimburse the seller for such real estate taxes paid or to be paid by the seller. On the other hand, where the purchaser pays (or assumes liability for) real estate taxes which are treated under section 164(d) as imposed upon the seller, such taxes shall be considered part of the cost of the property. It is immaterial whether or not the contract of sale specifies that the sale price has been reduced by, or is in any way intended to reflect, real estate taxes allocable to the seller under section 164(d). For illustrations of the application of this paragraph, see paragraph (b) of § 1.1001-1.

(c) *Sale of stock*—(1) *In general.* If shares of stock in a corporation are sold or transferred by a taxpayer who purchased or acquired lots of stock on different dates or at different prices, and the lot from which the stock was sold or transferred cannot be adequately identified, the stock sold or transferred shall be charged against the earliest of such lots purchased or acquired in order to determine the cost or other basis of such stock and in order to determine the holding period of such stock for purposes of subchapter P, chapter 1 of the code. If, on the other hand, the lot from which the stock is sold or transferred can be adequately identified, the rule stated in the preceding sentence is not applicable. As to what constitutes “adequate identification”, see subparagraphs (2), (3), and (4) of this paragraph.

(2) *Identification of stock.* An adequate identification is made if it is shown that certificates representing shares of stock from a lot which was purchased or acquired on a certain date or for a certain price were delivered to the taxpayer’s transferee. Except as otherwise provided in subparagraph (3) or (4) of this paragraph, such stock certificates delivered to the transferee constitute the stock sold or transferred by the taxpayer. Thus, unless the requirements of subparagraph (3) or (4) of this paragraph are met, the stock sold or

transferred is charged to the lot to which the certificates delivered to the transferee belong, whether or not the taxpayer intends, or instructs his broker or other agent, to sell or transfer stock from a lot purchased or acquired on a different date or for a different price.

(3) *Identification on confirmation document.* (i) Where the stock is left in the custody of a broker or other agent, an adequate identification is made if—

(a) At the time of the sale or transfer, the taxpayer specifies to such broker or other agent having custody of the stock the particular stock to be sold or transferred, and

(b) Within a reasonable time thereafter, confirmation of such specification is set forth in a written document from such broker or other agent.

Stock identified pursuant to this subdivision is the stock sold or transferred by the taxpayer, even though stock certificates from a different lot are delivered to the taxpayer’s transferee.

(ii) Where a single stock certificate represents stock from different lots, where such certificate is held by the taxpayer rather than his broker or other agent, and where the taxpayer sells a part of the stock represented by such certificate through a broker or other agent, an adequate identification is made if—

(a) At the time of the delivery of the certificate to the broker or other agent, the taxpayer specifies to such broker or other agent the particular stock to be sold or transferred, and

(b) Within a reasonable time thereafter, confirmation of such specification is set forth in a written document from such broker or agent.

Where part of the stock represented by a single certificate is sold or transferred directly by the taxpayer to the purchaser or transferee instead of through a broker or other agent, an adequate identification is made if the taxpayer maintains a written record of the particular stock which he intended to sell or transfer.

(4) *Stock held by a trustee, executor, or administrator.* Where stock is held by a trustee or by an executor or administrator of an estate (and not left in the custody of a broker or other agent), an adequate identification is made if at

the time of a sale, transfer, or distribution, the trustee, executor, or administrator—

(i) Specifies in writing in the books and records of the trust or estate the particular stock to be sold, transferred, or distributed, and

(ii) In the case of a distribution, also furnishes the distributee with a written document setting forth the particular stock distributed to him.

Stock identified pursuant to this subparagraph is the stock sold, transferred, or distributed by the trust or estate, even though stock certificates from a different lot are delivered to the purchaser, transferee, or distributee.

(5) *Subsequent sales.* If stock identified under subparagraph (3) or (4) of this paragraph as belonging to a particular lot is sold, transferred, or distributed, the stock so identified shall be deemed to have been sold, transferred, or distributed, and such sale, transfer, or distribution will be taken into consideration in identifying the taxpayer's remaining stock for purposes of subsequent sales, transfers, or distributions.

(6) *Bonds.* The provisions of subparagraphs (1) through (5) of this paragraph shall apply to the sale or transfer of bonds after July 13, 1965.

