

Internal Revenue Service, Treasury

§ 1.1245-2

extent such amount was applied to adjust the amount of the deductions allowed or allowable to the partner for depreciation or amortization of section 1245 property attributable to periods referred to in paragraph (a)(2) of § 1.1245-2. The terms *allowed or allowable, depreciation or amortization, and attributable to periods* shall have the meanings assigned to these terms in paragraph (a) of § 1.1245-2.

(4) The application of subparagraph (3) of this paragraph may be illustrated by the following example:

Example: A, B, and C each hold a one-third interest in calendar year partnership ABC. On December 31, 1962, the firm holds section 1245 property which has an adjusted basis of \$30,000 and a recomputed basis of \$33,000. Depreciation deductions in respect of the property for 1962 were \$3,000. On January 1, 1963, when D purchases C's partnership interest, the election under section 754 is in effect and a \$5,000 special basis adjustment is made in respect of D to his one-third share of the common partnership adjusted basis for the property. For 1963 and 1964 the partnership deducts \$6,000 as depreciation in respect of the property, thereby reducing its adjusted basis to \$24,000, and D deducts \$2,800, i.e., his distributive share of partnership depreciation (\$2,000) plus depreciation in respect of his special basis adjustment (\$800). On March 15, 1965, the partnership sells the property for \$48,000. Since the partnership's recomputed basis for the property (\$33,000, i.e., \$24,000 adjusted basis plus \$9,000 in depreciation deductions) is lower than the amount realized upon the sale (\$48,000), the excess of recomputed basis over adjusted basis, or \$9,000, is treated as partnership gain under section 1245(a)(1). D's distributive share of such gain is \$3,000 (1/3 of \$9,000). However, the amount of gain recognized by D under section 1245 (a)(1) is only \$2,800, determined as follows:

(1) Adjusted basis:		
D's portion of partnership adjusted basis (1/3 of \$24,000)	\$8,000	
D's special basis adjustment as of December 31, 1964 (\$5,000 minus \$800)	4,200	
D's adjusted basis	\$12,200	
(2) Recomputed basis:		
D's adjusted basis	12,200	
D's portion of partnership depreciation for 1963 and 1964, i.e., for periods after he acquired his partnership interest (1/3 of \$6,000)	2,000	
Depreciation for 1963 and 1964 in respect of D's special basis adjustment	800	
D's recomputed basis	15,000	

(3) D's portion of amount realized by partnership (1/3 of \$48,000)	16,000
(4) Gain recognized to D under section 1245(a)(1), i.e., the lower of (2) or (3), minus (1)	2,800

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§ 1.1245-2 Definition of recomputed basis.

(a) *General rule*—(1) *Recomputed basis defined.* The term *recomputed basis* means, with respect to any property, an amount equal to the sum of:

- (i) The adjusted basis of the property, as defined in section 1011, plus
- (ii) The amount of the adjustments reflected in the adjusted basis.

(2) *Definition of adjustments reflected in adjusted basis.* The term *adjustments reflected in the adjusted basis* means:

- (i) With respect to any property other than property described in subdivision (ii), (iii), or (iv) of this subparagraph, the amount of the adjustments attributable to periods after December 31, 1961,
- (ii) With respect to an elevator or escalator, the amount of the adjustments attributable to periods after June 30, 1963,
- (iii) With respect to livestock (described in subparagraph (4) of § 1.1245-3(a)), the amount of the adjustments attributable to periods after December 31, 1969, or
- (iv) [Reserved]

which are reflected in the adjusted basis of such property on account of deductions allowed or allowable for depreciation or amortization (within the meaning of subparagraph (3) of this paragraph). For cases where the taxpayer can establish that the amount allowed for any period was less than the amount allowable, see subparagraph (7) of this paragraph. For determination of adjusted basis of property in a multiple asset account, see paragraph (c)(3) of § 1.167(a)-8.

(3) *Meaning of depreciation or amortization.* (i) For purposes of subparagraph (2) of this paragraph, the term *depreciation or amortization* includes allowances (and amounts treated as allowances) for depreciation (or amortization in lieu thereof), and deductions for amortization of emergency facilities under

section 168. Thus, for example, such term includes a reasonable allowance for exhaustion, wear and tear (including a reasonable allowance for obsolescence) under section 167, an expense allowance (additional first-year depreciation allowance for property placed in service before January 1, 1981), under section 179, an expenditure treated as an amount allowed under section 167 by reason of the application of section 182(d)(2)(B) (relating to expenditures by farmers for clearing land), and a deduction for depreciation of improvements under section 611 (relating to depletion). For further examples, the term *depreciation or amortization* includes periodic deductions referred to in § 1.162-11 in respect of a specified sum paid for the acquisition of a leasehold and in respect of the cost to a lessee of improvements on property of which he is the lessee. However, such term does not include deductions for the periodic payment of rent.

