

§ 1.1015-5 Increased basis for gift tax paid.

(a) *General rule in the case of gifts made on or before December 31, 1976.* (1)(i) Subject to the conditions and limitations provided in section 1015(d), as added by the Technical Amendments Act of 1958, the basis (as determined under section 1015(a) and paragraph (a) of § 1.1015-1) of property acquired by gift is increased by the amount of gift tax paid with respect to the gift of such property. Under section 1015(d)(1)(A), such increase in basis applies to property acquired by gift on or after September 2, 1958 (the date of enactment of the Technical Amendments Act of 1958). Under section 1015(d)(1)(B), such increase in basis applies to property acquired by gift before September 2, 1958, and not sold, exchanged, or otherwise disposed of before such date. If section 1015(d)(1)(A) applies, the basis of the property is increased as of the date of the gift regardless of the date of payment of the gift tax. For example, if the property was acquired by gift on September 8, 1958, and sold by the donee on October 15, 1958, the basis of the property would be increased (subject to the limitation of section 1015(d)) as of September 8, 1958 (the date of the gift), by the amount of gift tax applicable to such gift even though such tax was not paid until March 1, 1959. If section 1015(d)(1)(B) applies, any increase in the basis of the property due to gift tax paid (regardless of date of payment) with respect to the gift is made as of September 2, 1958. Any increase in basis under section 1015(d) can be no greater than the amount by which the fair market value of the property at the time of the gift exceeds the basis of such property in the hands of the donor at the time of the gift. See paragraph (b) of this section for rules for determining the amount of gift tax paid in respect of property transferred by gift.

(ii) With respect to property acquired by gift before September 2, 1958, the provisions of section 1015(d) and this section do not apply if, before such date, the donee has sold, exchanged, or otherwise disposed of such property. The phrase *sold, exchanged, or otherwise disposed of* includes the surrender of a stock certificate for corporate assets in complete or partial liquidation of a

corporation pursuant to section 331. It also includes the exchange of property for property of a like kind such as the exchange of one apartment house for another. The phrase does not, however, extend to transactions which are mere changes in form. Thus, it does not include a transfer of assets to a corporation in exchange for its stock in a transaction with respect to which no gain or loss would be recognizable for income tax purposes under section 351. Nor does it include an exchange of stock or securities in a corporation for stock or securities in the same corporation or another corporation in a transaction such as a merger, recapitalization, reorganization, or other transaction described in section 368(a) or 355, with respect to which no gain or loss is recognizable for income tax purposes under section 354 or 355. If a binding contract for the sale, exchange, or other disposition of property is entered into, the property is considered as sold, exchanged, or otherwise disposed of on the effective date of the contract, unless the contract is not subsequently carried out substantially in accordance with its terms. The effective date of a contract is normally the date it is entered into (and not the date it is consummated, or the date legal title to the property passes) unless the contract specifies a different effective date. For purposes of this subdivision, in determining whether a transaction comes within the phrase *sold, exchanged, or otherwise disposed of*, if a transaction would be treated as a mere change in the form of the property if it occurred in a taxable year subject to the Internal Revenue Code of 1954, it will be so treated if the transaction occurred in a taxable year subject to the Internal Revenue Code of 1939 or prior revenue law.

(2) Application of the provisions of subparagraph (1) of this paragraph may be illustrated by the following examples:

Example 1. In 1938, A purchased a business building at a cost of \$120,000. On September 2, 1958, at which time the property had an adjusted basis in A's hands of \$60,000, he gave the property to his nephew, B. At the time of the gift to B, the property had a fair market value of \$65,000 with respect to which A paid a gift tax in the amount of \$7,545. The basis of the property in B's hands at the time of

the gift, as determined under section 1015(a) and § 1.1015-1, would be the same as the adjusted basis in A's hands at the time of the gift, or \$60,000. Under section 1015(d) and this section, the basis of the building in B's hands as of the date of the gift would be increased by the amount of the gift tax paid with respect to such gift, limited to an amount by which the fair market value of the property at the time of the gift exceeded the basis of the property in the hands of A at the time of gift, or \$5,000. Therefore, the basis of the property in B's hands immediately after the gift, both for determining gain or loss on the sale of the property, would be \$65,000.

