

Internal Revenue Service, Treasury

§ 1.1016-2

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

[T.D. 6693, 28 FR 12818, Dec. 3, 1963, as amended by T.D. 7238, 37 FR 28715, Dec. 29, 1972; T.D. 7910, 48 FR 40372, Sept. 7, 1983; T.D. 8612, 60 FR 43537, Aug. 22, 1995]

§ 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 basis of property to determine the adjusted basis as defined in section 1011. However, if the property was acquired from a decedent before his death, see § 1.1014-6 for adjustments on account of certain deductions allowed the taxpayer for the period between the date of acquisition of the property and the date of death of the decedent. If an election has been made under the Retirement-Straight Line Adjustment Act of 1958 (26 U.S.C. 1016 note), see § 1.9001-1 for special rules for determining adjusted basis in the case of a taxpayer who has changed from the retirement to the straight-line method of computing depreciation allowances.

§ 1.1016-2 Items properly chargeable to capital account.

(a) The cost or other basis shall be properly adjusted for any expenditure, receipt, loss, or other item, properly chargeable to capital account, including the cost of improvements and betterments made to the property. No adjustment shall be made in respect of any item which, under any applicable provision of law or regulation, is treated as an item not properly chargeable to capital account but is allowable as a deduction in computing net or taxable income for the taxable year. For example, in the case of oil and gas wells no adjustment may be made in respect of any intangible drilling and development expense allowable as a deduction in computing net or taxable income. See the regulations under section 263(c).

(b) The application of the foregoing provisions may be illustrated by the following example:

Example: A, who makes his returns on the calendar year basis, purchased property in 1941 for \$10,000. He subsequently expended \$6,000 for improvements. Disregarding, for the purpose of this example, the adjustments required for depreciation, the adjusted basis of the property is \$16,000. If A sells the property in 1954 for \$20,000, the amount of his gain will be \$4,000.

(c) Adjustments to basis shall be made for carrying charges such as taxes and interest, with respect to property (whether real or personal, improved or unimproved, and whether productive or unproductive), which the taxpayer elects to treat as chargeable to capital account under section 266,