(ii) The provisions of this subparagraph may be illustrated by the following example:

Example: On January 1, 1966, Smith purchases for \$1,000, and places in service, an item of property described in section 1245(a)(3)(A). Smith deducts an additional first-year allowance for depreciation under section 179 of \$200. Accordingly, the basis of the property for purposes of depreciation is \$800 on January 1, 1966. Between that date and January 1, 1974, Smith deducts \$640 in depreciation (the amount allowable) with respect to the property, thereby reducing its adjusted basis to \$160. Since this adjusted basis reflects deductions for depreciation and amortization (within the meaning of this subparagraph) amounting to \$840 (\$200 plus \$640), the recomputed basis of the property is \$1,000 (\$160 plus \$840).

(4) *Adjustments of other taxpayers or in respect of other property.* (i) For purposes of subparagraph (2) of this paragraph, the adjustments reflected in adjusted basis on account of depreciation or amortization which must be taken into account in determining recomputed basis are not limited to those adjustments on account of depreciation or amortization with respect to the property disposed of, nor are such adjustments limited to those on account of depreciation or amortization allowed or allowable to the taxpayer disposing of such property. Except as pro-

vided in subparagraph (7) of this paragraph, all such adjustments are taken into account, whether the deductions were allowed or allowable in respect of the same or other property and whether to the taxpayer or to any other person. For manner of determining the amount of adjustments reflected in the adjusted basis of property immediately after certain dispositions, see paragraph (c) of this section.

(ii) The provisions of this subparagraph may be illustrated by the following example:

Example: On January 1, 1966, Jones purchases machine X for use in his trade or business. The machine, which is section 1245 property, has a basis for depreciation of \$10,000. After taking depreciation deductions of \$2,000 (the amount allowable), Jones transfers the machine to his son as a gift on January 1, 1968. Since the exception for gifts in section 1245(b)(1) applies, Jones does not recognize gain under section 1245(a)(1). The son's adjusted basis for the machine is \$8,000. On January 1, 1969, after taking a depreciation deduction of \$1,000 (the amount allowable), the son exchanges machine X for machine Y in a like kind exchange described in section 1031. Since the exception for like kind exchanges in section 1245(b)(4) applies, the son does not recognize gain under section 1245(a)(1). The son's adjusted basis for machine Y is \$7,000. In 1969, the son takes a depreciation deduction of \$1,000 (the amount allowable) in respect of machine Y. The son sells machine Y on June 30, 1970. No depreciation was allowed or allowable for 1970, the year of the sale. The recomputed basis of machine Y on June 30, 1970, is determined in the following manner:

Adjusted basis	\$6,000
Adjustments reflected in the adjusted basis:	
Depreciation deducted by Jones for 1966 and 1967 on machine X	2,000
Depreciation deducted by son for 1968 on machine X	1,000
Depreciation deducted by son for 1969 on machine Y	1,000
Total adjustments reflected in the adjusted basis	\$4,000
Recomputed basis	10,000

(5) *Adjustments reflected in adjusted basis of property described in section 1245(a)(3)(B).* For purposes of subparagraph (2) of this paragraph, the adjustments reflected in the adjusted basis of property described in section 1245(a)(3)(B), on account of depreciation or amortization which must be

taken into account in determining recomputed basis, may include deductions attributable to periods during which the property is not used as an integral part of an activity, or does not constitute a facility, specified in section 1245(a)(3)(B) (i) or (ii). Thus, for example, if depreciation deductions taken with respect to such property after December 31, 1961, amount to \$10,000 (the amount allowable), of which \$6,000 is attributable to periods during which the property is used as an integral part of a specified activity or constitutes a specified facility, then the entire \$10,000 of depreciation deductions are adjustments reflected in the adjusted basis for purposes of determining recomputed basis. Moreover, if the property was never so used but was acquired in a transaction to which section 1245(b)(4) (relating to like kind exchanges and involuntary conversions) applies, and if by reason of the application of paragraph (d)(3) of § 1.1245-4 the property is considered as section 1245 property described in section 1245(a)(3)(B), then the entire \$10,000 of depreciation deductions would also be adjustments reflected in the adjusted basis for purposes of determining recomputed basis.