Example 2. C purchased property in 1938 at a cost of \$100,000. On October 1, 1952, at which time the property had an adjusted basis of \$72,000 in C's hands, he gave the property to his daughter, D. At the date of the gift to D, the property had a fair market value of \$85,000 with respect to which C paid a gift tax in the amount of \$11,745. On September 2, 1958, D still held the property which then had an adjusted basis in her hands of \$65,000. Since the excess of the fair market value of the property at the time of the gift to D over the adjusted basis of the property in C's hands at such time is greater than the amount of gift tax paid, the basis of the property in D's hands would be increased as of September 2, 1958, by the amount of the gift tax paid, or \$11,745. The adjusted basis of the property in D's hands, both for determining gain or loss on the sale of the property, would then be \$76,745 (\$65,000 plus \$11,745).

Example 3. On December 31, 1951, E gave to his son, F, 500 shares of common stock of the X Corporation which shares had been purchased earlier by E at a cost of \$100 per share, or a total cost of \$50,000. The basis in E's hands was still \$50,000 on the date of the gift to F. On the date of the gift, the fair market value of the 500 shares was \$80,000 with respect to which E paid a gift tax in the amount of \$10,695. In 1956, the 500 shares of X Corporation stock were exchanged for 500 shares of common stock of the Y Corporation in a reorganization with respect to which no gain or loss was recognized for income tax purposes under section 354. F still held the 500 shares of Y Corporation stock on September 2, 1958. Under such circumstances, the 500 shares of X Corporation stock would not, for purposes of section 1015(d) and this section, be considered as having been sold, exchanged, or otherwise disposed of by F before September 2, 1958. Therefore, the basis of the 500 shares of Y Corporation stock held by F as of such date would, by reason of section 1015(d) and this section, be increased by \$10,695, the amount of gift tax paid with respect to the gift to F of the X Corporation stock.

Example 4. On November 15, 1953, G gave H property which had a fair market value of

\$53,000 and a basis in the hands of G of \$20,000. G paid gift tax of \$5,250 on the transfer. On November 16, 1956, H gave the property to J who still held it on September 2, 1958. The value of the property on the date of the gift to J was \$63,000 and H paid gift tax of \$7,125 on the transfer. Since the property was not sold, exchanged, or otherwise disposed of by J before September 2, 1958, and the gift tax paid on the transfer to J did not exceed \$43,000 (\$63,000, fair market value of property at time of gift to J, less \$20,000, basis of property in H's hands at that time), the basis of property in his hands is increased on September 2, 1958, by \$7,125, the amount of gift tax paid by H on the transfer. No increase in basis is allowed for the \$5,250 gift tax paid by G on the transfer to H, since H had sold, exchanged, or otherwise disposed of the property before September 2, 1958.

(b) *Amount of gift tax paid with respect to gifts made on or before December 31, 1976.* (1)(i) If only one gift was made during a certain *calendar period* (as defined in § 25.2502-1(c)(1)), the entire amount of the gift tax paid under chapter 12 or the corresponding provisions of prior revenue laws for that calendar period is the amount of the gift tax paid with respect to the gift.

(ii) If more than one gift was made during a certain calendar period, the amount of the gift tax paid under chapter 12 or the corresponding provisions of prior revenue laws with respect to any specified gift made during that calendar period is an amount, A, which bears the same ratio to B (the total gift tax paid for that calendar period) as C (the *amount of the gift*, computed as described in this paragraph (b)(1)(ii)) bears to D (the total taxable gifts for the calendar period computed without deduction for the gift tax specific exemption under section 2521 (as in effect prior to its repeal by the Tax Reform Act of 1976) or the corresponding provisions of prior revenue laws). Stated algebraically, the amount of the gift tax paid with respect to a gift equals:

$$[\text{Amount of the gift (C)} / \text{TOTAL TAXABLE GIFTS, PLUS SPECIFIC EXEMPTION ALLOWED (D)}] \times \text{TOTAL GIFT TAX PAID (B)}$$