(7) *Book-entry securities.* (i) In applying the provisions of subparagraph (3)(i)(a) of this paragraph in the case of a sale or transfer of a book-entry security (as defined in subdivision (iii) (a) of this subparagraph) which is made after December 31, 1970, pursuant to a written instruction by the taxpayer, a specification by the taxpayer of the unique lot number which he has assigned to the lot which contains the securities being sold or transferred shall constitute specification as required by such subparagraph. The specification of the lot number shall be made either—

(a) In such written instruction, or

(b) In the case of a taxpayer in whose name the book entry by the Reserve Bank is made, in a list of lot numbers with respect to all book-entry securities on the books of the Reserve Bank sold or transferred on that date by the taxpayer, provided such list is mailed to or received by the Reserve Bank on or before the Reserve Bank's next business day.

This subdivision shall apply only if the taxpayer assigns lot numbers in numerical sequence to successive purchases of securities of the same loan title (series) and maturity date, except that securities of the same loan title (series) and maturity date which are purchased at the same price on the same date may be included within the same lot.

(ii) In applying the provisions of subparagraph (3)(i)(b) of this paragraph in the case of a sale or transfer of a book-entry security which is made pursuant to a written instruction by the taxpayer, a confirmation as required by such subparagraph shall be deemed made by—

(a) In the case of a sale or transfer made after December 31, 1970, the furnishing to the taxpayer of a written advice of transaction, by the Reserve Bank or the person through whom the taxpayer sells or transfers the securities, which specifies the amount and description of the securities sold or transferred and the date of the transaction, or

(b) In the case of a sale or transfer made before January 1, 1971, the furnishing of a serially-numbered advice of transaction by a Reserve Bank.

(iii) For purposes of this subparagraph:

(a) The term *book-entry security* means—

(1) In the case of a sale or transfer made after December 31, 1970, a transferable Treasury bond, note, certificate of indebtedness, or bill issued under the Second Liberty Bond Act (31 U.S.C. 774 (2)), as amended, or other security of the United States (as defined in (b) of this subdivision (iii)) in the form of an entry made as prescribed in 31 CFR part 306, or other comparable Federal regulations, on the records of a Reserve Bank, or

(2) In the case of a sale or transfer made before January 1, 1971, a transferable Treasury bond, note, certificate of indebtedness, or bill issued under the Second Liberty Bond Act, as amended, in the form of an entry made as prescribed in 31 CFR part 306, subpart O, on the records of a Reserve Bank which is deposited in an account with a Reserve Bank (i) as collateral pledged to a

Reserve Bank (in its individual capacity) for advances by it, (ii) as collateral pledged to the United States under Treasury Department Circular No. 92 or 176, both as revised and amended, (iii) by a member bank of the Federal Reserve System for its sole account for safekeeping by a Reserve Bank in its individual capacity, (iv) in lieu of a surety or sureties upon the bond required by section 61 of the Bankruptcy Act, as amended (11 U.S.C. 101), of a banking institution designated by a judge of one of the several courts of bankruptcy under such section as a depository for the moneys of a bankrupt's estate, (v) pursuant to 6 U.S.C. 15, in lieu of a surety or sureties required in connection with any recognition, stipulation, bond, guaranty, or undertaking which must be furnished under any law of the United States or regulations made pursuant thereto, (vi) by a banking institution, pursuant to a State or local law, to secure the deposit in such banking institution of public funds by a State, municipality, or other political subdivision, (vii) by a State bank or trust company or a national bank, pursuant to a State or local law, to secure the faithful performance of trust or other fiduciary obligations by such State bank or trust company or national bank, or (viii) to secure funds which are deposited or held in trust by a State bank or trust company or a national bank and are awaiting investment, but which are used by such State bank or trust company or national bank in the conduct of its business;

(b) The term *other security of the United States* means a bond, note, certificate of indebtedness, bill, debenture, or similar obligation which is subject to the provisions of 31 CFR part 306 or other comparable Federal regulations and which is issued by (1) any department or agency of the Government of the United States, or (2) the Federal National Mortgage Association, the Federal Home Loan Banks, the Federal Home Loan Mortgage Corporation, the Federal Land Banks, the Federal Intermediate Credit Banks, the Banks for Cooperatives, or the Tennessee Valley Authority;

(c) The term *serially-numbered advice of transaction* means the confirmation

(prescribed in 31 CFR 306.116) issued by the Reserve Bank which is identifiable by a unique number and indicates that a particular written instruction to the Reserve Bank with respect to the deposit or withdrawal of a specified book-entry security (or securities) has been executed; and

(d) The term *Reserve Bank* means a Federal Reserve Bank and its branches acting as Fiscal Agent of the United States.

