

§ 1.1016-3

rather than as an allowable deduction. The term *taxes* for this purpose includes duties and excise taxes but does not include income taxes.

(d) Expenditures described in section 173 to establish, maintain, or increase the circulation of a newspaper, magazine, or other periodical are chargeable to capital account only in accordance with and in the manner provided in the regulations under section 173.

**§ 1.1016-3 Exhaustion, wear and tear, obsolescence, amortization, and depletion for periods since February 28, 1913.**

(a) *In general*—(1) *Adjustment where deduction is claimed.* (i) For taxable periods beginning on or after January 1, 1952, the cost or other basis of property shall be decreased for exhaustion, wear and tear, obsolescence, amortization, and depletion by the greater of the following two amounts:

(a) The amount allowed as deductions in computing taxable income, to the extent resulting in a reduction of the taxpayer's income taxes, or

(b) The amount allowable for the years involved.

See paragraph (b) of this section. Where the taxpayer makes an appropriate election the above rule is applicable for periods since February 28, 1913, and before January 1, 1952. See paragraph (d) of this section. For rule for such periods where no election is made, see paragraph (c) of this section.

(ii) The determination of the amount properly allowable for exhaustion, wear and tear, obsolescence, amortization, and depletion shall be made on the basis of facts reasonably known to exist at the end of the taxable year. A taxpayer is not permitted to take advantage in a later year of his prior failure to take any such allowance or his taking an allowance plainly inadequate under the known facts in prior years. In the case of depreciation, if in prior years the taxpayer has consistently taken proper deductions under one method, the amount allowable for such prior years shall not be increased even though a greater amount would have been allowable under another proper method. For rules governing losses on retirement of depreciable property, including rules for determining basis, see

§ 1.167(a)-8. This subdivision may be illustrated by the following example:

*Example:* An asset was purchased January 1, 1950, at a cost of \$10,000. The useful life of the asset is 10 years. It has no salvage value. Depreciation was deducted and allowed for 1950 to 1954 as follows:

1950 .....	\$500
1951 .....	1,000
1952 .....	1,000
1953 .....	1,000
1954 .....	1,000
Total amount allowed .....	3,500

The correct reserve as of December 31, 1954, is computed as follows:

December 31:	
1950 (\$10,000÷10) .....	\$1,000
1951 (\$9,000÷9) .....	1,000
1952 (\$8,000÷8) .....	1,000
1953 (\$7,000÷7) .....	1,000
1954 (\$6,000÷6) .....	1,000
Reserve December 31, 1954 .....	5,000
Depreciation for 1955 is computed as follows:	
Cost .....	10,000
Reserve as of December 31, 1954 .....	5,000
Unrecovered cost .....	5,000
Depreciation allowable for 1955 (\$5,000÷5) .....	1,000

(2) *Adjustment for amount allowable where no depreciation deduction claimed.*

(i) If the taxpayer has not taken a depreciation deduction either in the taxable year or for any prior taxable year, adjustments to basis of the property for depreciation allowable shall be determined by using the straight-line method of depreciation. (See § 1.1016-4 for adjustments in the case of persons exempt from income taxation.)

(ii) For taxable years beginning after December 31, 1953, and ending after August 16, 1954, if the taxpayer with respect to any property has taken a deduction for depreciation properly under one of the methods provided in section 167(b) for one or more years but has omitted the deduction in other years, the adjustment to basis for the depreciation allowable in such a case will be the deduction under the method which was used by the taxpayer with respect to that property. Thus, if A acquired property in 1954 on which he properly computed his depreciation deduction under the method described in section 167(b)(2) (the declining-balance method) for the first year of its useful life but did not take a deduction in the second and third year of the asset's life, the

adjustment to basis for depreciation allowable for the second and third year will be likewise computed under the declining-balance method.

(3) *Adjustment for depletion deductions with respect to taxable years before 1932.* Where for any taxable year before the taxable year 1932 the depletion allowance was based on discovery value or a percentage of income, then the adjustment for depletion for such year shall not exceed a depletion deduction which would have been allowable for such year if computed without reference to discovery value or a percentage of income.