For purposes of the ratio stated in the preceding sentence, the *amount of the gift* referred to as factor "C" is the

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value of the gift reduced by any portion excluded or deducted under section 2503(b) (annual exclusion), 2522 (charitable deduction), or 2523 (marital deduction) of the Code or the corresponding provisions of prior revenue laws. In making the computations described in this paragraph, the values to be used are those finally determined for purposes of the gift tax.

(iii) If a gift consists of more than one item of property, the gift tax paid with respect to each item shall be computed by allocating to each item a proportionate part of the gift tax paid with respect to the gift, computed in accordance with the provisions of this paragraph.

(2) For purposes of this paragraph, it is immaterial whether the gift tax is paid by the donor or the donee. Where more than one gift of a present interest in property is made to the same donee during a *calendar period* (as defined in § 25.2502-1(c)(1)), the annual exclusion shall apply to the earliest of such gifts in point of time.

(3) Where the donor and his spouse elect under section 2513 or the corresponding provisions of prior law to have any gifts made by either of them considered as made one-half by each, the amount of gift tax paid with respect to such a gift is the sum of the amounts of tax (computed separately) paid with respect to each half of the gift by the donor and his spouse.

(4) The method described in section 1015(d)(2) and this paragraph for computing the amount of gift tax paid in respect of a gift may be illustrated by the following examples:

Example 1. Prior to 1959 H made no taxable gifts. On July 1, 1959, he made a gift to his wife, W, of land having a value for gift purposes of \$60,000 and gave to his son, S, certain securities valued at \$60,000. During the year 1959, H also contributed \$5,000 in cash to a charitable organization described in section 2522. H filed a timely gift tax return for 1959 with respect to which he paid gift tax in the amount of \$6,000, computed as follows:

Value of land given to W	\$60,000	
Less: Annual exclusion	\$3,000	
Marital deduction	30,000	33,000
Included amount of gift		\$27,000
Value of securities given to S	60,000	
Less: Annual exclusion	3,000	

Included amount of gift		57,000
Gift to charitable organization	5,000	
Less: Annual exclusion	3,000	
Charitable deduction	2,000	5,000
Included amount of gift		0
Total included gifts		84,000
Less: Specific exemption allowed		30,000
Taxable gifts for 1959		54,000
Gift tax on \$54,000		6,000

In determining the gift tax paid with respect to the land given to W, amount C of the ratio set forth in subparagraph (1)(ii) of this paragraph is \$60,000, value of property given to W, less \$33,000 (the sum of \$3,000, the amount excluded under section 2503(b), and \$30,000, the amount deducted under section 2523), or \$27,000. Amount D of the ratio is \$84,000 (the amount of taxable gifts, \$54,000, plus the gift tax specific exemption, \$30,000). The gift tax paid with respect to the land given to W is \$1,928.57, computed as follows:

$$\$27,000(C) \div \$84,000(D) \times \$6,000(B)$$

Example 2. The facts are the same as in example (1) except that H made his gifts to W and S on July 1, 1971, and that prior to 1971, H made no taxable gifts. Furthermore, H made his charitable contribution on August 12, 1971. These were the only gifts made by H during 1971. H filed his gift tax return for the third quarter of 1971 on November 15, 1971, as required by section 6075(b). With respect to the above gifts H paid a gift tax in the amount of \$6,000 on total taxable gifts of \$54,000 for the third quarter of 1971. The gift tax paid with respect to the land given to W is \$1,928.57. The computations for these figures are identical to those used in example (1).