(d) *Obligations issued as part of an investment unit.* For purposes of determining the basis of the individual elements of an investment unit (as defined in paragraph (b)(2)(ii)(a) of §1.1232-3) consisting of an obligation and an option (which is not an excluded option under paragraph (b)(1)(iii)(c) of §1.1232-3), security, or other property, the cost of such investment unit shall be allocated to such individual elements on the basis of their respective fair market values. In the case of the initial issuance of an investment unit consisting of an obligation and an option, security, or other property, where neither the obligation nor the option, security, or other property has a readily ascertainable fair market value, the portion of the cost of the unit which is allocable to the obligation shall be an amount equal to the issue price of the obligation as determined under paragraph (b)(2)(ii)(a) of §1.1232-3.

(e) *Election as to certain regulated investment company stock—(1) General rule—(i) In general.* Notwithstanding paragraph (c) of this section, and except as provided in subdivision (ii) of this subparagraph, if—

(a) Shares of stock of a regulated investment company (as defined in subparagraph (5) of this paragraph) are left by a taxpayer in the custody of a custodian or agent in an account maintained for the acquisition or redemption of shares of such company, and

(b) The taxpayer purchased or acquired shares of stock held in the account at different prices or bases, the taxpayer may elect to determine the cost or other basis of shares of stock he sells or transfers from such account by using one of the methods described in subparagraphs (3) and (4) of this paragraph. The cost or other basis determined in accordance with either of

such methods shall be known as the *average basis*. For purposes of this paragraph, securities issued by unit investment trusts shall be treated as shares of stock and the term *share* or *shares* shall include fractions of a share.

(ii) *Certain gift shares.* (a) Except as provided in subdivision (b) of this subdivision (ii), this paragraph shall not apply to any account which contains shares which were acquired by the taxpayer by gift after December 31, 1920, if the basis of such shares (adjusted for the period before the date of the gift as provided in section 1016) in the hands of the donor or the last preceding owner by whom it was not acquired by gift was greater than the fair market value of such shares at the time of the gift. However, shares acquired by a taxpayer as a result of a taxable dividend or a capital gain distribution from such an account may be included in an account to which this paragraph applies.

(b) Notwithstanding the provisions of subdivision (a) of this subdivision (ii), this paragraph shall apply with respect to accounts containing gift shares described in such subdivision (a) if, at the time the election described in this paragraph is made in the manner prescribed in subparagraph (6) of this paragraph, the taxpayer includes a statement, in writing, indicating that the basis of such gift shares shall be the fair market value of such gift shares at the time they were acquired by the taxpayer by gift and that such basis shall be used in computing average basis in the manner described in subparagraph (3) or (4) of this paragraph. Such statement shall be effective with respect to gift shares acquired prior to making such election and with respect to gift shares acquired after such time and shall remain in effect so long as such election remains in effect.

(2) *Determination of average basis.* Average basis shall be determined using either the method described in subparagraph (3) of this paragraph (the double-category method) or the method described in subparagraph (4) of this paragraph (the single-category method). The taxpayer shall specify, in the manner described in subparagraph (6) of this paragraph, the method used. Such method shall be used with respect

to an account until such time as the election is revoked with the consent of the Commissioner. Although a taxpayer may specify different methods with respect to accounts in different regulated investment companies, the same method shall be used with respect to all of the taxpayer's accounts in the same regulated investment company.

(3) *Double-category method—(i) In general.* In determining average basis using the double category method, all shares in an account at the time of each sale or transfer shall be divided into two categories. The first category shall include all shares in such account having, at the time of the sale or transfer, a holding period of more than 1-year (6-months for taxable years beginning before 1977; 9-months for taxable years beginning in 1977) (the "more-than 1-year (6-months for taxable years beginning before 1977; 9-months for taxable years beginning in 1977)" category), and the second category shall include all shares in such account having, at such time, a holding period of 1-year (6-months for taxable years beginning before 1977; 9-months for taxable years beginning in 1977) or less (the "1-year (6-months for taxable years beginning before 1977; 9-months for taxable years beginning in 1977)-or-less" category). The cost or other basis of each share in a category shall be an amount equal to the remaining aggregate cost or other basis of all shares in that category at the time of the sale or transfer divided by the aggregate number of shares in that category at such time.