(6) *Allocation of adjustments attributable to periods after certain dates.* (i) For purposes of determining recomputed basis, the amount of adjustments reflected in the adjusted basis of property other than property described in subparagraph (2) (ii), (iii), or (iv) of this paragraph are limited to adjustments attributable to periods after December 31, 1961. Accordingly, if depreciation deducted with respect to such property of a calendar year taxpayer is \$1,000 a year (the amount allowable) for each of 10 years beginning with 1956, only the depreciation deducted in 1962 and succeeding years shall be treated as reflected in the adjusted basis for purposes of determining recomputed basis. With respect to a taxable year beginning in 1961 and ending in 1962, the deduction for depreciation or amortization shall be ascertained by applying the principles stated in paragraph (c)(3) of § 1.167(a)-8 (relating to determination of adjusted basis of retired asset). The amount of the deduction, determined in such manner, shall be allo-

cated on a daily basis in order to determine the portion thereof which is attributable to a period after December 31, 1961. Thus, for example, if a taxpayer, whose fiscal year ends on May 31, 1962, acquires section 1245 property on November 12, 1961, and the deduction for depreciation attributable to the property for such fiscal year is ascertained (under the principles of paragraph (c)(3) of § 1.167(a)-8) to be \$400, then the portion thereof attributable to a period after December 31, 1961, is \$302 ($15\frac{1}{2}/200$ of \$400). If, however, the property were acquired by such taxpayer after December 31, 1961, the entire deduction for depreciation attributable to the property for such fiscal year would be allocable to a period after December 31, 1961. For treatment of certain normal retirements described in paragraph (e)(2) of § 1.167(a)-8, see paragraph (c) of § 1.1245-6. For principles of determining the amount of adjustments for depreciation or amortization reflected in the adjusted basis of property upon an abnormal retirement of property in a multiple asset account, see paragraph (c)(3) of § 1.167(a)-8.

(ii) For purposes of determining recomputed basis, the amount of adjustments reflected in the adjusted basis of an elevator or escalator are limited to adjustments attributable to periods after June 30, 1963.

(iii) For purposes of determining recomputed basis, the amount of adjustments reflected in the adjusted basis of livestock (described in subparagraph (2)(iii) of this paragraph) are limited to adjustments attributable to periods after December 31, 1969.

(7) *Depreciation or amortization allowed or allowable.* For purposes of determin-

ing recomputed basis, generally all adjustments (for periods after Dec. 31, 1961, or, in the case of property described in subparagraph (2) (ii), (iii), or (iv) of this paragraph, for periods after the applicable date) attributable to allowed or allowable depreciation or amortization must be taken into account. See section 1016(a)(2) and the regulations thereunder for the meaning of *allowed* and *allowable*. However, if a taxpayer can establish by adequate records or other sufficient evidence

that the amount allowed for depreciation or amortization for any period was less than the amount allowable for such period, the amount to be taken into account for such period shall be the amount allowed. No adjustment is to be made on account of the tax imposed by section 56 (relating to the minimum tax for tax preferences). See paragraph (b) of this section (relating to records to be kept and information to be filed). For example, assume that in the year 1967 it becomes necessary to determine the recomputed basis of property, the \$500 adjusted basis of which reflects adjustments of \$1,000 with respect to depreciation deductions allowable for periods after December 31, 1961. If the taxpayer can establish by adequate records or other sufficient evidence that he had been allowed deductions amounting to only \$800 for the period, then in determining recomputed basis the amount added to adjusted basis with respect to the \$1,000 adjustments to basis for the period will be only \$800.

(8) *Exempt organizations.* In respect of property disposed of by an organization which is or was exempt from income taxes (within the meaning of section 501(a)), adjustments reflected in the adjusted basis (within the meaning of subparagraph (2) of this paragraph) shall include only depreciation or amortization allowed or allowable (i) in computing unrelated business taxable income (as defined in section 512(a)), or (ii) in computing taxable income of the organization (or a predecessor organization) for a period during which it was not exempt or, by reason of the application of section 502, 503, or 504, was denied its exemption.