Example 3. On January 15, 1956, A made a gift to his nephew, N, of land valued at \$86,000, and on June 30, 1956, gave N securities valued at \$40,000. On July 1, 1956, A gave to his sister, S, \$46,000 in cash. A and his wife, B, were married during the entire calendar year 1956. The amount of A's taxable gifts for prior years was zero although in arriving at that amount A had used in full the specific exemption authorized by section 2521. B did not make any gifts before 1956. A and B elected under section 2513 to have all gifts made by either during 1956 treated as made one-half by A and one-half by B. Pursuant to that election, A and B each filed a gift tax return for 1956. A paid gift tax of \$11,325 and B paid gift tax of \$5,250, computed as follows:

	A	B
Value of land given to N	\$43,000	\$43,000
Less: exclusion	3,000	3,000

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	A	B
Included amount of gift	40,000	40,000
Value of securities given to N	20,000	20,000
Less: exclusion	None	None
Included amount of gift	20,000	20,000
Cash gift to S	23,000	23,000
Less: exclusion	3,000	3,000
Included amount of gift	20,000	20,000
Total included gifts	80,000	80,000
Less: specific exemption	None	30,000
Taxable gifts for 1956	80,000	50,000
Gift tax for 1956	11,325	5,250

The amount of the gift tax paid by A with respect to the land given to N is computed as follows:

$$\$40,000(C) / \$80,000(D) \times \$11,325(B) = \$5,662.50$$

The amount of the gift tax paid by B with respect to the land given to N is computed as follows:

$$\$40,000(C) / \$80,000(D) \times \$5,250(B) = \$2,625$$

The amount of the gift tax paid with respect to the land is \$5,662.50 plus \$2,625, or \$8,287.50. Computed in a similar manner, the amount of gift tax paid by A with respect to the securities given to N is \$2,831.25, and the amount of gift tax paid by B with respect thereto is \$1,312.50, or a total of \$4,143.75.

Example 4. The facts are the same as in example (3) except that A gave the land to N on January 15, 1972, the securities to N on February 3, 1972, and the cash to S on March 7, 1972. As in example (3), the amount of A's taxable gifts for taxable years prior to 1972 was zero, although in arriving at that amount A had used in full the specific exemption authorized by section 2521. B did not make any gifts before 1972. Pursuant to the election under section 2513, A and B treated all gifts made by either during 1972 as made one-half by A and one-half by B. A and B each filed a gift tax return for the first quarter of 1972 on May 15, 1972, as required by section 6075(b). A paid gift tax of \$11,325 on taxable gifts of \$80,000 and B paid gift tax of \$5,250 on taxable gifts of \$50,000. The amount of the gift tax paid by A and B with respect to the land given to N is \$5,662.50 and \$2,625, respectively. The computations for these figures are identical to those used in example (3).

(c) *Special rule for increased basis for gift tax paid in the case of gifts made after December 31, 1976—(1) In general.* With respect to gifts made after December 31, 1976 (other than gifts between spouses described in section 1015(e)), the increase in basis for gift

tax paid is determined under section 1015(d)(6). Under section 1015(d)(6)(A), the increase in basis with respect to gift tax paid is limited to the amount (not in excess of the amount of gift tax paid) that bears the same ratio to the amount of gift tax paid as the net appreciation in value of the gift bears to the amount of the gift.

(2) *Amount of gift.* In general, for purposes of section 1015(d)(6)(A)(ii), the amount of the gift is determined in conformance with the provisions of paragraph (b) of this section. Thus, the amount of the gift is the amount included with respect to the gift in determining (for purposes of section 2503(a)) the total amount of gifts made during the calendar year (or calendar quarter in the case of a gift made on or before December 31, 1981), reduced by the amount of any annual exclusion allowable with respect to the gift under section 2503(b), and any deductions allowed with respect to the gift under section 2522 (relating to the charitable deduction) and section 2523 (relating to the marital deduction). Where more than one gift of a present interest in property is made to the same donee during a calendar year, the annual exclusion shall apply to the earliest of such gifts in point of time.