(ii) *Order of disposition of shares old or transferred.* Prior to a sale or transfer of shares from such an account, the taxpayer may specify, to the custodian or agent having custody of the account, from which category (described in subdivision (i) of this subparagraph) the shares are to be sold or transferred. Shares shall be deemed sold or transferred from the category specified without regard to the stock certificates, if any, actually delivered if, within a reasonable time thereafter, confirmation of such specification is set forth in a written document from the custodian or agent having custody of the account. In the absence of such specification or confirmation, shares sold or transferred shall be charged

against the more-than-1-year (6-months for taxable years beginning before 1977; 9-months for taxable years beginning in 1977) category. However, if the number of shares sold or transferred exceeds the number in such category, the additional shares sold or transferred shall be charged against the shares in the 1-year (6-months for taxable years beginning before 1977; 9-months for taxable years beginning in 1977)-or-less category. Any gain or loss attributable to a sale or transfer which is charged against shares in the more-than-1-year (6-months for taxable years beginning before 1977; 9-months for taxable years beginning in 1977) category shall constitute long-term gain or loss, and any gain or loss attributable to a sale or transfer which is charged against shares in the 1-year (6-months for taxable years beginning before 1977; 9-months for taxable years beginning in 1977)-or-less category shall constitute short-term gain or loss. As to adjustments from wash sales, see section 1091(d) and subdivisions (iii) (c) and (d) of this subparagraph.

(iii) *Special rules with respect to shares from the 1 year-or-less category.* (a) After the taxpayer's holding period with respect to a share is more than 1-year (6-months for taxable years beginning before 1977; 9-months for taxable years beginning in 1977), such share shall be changed from the 1-year (6-months for taxable years beginning before 1977; 9-months for taxable years beginning in 1977)-or-less category to the more-than-1-year (6-months for taxable years beginning before 1977; 9-months for taxable years beginning in 1977) category. For purposes of such change, the basis of a changed share shall be its actual cost or other basis to the taxpayer or its basis determined in accordance with the rules contained in subdivision (b)(2) of this subdivision (iii) if the rules of such subdivision (b)(2) are applicable.

(b) If, during the period that shares are in the 1-year (6-months for taxable years beginning before 1977; 9-months for taxable years beginning in 1977)-or-less category some but not all of the shares in such category are sold or transferred, then—

(1) The shares sold or transferred (the basis of which was determined in the manner prescribed by subdivision (i) of

this subparagraph) shall be assumed to be those shares in such category which were earliest purchased or acquired, and

(2) The basis of those shares which are not sold or transferred and which are changed from the 1-year (6-months for taxable years beginning before 1977; 9-months for taxable years beginning in 1977)-or-less category to the more-than-1-year (6-months for taxable years beginning before 1977; 9-months for taxable years beginning in 1977) category shall be the average basis of the shares in the 1-year (6-months for taxable years beginning before 1977; 9-months for taxable years beginning in 1977)-or-less category at the time of the most recent sale or transfer of shares from such category. For such purposes, the average basis shall be determined in the manner prescribed in subdivision (i) of this subparagraph.

(c) Paragraph (a) of § 1.1091-2 contains examples which illustrate the general application of section 1091(d), relating to unadjusted basis in the case of a wash sale of stock. However, in the case of certain wash sales of stock from the 1-year (6-months for taxable years beginning before 1977; 9-months for taxable years beginning in 1977)-or-less category, the provisions of section 1091(d) shall be applied in the manner described in subdivision (d) of this subdivision (iii).

(d) In the case of a wash sale of stock (determined in accordance with the provisions of section 1091) from the 1-year (6-months for taxable years beginning before 1977; 9-months for taxable years beginning in 1977)-or-less category which occurs after the acquisition of shares of stock into such category, the aggregate cost or other basis of all shares remaining in the 1-year (6-months for taxable years beginning before 1977; 9-months for taxable years beginning in 1977)-or-less category after such sale shall be increased by the amount of the loss which is not deductible because of the provisions of section 1091 and the regulations thereunder. The provisions of this subdivision may be illustrated by the following example:

*Example:* Assume the following acquisitions to, and sale from, the 1-year (6-months for taxable years beginning before 1977; 9-

**Internal Revenue Service, Treasury**

**§ 1.1012-1**

months for taxable years beginning in 1977)-or-less category:

**1-YEAR (6-MONTHS FOR TAXABLE YEARS BEGINNING BEFORE 1977; 9-MONTHS FOR TAXABLE YEARS BEGINNING IN 1977)-OR-LESS CATEGORY**

Date	Action	Number shares	Price/share	Aggregate
1-5-71 .....	Purchase ..	10	\$110	\$1,100
2-5-71 .....	.....do .....	10	100	1,000
3-5-71 .....	.....do .....	10	90	900
Average ....	.....	30	100	3,000
3-15-71 ....	Sale .....	10	90	900
	Loss .....	10	10	100

In this example, the unadjusted basis of the shares remaining in the account after the sale is \$2,000 (aggregate basis of \$3,000 before the sale, less \$1,000, the aggregate basis of the shares sold after the averaging of costs). The adjusted basis of the shares remaining in the 1-year (6-months for taxable years beginning before 1977; 9-months for taxable years beginning in 1977)-or-less category after the sale and after adjustment is \$2,100 (the unadjusted basis of \$2,000, plus the \$100 loss resulting from the sale).