(b) *Records to be kept.* In any case in which it is necessary to determine recomputed basis of an item of section 1245 property, the taxpayer shall have available permanent records of all the facts necessary to determine with reasonable accuracy the amount of such recomputed basis, including the following:

(1) The date, and the manner in which, the property was acquired,

(2) The taxpayer's basis on the date the property was acquired and the manner in which the basis was determined,

(3) The amount and date of all adjustments to the basis of the property allowed or allowable to the taxpayer for depreciation or amortization and the amount and date of any other adjustments by the taxpayer to the basis of the property,

(4) In the case of section 1245 property which has an adjusted basis reflecting adjustments for depreciation or amortization taken by the taxpayer with respect to other property, or by another taxpayer with respect to the same or other property, the information described in subparagraphs (1), (2), and (3) of this paragraph with respect to such other property or such other taxpayer.

(c) *Adjustments reflected in adjusted basis immediately after certain acquisitions—(1) Zero.* (i) If on the date a person acquires property his basis for the property is determined solely by reference to its cost (within the meaning of section 1012), then on such date the amount of the adjustments reflected in his adjusted basis for the property is zero.

(ii) If on the date a person acquires property his basis for the property is determined solely by reason of the application of section 301(d) (relating to basis of property received in corporate distribution) or section 334(a) (relating to basis of property received in a liquidation in which gain or loss is recognized), then on such date the amount of the adjustments reflected in his adjusted basis for the property is zero.

(iii) If on the date a person acquires property his basis for the property is determined solely under the rules of section 334 (b)(2) or (c) relating to basis of property received in certain corporate liquidations), then on such date the amount of the adjustments reflected in his adjusted basis for the property is zero.

(iv) If as of the date a person acquires property from a decedent such person's basis is determined, by reason of the application of section 1014(a), solely by reference to the fair market value of the property on the date of the decedent's death or on the applicable date provided in section 2032 (relating to alternate valuation date), then on such

date the amount of the adjustments reflected in his adjusted basis for the property is zero.

(2) *Gifts and certain tax-free transactions.* (i) If property is disposed of in a transaction described in subdivision (ii) of this subparagraph, then the amount of the adjustments reflected in the adjusted basis of the property in the hands of a transferee immediately after the disposition shall be an amount equal to:

(a) The amount of the adjustments reflected in the adjusted basis of the property in the hands of the transferor immediately before the disposition, minus

(b) The amount of any gain taken into account under section 1245(a)(1) by the transferor upon the disposition.

(ii) The transactions referred to in subdivision (i) of this subparagraph are:

(a) A disposition which is in part a sale or exchange and in part a gift (see paragraph (a)(3) of § 1.1245-4).

(b) A disposition (other than a disposition to which section 1245(b)(6)(A) applies) which is described in section 1245(b)(3) (relating to certain tax-free transactions), or

(c) An exchange described in paragraph (e)(2) of § 1.1245-4 (relating to transfers described in section 1081(d)(1)(A)).

(iii) The provisions of this subparagraph may be illustrated by the following example:

Example: Jones transfers section 1245 property to a corporation in exchange for stock of the corporation and \$1,000 cash in a transaction which qualifies under section 351 (relating to transfer to a corporation controlled by transferor). Before the exchange the amount of the adjustments reflected in the adjusted basis of the property is \$3,000. Upon the exchange \$1,000 gain is recognized under section 1245(a)(1). Immediately after the exchange, the amount of the adjustments reflected in the adjusted basis of the property in the hands of the corporation is \$2,000 (that is, \$3,000 minus \$1,000).

(3) *Certain transfers at death.* (i) If property is acquired in a transfer at death to which section 1245(b)(2) applies, the amount of the adjustments reflected in the adjusted basis of property in the hands of the transferee immediately after the transfer shall be the amount (if any) of depreciation or

amortization deductions allowed the transferee before the decedent's death, to the extent that the basis of the property (determined under section 1014(a)) is required to be reduced under the second sentence of section 1014(b)(9) (relating to adjustments to basis where property is acquired from a decedent prior to his death).

(ii) The provisions of this subparagraph may be illustrated by the following example:

Example: H purchases section 1245 property in 1965 which he immediately conveys to himself and W, his wife, as tenants by the entirety. Under local law each spouse is entitled to one-half the income from the property. H and W file joint income tax returns for calendar years 1965, 1966, and 1967. Over the 3 years, depreciation deductions amounting to \$4,000 (the amount allowable) are allowed in respect of the property of which one-half thereof, or \$2,000, is allocable to W. On January 1, 1968, H dies and the entire value of the property at the date of death is included in H's gross estate. Since W's basis for the property (determined under section 1014(a)) is reduced (under the second sentence of section 1014(b)(9)) by the \$2,000 depreciation deductions allowed W before H's death, the adjustments reflected in the adjusted basis of the property in the hands of W immediately after H's death amount to \$2,000.