(3) *Amount of gift tax paid with respect to the gift.* In general, for purposes of section 1015(d)(6), the amount of gift tax paid with respect to the gift is determined in conformance with the provisions of paragraph (b) of this section. Where more than one gift is made by the donor in a calendar year (or quarter in the case of gifts made on or before December 31, 1981), the amount of gift tax paid with respect to any specific gift made during that period is the amount which bears the same ratio to the total gift tax paid for that period (determined after reduction for any gift tax unified credit available under section 2505) as the amount of the gift (computed as described in paragraph (c)(2) of this section) bears to the total taxable gifts for the period.

(4) *Qualified domestic trusts.* For purposes of section 1015(d)(6), in the case of a qualified domestic trust (QDOT) described in section 2056A(a), any distribution during the noncitizen surviving spouse's lifetime with respect to

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which a tax is imposed under section 2056A(b)(1)(A) is treated as a transfer by gift, and any estate tax paid on the distribution under section 2056A(b)(1)(A) is treated as a gift tax. The rules under this paragraph apply in determining the extent to which the basis in the assets distributed is increased by the tax imposed under section 2056A(b)(1)(A).

(5) *Examples.* Application of the provisions of this paragraph (c) may be illustrated by the following examples:

Example 1. (i) Prior to 1995, X exhausts X's gift tax unified credit available under section 2505. In 1995, X makes a gift to X's child Y, of a parcel of real estate having a fair market value of \$100,000. X's adjusted basis in the real estate immediately before making the gift was \$70,000. Also in 1995, X makes a gift to X's child Z, of a painting having a fair market value of \$70,000. X timely files a

gift tax return for 1995 and pays gift tax in the amount of \$55,500, computed as follows:

Value of real estate transferred to Y	\$100,000
Less: Annual exclusion	10,000
Included amount of gift (C)		\$90,000
Value of painting transferred to Z	\$70,000
Less: annual exclusion	10,000
Included amount of gift		60,000
Total included gifts (D)		\$150,000
Total gift tax liability for 1995 gifts (B)		\$55,500

(ii) The gift tax paid with respect to the real estate transferred to Y, is determined as follows:

$$\frac{\$90,000 \text{ (C)}}{\$150,000 \text{ (D)}} \times \$55,500 \text{ (B)} = \$33,300$$

(iii)(A) The amount by which Y's basis in the real property is increased is determined as follows:

$$\frac{\$30,000 \text{ (net appreciation)}}{\$90,000 \text{ (amount of gift)}} \times \$33,300 = \$11,100$$

(B) Y's basis in the real property is \$70,000 plus \$11,100, or \$81,100. If X had not exhausted any of X's unified credit, no gift tax would have been paid and, as a result, Y's basis would not be increased.

Example 2. (i) X dies in 1995. X's spouse, Y, is not a United States citizen. In order to obtain the marital deduction for property passing to X's spouse, X established a QDOT in X's will. In 1996, the trustee of the QDOT

makes a distribution of principal from the QDOT in the form of shares of stock having a fair market value of \$70,000 on the date of distribution. The trustee's basis in the stock (determined under section 1014) is \$50,000. An estate tax is imposed on the distribution under section 2056A(b)(1)(A) in the amount \$38,500, and is paid. Y's basis in the shares of stock is increased by a portion of the section 2056A estate tax paid determined as follows:

$$\frac{\$20,000 \text{ (net appreciation)}}{\$70,000 \text{ (distribution)}} \times \$38,500 \text{ (section 2056A estate tax)} = \$11,000$$

(ii) Y's basis in the stock is \$50,000 plus \$11,000, or \$61,000.

(6) *Effective date.* The provisions of this paragraph (c) are effective for gifts made after August 22, 1995.

(d) *Treatment as adjustment to basis.* Any increase in basis under section 1015(d) and this section shall, for purposes of section 1016(b) (relating to adjustments to a substituted basis), be treated as an adjustment under section 1016(a) to the basis of the donee's prop-

erty to which such increase applies. See paragraph (p) of § 1.1016-5.

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§ 1.1016-1 Adjustments to basis; scope of section.

Section 1016 and §§ 1.1016-2 to 1.1016-10, inclusive, contain the rules relating to the adjustments to be made to the