(4) *Single-category method*—(i) *In general.* In determining average basis using the single-category method, the cost or other basis of all shares in an account at the time of each sale or transfer (whether such shares have a holding period of more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977) or 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977)-or-less) shall be used in making the computation. The cost or other basis of each share in such account shall be an amount equal to the remaining aggregate cost or other basis of all shares in such account at the time of the sale or transfer divided by the aggregate number of shares in such account at such time.

(ii) *Order of disposition of shares sold or transferred.* In the case of the sale or transfer of shares from an account to which the election provided by this paragraph applies, and with respect to which the taxpayer has specified that he uses the single-category method of determining average basis, shares sold or transferred shall be deemed to be those shares first acquired. Thus, when shares are sold or transferred from an

account such shares will be those with a holding period of more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977) to the extent that such account contains shares with a holding period of more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977). If the number of shares sold or transferred exceeds the number of shares in the account with a holding period of more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977), any such excess shares sold or transferred will be deemed to be shares with a holding period of 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977) or less. Any gain or loss attributable to shares held for more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977) shall constitute long-term gain or loss, and any gain or loss attributable to shares held for 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977) or less shall constitute short-term gain or loss. For example, if a taxpayer sells or transfers 50 shares from an account containing 100 shares with a holding period of more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977) and 100 shares with a holding period of 6 months or less, all of the shares sold or transferred will be deemed to be shares with a holding period of more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977). If, however, the account contains 40 shares with a holding period of more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977) and 100 shares with a holding period of 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977) or less, the taxpayer will be deemed to have sold or transferred 40 shares with a holding period of more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977) and 10

shares with a holding period of 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977) or less.

(iii) *Restriction on use of single-category method.* The single-category method of determining average basis shall not be used where it appears from the facts and circumstances that a purpose of using such single-category method is to convert long-term capital gains or losses to short-term capital gains or losses or to convert short-term capital gains or losses to long-term capital gains or losses.

(iv) *Wash sales.* The provisions of section 1091(d) (relating to unadjusted basis in the case of a wash sale of stock) and the regulations thereunder shall apply in the case of wash sales of stock from an account with respect to which the single-category method of determining average basis is being used.

(5) *Definition.* (i) For purposes of this paragraph, a *regulated investment company* means any domestic corporation (other than a personal holding company as defined in section 542) which meets the limitations of section 851(b) and § 1.851-2, and which is registered at all times during the taxable year under the Investment Company Act of 1940, as amended (15 U.S.C. 80a-1 to 80b-2), either as a management company, or as a unit investment trust.

(ii) Notwithstanding subdivision (i), this paragraph shall not apply in the case of a unit investment trust unless it is one—

(a) Substantially all of the assets of which consist (1) of securities issued by a single management company (as defined in such Act) and securities acquired pursuant to subdivision (b) of this subdivision (ii), or (2) securities issued by a single other corporation, and

(b) Which has no power to invest in any other securities except securities issued by a single other management company, when permitted by such Act or the rules and regulations of the Securities and Exchange Commission.

(6) *Election.* (i) An election to adopt one of the methods described in this paragraph shall be made in an income tax return for the first taxable year ending on or after December 31, 1970,

for which the taxpayer desires the election to apply. If the taxpayer does not file a timely return (taking into account extensions of the time for filing) for such taxable year, the election shall be filed at the time the taxpayer files his first return for such year. The election may be made with an amended return only if such amended return is filed no later than the time prescribed by law (including extensions thereof) for filing the return for such taxable year. If the election is made, the taxpayer shall clearly indicate on his income tax return for each year to which the election is applicable that an average basis has been used in reporting gain or loss from the sale or transfer of shares sold or transferred. In addition, the taxpayer shall specify on such return the method (either the single-category method or the double-category method) used in determining average basis. The taxpayer shall also indicate in a statement described in subparagraph (1)(ii)(b) of this paragraph if the election is to apply to accounts described in subparagraph (1)(ii) of this paragraph. Such statement shall be attached to, or incorporated in, such return. A taxpayer making the election shall maintain such records as are necessary to substantiate the average basis (or bases) used on his income tax return.