(b) *Adjustment for periods beginning on or after January 1, 1952.* The decrease required by paragraph (a) of this section for deductions in respect of any period beginning on or after January 1, 1952, shall be whichever is the greater of the following amounts:

(1) The amount allowed as deductions in computing taxable income under subtitle A of the Code or prior income tax laws and resulting (by reason of the deductions so allowed) in a reduction for any taxable year of the taxpayer's taxes under subtitle A of the Code (other than chapter 2, relating to tax on self-employment income) or prior income, war-profits, or excess-profits tax laws; or

(2) The amount properly allowable as deductions in computing taxable income under subtitle A of the Code or prior income tax laws (whether or not the amount properly allowable would have caused a reduction for any taxable year of the taxpayer's taxes).

(c) *Adjustment for periods since February 28, 1913, and before January 1, 1952, where no election made.* If no election has been properly made under section 1020, or under section 113(d) of the Internal Revenue Code of 1939 (see paragraph (d) of this section), the decrease required by paragraph (a) of this section for deductions in respect of any period since February 28, 1913, and before January 1, 1952, shall be whichever of the following amounts is the greater:

(1) The amount allowed as deductions in computing net income under chapter 1 of the Internal Revenue Code of 1939 or prior income tax laws;

(2) The amount properly allowable in computing net income under chapter 1 of the Internal Revenue Code of 1939 or prior income tax laws.

For the purpose of determining the decrease required by this paragraph, it is immaterial whether or not the amount under subparagraph (1) of this paragraph or the amount under subparagraph (2) of this paragraph would have resulted in a reduction for any taxable year of the taxpayer's taxes.

(d) *Adjustment for periods since February 28, 1913, and before January 1, 1952, where election made.* If an election has been properly made under section 1020, or under section 113(d) of the Internal Revenue Code of 1939, the decrease required by paragraph (a) of this section for deductions in respect of any period since February 28, 1913, and before January 1, 1952, shall be whichever is the greater of the following amounts:

(1) The amount allowed as deductions in computing net income under chapter 1 of the Internal Revenue Code of 1939 or prior income tax laws and resulting (by reason of the deductions so allowed) in a reduction for any taxable year of the taxpayer's taxes under such chapter 1 (other than subchapter E, relating to tax on self-employment income), subchapter E, chapter 2, of the Internal Revenue Code of 1939, or prior income, war-profits, or excess-profits tax laws;

(2) The amount properly allowable as deductions in computing net income under chapter 1 of the Internal Revenue Code of 1939 or prior income tax laws (whether or not the amount properly allowable would have caused a reduction for any taxable year of the taxpayer's taxes).

(e) *Determination of amount allowed which reduced taxpayer's taxes.* (1) As indicated in paragraphs (b) and (d) of this section, there are situations in which it is necessary to determine (for the purpose of ascertaining the basis adjustment required by paragraph (a) of this section) the extent to which the amount allowed as deductions resulted in a reduction for any taxable year of the taxpayer's taxes under subtitle A (other than chapter 2 relating to tax on self-employment income) of the Code, or prior income, war-profits, or excess-profits tax laws. This amount (amount

allowed which resulted in a reduction of the taxpayer's taxes) is hereinafter referred to as the *tax-benefit amount allowed*. For the purpose of determining whether the tax-benefit amount allowed exceeded the amount allowable, a determination must be made of that portion of the excess of the amount allowed over the amount allowable which, if disallowed, would not have resulted in an increase in any such tax previously determined. If the entire excess of the amount allowed over the amount allowable could be disallowed without any such increase in tax, the tax-benefit amount allowed shall not be considered to have exceeded the amount allowable. In such a case (if paragraph (b) or (d) of this section is applicable) the reduction in basis required by paragraph (a) of this section would be the amount properly allowable as a deduction. If only part of such excess could be disallowed without any such increase in tax, the tax-benefit amount allowed shall be considered to exceed the amount allowable to the extent of the remainder of such excess. In such a case (if paragraph (b) or (d) of this section is applicable), the reduction in basis required by paragraph (a) of this section would be the amount of the tax-benefit amount allowed.

(2) For the purpose of determining the tax-benefit amount allowed the tax previously determined shall be determined under the principles of section 1314. The only adjustments made in determining whether there would be an increase in tax shall be those resulting from the disallowance of the amount allowed. The taxable years for which the determination is made shall be the taxable year for which the deduction was allowed and any other taxable year which would be affected by the disallowance of such deduction. Examples of such other taxable years are taxable years to which there was a carryover or carryback of a net operating loss from the taxable year for which the deduction was allowed, and taxable years for which a computation under section 111 or section 1333 was made by reference to the taxable year for which the deduction was allowed. In determining whether the disallowance of any part of the deduction would not have resulted in an increase in any tax

previously determined, proper adjustment must be made for previous determinations under section 1311, or section 3801 of the Internal Revenue Code of 1939, and for any previous application of section 1016(a)(2)(B), or section 113(b) (1)(B)(ii) of the Internal Revenue Code of 1939.