(4) *Property received in a like kind exchange, involuntary conversion, or F.C.C. transaction.* (i) If property is acquired in a transaction described in subdivision (ii) of this subparagraph then immediately after the acquisition (and before applying subparagraph (5) of this paragraph, if applicable) the amount of the adjustments reflected in the adjusted basis of the property acquired shall be an amount equal to:

(a) The amount of the adjustments reflected in the adjusted basis of the property disposed of immediately before the disposition, minus

(b) The sum of (1) the amount of any gain recognized under section 1245(a)(1) upon the disposition, plus (2) the amount of gain (if any) referred to in subparagraph (5)(ii) of this paragraph.

(ii) The transactions referred to in subdivision (i) of this subparagraph are:

(a) A disposition which is a like kind exchange or an involuntary conversion to which section 1245(b)(4) applies, or

(b) A disposition to which the provisions of section 1071 and paragraph (e)(1) of § 1.1245-4 apply.

(iii) The provisions of subdivisions (i) and (ii) of this subparagraph may be illustrated by the following examples:

Example 1. Smith exchanges machine A for machine B and \$1,000 cash in a like kind exchange. Gain of \$1,000 is recognized under section 1245(a)(1). If before the exchange the amount of the adjustments reflected in the adjusted basis of machine A was \$5,000, the amount of adjustments reflected in the adjusted basis of machine B after the exchange is \$4,000 (that is, \$5,000 minus \$1,000).

Example 2. Assume the same facts as in example (1) except that machine A is destroyed by fire, that \$5,000 in insurance proceeds are received of which \$4,000 is used to purchase machine B, and that Smith properly elects under section 1033(a)(3)(A) to limit recognition of gain. The result is the same as in example (1), that is, the amount of adjustments reflected in the adjusted basis of machine B is \$4,000 (\$5,000 minus \$1,000).

(iv) If more than one item of section 1245 property is acquired in a transaction referred to in subdivision (i) of this subparagraph, the total amount of the adjustments reflected in the adjusted bases of the items acquired shall be allocated to such items in proportion to their respective adjusted bases.

(5) *Property after a reduction in basis pursuant to election under section 1071 or application of section 1082(a)(2).* If the basis of section 1245 property is reduced pursuant to an election under section 1071 (relating to gain from sale or exchange to effectuate policies of F.C.C.), or the application of section 1082(a)(2) (relating to sale or exchange in obedience to order of S.E.C.), then immediately after the basis reduction the amount of the adjustments reflected in the adjusted basis of the property shall be the sum of:

(i) The amount of the adjustments reflected in the adjusted basis of the property immediately before the basis reduction (but after applying subparagraph (4) of this paragraph, if applicable), plus

(ii) The amount of gain which was not recognized under section 1245(a)(1) by reason of the reduction in the basis of the property. See paragraph (e)(1) of § 1.1245-4.

(6) *Partnership property after certain transactions.* (i) For the amount of ad-

justments reflected in the adjusted basis of property immediately after certain distributions of the property by a partnership to a partner, see section 1245(b)(6)(B).

(ii) If under paragraph (b)(3) of § 1.751-1 (relating to certain distributions of partnership property other than section 751 property treated as sales or exchanges) a partnership is treated as purchasing section 1245 property (or a portion thereof) from a distributee who relinquishes his interest in such property (or portion), then on the date of such purchase the amount of adjustments reflected in the adjusted basis of such purchased property (or portion) shall be zero.

(iii) See paragraph (e)(3)(ii) of § 1.1245-1 for the amount of adjustments reflected in the adjusted basis of partnership property in respect of a partner who acquired his partnership interest in certain transactions when an election under section 754 (relating to optional adjustments to basis of partnership property) was in effect.

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§ 1.1245-3 Definition of section 1245 property.

(a) *In general.* (1) The term *section 1245 property* means any property (other than livestock excluded by the effective date limitation in subparagraph (4) of this paragraph) which is or has been property of a character subject to the allowance for depreciation provided in section 167 and which is either:

(i) Personal property (within the meaning of paragraph (b) of this section),

(ii) Property described in section 1245(a)(3)(B) (see paragraph (c) of this section), or

(iii) An elevator or an escalator within the meaning of subparagraph (C) of section 48(a)(1) (relating to the definition of *section 38 property* for purposes of the investment credit), but without regard to the limitations in such subparagraph (C).

(2) If property is section 1245 property under a subdivision of subparagraph (1) of this paragraph, a leasehold of such