(ii) An election made with respect to some of the shares of a regulated investment company sold or transferred from an account described in subparagraph (1)(i) of this paragraph applies to all such shares in the account. Such election also applies to all shares of that regulated investment company held in other such accounts (i.e., those described in subparagraph (1)(i) of this paragraph) by the electing taxpayer for his own benefit. Thus, the election shall apply to all shares of the regulated investment company held by the electing taxpayer (for his own benefit) in such accounts on or after the first day of the first taxable year for which the election is made. Such election does not apply to shares held in accounts described in subparagraph (1)(ii) of this paragraph unless the taxpayer indicates, in the manner described in subdivision (i) of this subparagraph, that the election is to apply to shares

**Internal Revenue Service, Treasury**

**§ 1.1012-1**

held in such accounts. An election made pursuant to the provisions of this paragraph may not be revoked without the prior written permission of the Commissioner.

(7) *Examples.* The provisions of this paragraph may be illustrated by the following examples:

*Example 1.* (i) On January 11, 1971, taxpayer A, who files his income tax return on a calendar year basis, enters into an agreement with the W Bank establishing an account for the periodic acquisition of shares of the Y Company, an open-end mutual fund. The agreement provides (1) that the bank is to purchase, for A, shares of Y stock as A may from time to time direct, (2) that all shares in the account are to be left in the custody of the bank, and (3) that the bank is to reinvest any dividends paid by Y (including capital gain dividends) in additional shares of Y stock. Pursuant to the agreement, on January 11, 1971, February 1, 1971, and March 1, 1971, respectively, the bank purchases, at A's direction, 100 shares of Y stock for a total of \$1,880, 20 shares of Y stock for a total of \$400, and 20 shares of Y stock for a total of \$410. On March 15, 1971, the bank reinvests a \$1-per-share capital gain dividend (that is, a total of \$140) in seven additional shares of Y stock. The acquisitions to A's account, are, therefore, as follows:

Date	Number of shares	Basis
January 11, 1971 .....	100	\$1,880
February 1, 1971 .....	20	400
March 1, 1971 .....	20	410
March 15, 1971 .....	7	140

On August 20, 1971, at A's direction, the bank redeems (i.e., sells) 40 shares of Y stock, and on September 20, 1971, 30 shares. A elects to determine the gain or loss from the sales of the stock by reference to its average basis using the double-category method of determining average basis. A did not specify from which category the sales were to take place, and therefore, each sale is deemed to have been made from the more-than-6-months category.

(ii) The average basis for the shares sold on August 20, 1971, is \$19, and the total average basis for the 40 shares which are sold is \$760, computed as follows:

Number of shares in the more-than-6-months category at the time of sale	Basis
100 .....	\$1,880
20 .....	400
Total 120 .....	2,280

Average cost or other basis:  $\$2,280 \div 120 = \$19.40$  shares  $\times$  \$19 each = \$760, total average

basis. Therefore, after the sale on August 20, 1971, 80 shares remain in the more-than-6-months category, and their remaining aggregate cost is \$1,520.

(iii) The average basis for the shares sold on September 20, 1971, must reflect the sale which was made on August 20, 1971. Accordingly, such average basis would be \$19.35 and may be computed as follows:

Number of shares in the more-than-6-months category at the time of sale	Basis
80 .....	\$1,520
20 .....	410
7 .....	140
Total 107 .....	2,070

Average cost or other basis:  $\$2,070 \div 107$  shares = \$19.35 (to the nearest cent).

*Example 2.* Taxpayer B, who files his income tax returns on a calendar year basis, enters into an agreement with the X Bank establishing an account for the periodic acquisition of shares of the Z Company, an open-end mutual fund. X acquired for B's account shares of Z on the following dates in the designated amounts:

January 15, 1971 .....	50 shares.
February 16, 1971 .....	30 shares.
March 15, 1971 .....	25 shares.