(3) If a determination under section 1016(a)(2)(B) must be made with respect to several properties for each of which the amount allowed for the taxable year exceeded the amount allowable, the tax-benefit amount allowed with respect to each of such properties shall be an allocated portion of the tax-benefit amount allowed determined by reference to the sum of the amounts allowed and the sum of the amounts allowable with respect to such several properties.

(4) In the case of property held by a partnership or trust, the computation of the tax-benefit amount allowed shall take into account the tax benefit of the partners or beneficiaries, as the case may be, from the deduction by the partnership or trust of the amount allowed to the partnership or the trust. For this purpose, the determination of the amount allowed which resulted in a tax benefit to the partners or beneficiaries shall be made in the same manner as that provided above with respect to the taxes of the person holding the property.

(5) A taxpayer seeking to limit the adjustment to basis to the tax-benefit amount allowed for any period, in lieu of the amount allowed, must establish the tax-benefit amount allowed. A failure of adequate proof as to the tax-benefit amount allowed with respect to one period does not preclude the taxpayer from limiting the adjustment to basis to the tax-benefit amount allowed with respect to another period for which adequate proof is available. For example, a corporate transferee may have available adequate records with respect to the tax effect of the deduction of erroneous depreciation for certain taxable years, but may not have available adequate records with respect to the deduction of excessive depreciation for other taxable years during which the property was held by its transferor. In such case the corporate transferee shall not be denied

the right to apply this section with respect to the erroneous depreciation for the period for which adequate proof is available.

(f) *Determination of amount allowable in prior taxable years.* (1) One of the factors in determining the adjustment to basis as of any date is the amount of depreciation, depletion, etc., allowable for periods prior to such date. The amount allowable for such prior periods is determined under the law applicable to such prior periods; all adjustments required by the law applicable to such periods are made in determining the adjusted basis of the property for the purpose of determining the amount allowable. Provisions corresponding to the rules in section 1016(a)(2)(B) described in paragraphs (d) and (e) of this section, which limit adjustments to the *tax-benefit amount allowed* where an election is properly exercised, were first enacted by the Act of July 14, 1952 (66 Stat. 629). That law provided that corresponding rules are deemed to be includible in all revenue laws applicable to taxable years ending after December 31, 1931. Accordingly, those rules shall be taken into account in determining the amount of depreciation, etc., allowable for any taxable year ending after December 31, 1931. For example, if the adjusted basis of property held by the taxpayer since January 1, 1930, is determined as of January 1, 1955, and if an election was properly made under section 1020, or section 113(d) of the Internal Revenue Code of 1939, then the amount allowable which is taken into account in computing the adjusted basis as of January 1, 1955, shall be determined by taking those rules into account for all taxable years ending after December 31, 1931. The Act of July 14, 1952, made no change in the law applicable in determining the amount allowable for taxable years ending before January 1, 1932. If there was a final decision of a court prior to the enactment of the Act of July 14, 1952, determining the amount allowable for a particular taxable year, such determination shall be adjusted. In such case the adjustment shall be made only for the purpose of taking the provision of that law into account and only to the extent made necessary by such provisions.

(2) Although the Act of July 14, 1952, amended the law applicable to all taxable years ending after December 31, 1931, the amendment does not permit refund, credit, or assessment of a deficiency for any taxable year for which such refund, credit, or assessment was barred by any law or rule of law.

(g) *Property with transferred basis.* The following rules apply in the determination of the adjustments to basis of property in the hands of a transferee, donee, or grantee which are required by section 1016(b), or section 113(b)(2) of the Internal Revenue Code of 1939, with respect to the period the property was held by the transferor, donor, or grantor:

(1) An election or a revocation of an election under section 1020, or section 113(d) of the Internal Revenue Code of 1939, by a transferor, donor, or grantor, which is made after the date of the transfer, gift, or grant of the property shall not affect the basis of such property in the hands of the transferee, donee, or grantee. An election or a revocation of an election made before the date of the transfer, gift, or grant of the property shall be taken into account in determining under section 1016(b) the adjustments to basis of such property as of the date of the transfer, gift, or grant, whether or not an election or a revocation of an election under section 1020, or section 113(d) of the Internal Revenue Code of 1939, was made by the transferee, donee, or grantee.