Pursuant to B's direction, the Bank redeemed (i.e., sold) 25 shares from the account on February 1, 1971, and 20 shares on April 1, 1971, for a total of 45 shares. All of such shares had been held for less than 6 months. B elects to determine the gain or loss from the sales of the stock by reference to its average basis using the double-category method of determining average basis. Thus, the 45 shares which were sold are assumed to be from the 50 shares which were purchased on January 15, 1971. Accordingly, on July 16, 1971, only five shares from those shares which had been purchased on January 15, 1971, remain to be transferred from the 6-months-or-less category to the more-than-6-months category. The basis of such five shares for purposes of the change to the more-than-6-months category would be the average basis of the shares in the 6-months-or-less category at the time of the sale on April 1, 1971.

*Example 3.* Assume the same facts as in example (2), except that an additional sale of 18 shares was made on May 3, 1971. There were, therefore, a total of 63 shares sold during the 6-month period beginning on January 15, 1971, the date of the earliest purchase. Fifty of the shares which were sold during such period shall be assumed to be the shares purchased on January 15, 1971, and the remaining 13 shares shall be assumed to be from the shares which were purchased on February 16, 1971. Thus, none of the shares which were purchased on January 15, 1971, remain to be changed from the 6-months-or-less category

to the more-than-6-months category. In the absence of further dispositions of shares during the 6-month holding period for the shares purchased on February 16, 1971, there would be 17 of such shares to be changed over after the expiration of that period since 13 of the shares sold on May 3, 1971, were assumed to be from the shares purchased on February 16, 1971. The basis of the 17 shares for purposes of the change to the more-than-6-months category would be the average basis of the shares in the 6-months-or-less category at the time of the sale on May 3, 1971.

*Example 4.* Taxpayer C, who files his income tax returns on a calendar year basis, enters into an agreement with Y Bank establishing an account for the periodic acquisition of XYZ Company, a closed-end mutual fund. Y acquired for B's account shares of XYZ on the following dates in the designated amounts:

Date	Number of shares	Cost
January 8, 1971 .....	25	\$200
February 8, 1971 .....	24	200
March 8, 1971 .....	23	200
April 8, 1971 .....	23	200

Pursuant to C's direction, the bank redeemed (i.e., sold) 40 shares from the account on July 15, 1971, for \$10 per share or a total of \$400. C elects to determine the gain or loss from the sale of the stock by reference to its average basis using the single-category method of determining average basis. The average basis for the shares sold on July 15, 1971 (determined by dividing the total number of shares in the account at such time (95) into the aggregate cost of such shares (\$800)) is \$8.42 (to the nearest cent). Under the rules of subparagraph (4) of this paragraph the shares sold would be deemed to be those first acquired. Thus, C would realize a \$39.50 ( $\$1.58 \times 25$ ) long-term capital gain with respect to the 25 shares acquired on January 8, 1971, and he would realize a \$23.70 ( $\$1.58 \times 15$ ) short-term capital gain with respect to 15 of the shares acquired on February 8, 1971. The next sale occurred on August 16, 1971. At that time, absent further intervening acquisitions or dispositions, the account contained nine shares (the 24 shares acquired on February 8, 1971, less 15 of such shares which were sold on July 15, 1971) with a holding period of more than 6 months, and 46 shares with a holding period of 6 months or less.

*Example 5.* Taxpayer D owns four separate accounts (D-1, D-2, D-3, and D-4) for the periodic acquisition of shares of the Y Company, an open-end mutual fund. Account D-4 contains shares which D acquired by gift on April 15, 1970. These shares had an adjusted basis in the hands of the donor which was greater than the fair market value of the donated shares on such date. For his taxable year ending on December 31, 1971, D elects to

use an average basis for shares sold from account D-1 during such year using the single-category method of determining average basis. Under the provisions of subparagraph (1)(ii) of this paragraph, D may use an average basis for shares sold or transferred from account D-4 if he includes with his statement of election a statement, in writing, indicating that the basis of such gift shares in account D-4 shall be the fair market value of such shares at the time he acquired such shares and that such basis shall be used in computing the average basis of shares in account D-4. In addition, since D elected to use an average basis for shares sold from account D-1, he must also use an average basis for all shares sold or transferred from accounts D-2 and D-3 (as well as account D-1) for his taxable year ending on December 31, 1971, and for all subsequent years until he revokes (with the consent of the Commissioner) his election to use an average basis for such accounts. Further, D must use the single-category method of determining average basis with respect to accounts D-2, D-3 (and D-4 if the above-mentioned statement is filed).

(f) *Special rules.* For special rules for determining the basis for gain or loss in the case of certain vessels acquired through the Maritime Commission (or its successors) or pursuant to an agreement with the Secretary of Commerce, see sections 510, 511, and 607 of the Merchant Marine Act, 1936, as amended (46 U.S.C. 1160, 1161) and parts 2 and 3 of this chapter. For special rules for determining the unadjusted basis of property recovered in respect of war losses, see section 1336. For special rules with respect to taxable years beginning before January 1, 1964, for determining the basis for gain or loss in the case of a disposition of a share of stock acquired pursuant to the timely exercise of a restricted stock option where the option price was between 85 percent and 95 percent of the fair market value of the stock at the time the option was granted, see paragraph (b) of § 1.421-5. See section 423(c)(1) or 424(c)(1), whichever is applicable, for special rules with respect to taxable years ending after December 31, 1963, for determining the basis for gain or loss in the case of the disposition of a share of stock acquired pursuant to the timely exercise of a stock option described in such sections. See section 422(c)(1) for special rules with respect to taxable years ending after December 31, 1963, for determining the basis for gain or

loss in the case of an exercise of a qualified stock option.

(g) *Debt instruments issued in exchange for property*—(1) *In general.* For purposes of paragraph (a) of this section, if a debt instrument is issued in exchange for property, the cost of the property that is attributable to the debt instrument is the issue price of the debt instrument as determined under §1.1273-2 or §1.1274-2, whichever is applicable. If, however, the issue price of the debt instrument is determined under section 1273(b)(4), the cost of the property attributable to the debt instrument is its stated principal amount reduced by any unstated interest (as determined under section 483).

(2) *Certain tax-exempt obligations.* This paragraph (g)(2) applies to a tax-exempt obligation (as defined in section 1275(a)(3)) that is issued in exchange for property and that has an issue price determined under §1.1274-2(j) (concerning tax-exempt contingent payment obligations and certain tax-exempt variable rate debt instruments subject to section 1274). Notwithstanding paragraph (g)(1) of this section, if this paragraph (g)(2) applies to a tax-exempt obligation, for purposes of paragraph (a) of this section, the cost of the property that is attributable to the obligation is the sum of the present values of the noncontingent payments (as determined under §1.1274-2(c)).

(3) *Effective date.* This paragraph (g) applies to sales or exchanges that occur on or after August 13, 1996.

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

EDITORIAL NOTE: For FEDERAL REGISTER citations affecting §1.1012-1, see the List of CFR Sections Affected in the printed volume, 26 CFR part 600-end, and on GPO Access.

#### § 1.1012-2 Transfers in part a sale and in part a gift.

For rules relating to basis of property acquired in a transfer which is in part a gift and in part a sale, see §§1.170A-4(c), 1.1011-2(b), and §1.105-4.

[T.D. 7207, 37 FR 20799, Oct. 5, 1972]

#### § 1.1013-1 Property included in inventory.

The basis of property required to be included in inventory is the last inven-

tory value of such property in the hands of the taxpayer. The requirements with respect to the valuation of an inventory are stated in subpart D (section 471 and following), part II, subchapter E, chapter 1 of the Code, and the regulations thereunder.

#### § 1.1014-1 Basis of property acquired from a decedent.

(a) *General rule.* The purpose of section 1014 is, in general, to provide a basis for property acquired from a decedent which is equal to the value placed upon such property for purposes of the Federal estate tax. Accordingly, the general rule is that the basis of property acquired from a decedent is the fair market value of such property at the date of the decedent's death, or, if the decedent's executor so elects, at the alternate valuation date prescribed in section 2032, or in section 811(j) of the Internal Revenue Code of 1939. Property acquired from a decedent includes, principally, property acquired by bequest, devise, or inheritance, and, in the case of decedents dying after December 31, 1953, property required to be included in determining the value of the decedent's gross estate under any provision of the Internal Revenue Code of 1954 or the Internal Revenue Code of 1939. The general rule governing basis of property acquired from a decedent, as well as other rules prescribed elsewhere in this section, shall have no application if the property is sold, exchanged, or otherwise disposed of before the decedent's death by the person who acquired the property from the decedent. For general rules on the applicable valuation date where the executor of a decedent's estate elects under section 2032, or under section 811(j) of the Internal Revenue Code of 1939, to value the decedent's gross estate at the alternate valuation date prescribed in such sections, see paragraph (e) of §1.1014-3.

(b) *Scope and application.* With certain limitations, the general rule described in paragraph (a) of this section is applicable to the classes of property described in paragraphs (a) and (b) of §1.1014-2, including stock in a DISC or former DISC. In the case of stock in a DISC or former DISC, the provisions of this section and §§1.1014-2 through