(2) An election by the transferee, donee, or grantee or a revocation of such an election shall be applicable in determining the adjustments to basis for the period during which the property was held by the transferor, donor, or grantor, whether or not the transferor, donor, or grantor had made an election or a revocation of an election, provided that the property was held by the transferee, donee, or grantee at any time on or before the date on which the election or revocation was made.

(h) *Application to a change in method of accounting.* [Reserved]. For further guidance, see § 1.1016-3T(h).

(i) *Examples.* The application of section 1016(a) (1) and (2) may be illustrated by the following examples:

§ 1.1016-3

26 CFR Ch. I (4-1-04 Edition)

*Example 1.* The case of Corporation A discloses the following facts:

The cost or other basis is to be adjusted by \$16,500 with respect to the years 1952-54, that is, by the amount allowable but not less than the amount allowed which reduced the taxpayer's taxes. An adjustment must also be made with respect to the years 1949-1951, the amount of such adjustment depending upon whether an election was properly made

under section 1020, or section 113(d) of the Internal Revenue Code of 1939. If no such election was made, the amount of the adjustment with respect to the years 1949-1951 is \$19,500, that is, the amount allowed but not less than the amount allowable. If an election was properly made, the amount of the adjustment with respect to the years 1949-1951 is \$9,000, that is, the amount allowable but not less than the amount allowed which reduced the taxpayer's taxes.

(1)—Year	(2)—Amount allowed	(3)—Amount allowed which reduced taxpayer's taxes	(4)—Amount allowable	(5)—Amount allowable but not less than amount allowed	(6)—Amount allowable but not less than amount allowed which reduced taxpayer's taxes
1949 .....	\$6,000	\$5,500	\$5,000	\$6,000	\$5,500
1950 .....	7,000	7,000	6,500	7,000	7,000
1951 .....	5,000	4,000	6,500	6,500	6,500
Total, 1949-1951 .....				19,500	19,000
1952 .....	6,500	6,500	6,000		6,500
1953 .....	5,000	4,000	4,000		4,000
1954 .....	4,500	4,500	6,000		6,000
Total, 1952-1954 .....					16,500

*Example 2.* Corporation A, which files its returns on the basis of a calendar year, purchased a building on January 1, 1950, at a cost of \$100,000. On the basis of the facts reasonably known to exist at the end of 1950, a period of 50 years should have been used as the correct useful life of the building; nevertheless, depreciation was computed by Corporation A on the basis of a useful life of 25 years, and was allowed for 1950 through 1953

as a deduction in an annual amount of \$4,000. The building was sold on January 1, 1954. Corporation A did not make an election under section 1020, or section 113(d) of the Internal Revenue Code of 1939. No part of the amount allowed Corporation A for any of the years 1950 through 1953 resulted in a reduction of Corporation A's taxes. The adjusted basis of the building as of January 1, 1954, is \$88,166, computed as follows:

Taxable year	Adjustments to basis as of beginning of taxable year	Adjusted basis on January 1	Remaining life on January 1	Depreciation allowable	Depreciation allowed
1950 .....		\$100,000	50	\$2,000	\$4,000
1951 .....	\$4,000	96,000	49	1,959	4,000
1952 .....	8,000	92,000	48	1,917	4,000
1953 .....	9,917	90,083	47	1,917	4,000
1954 .....	11,834	88,166			

*Example 3.* The facts are the same as in example (2), except that Corporation A made a proper election under section 1020. In such

case, the adjusted basis of the building as of January 1, 1954, is \$92,000 computed as follows:

Taxable year	Adjustments to basis as of beginning of taxable year	Adjusted basis on January 1	Remaining life on January 1	Depreciation allowable	Depreciation allowed
1950 .....		\$100,000	50	\$2,000	\$4,000
1951 .....	\$2,000	98,000	49	2,000	4,000
1952 .....	4,000	96,000	48	2,000	4,000
1953 .....	6,000	94,000	47	2,000	4,000
1954 .....	8,000	92,000			

**Internal Revenue Service, Treasury**

**§ 1.1016-4**

*Example 4.* If it is assumed that in example (2), or in example (3), all of the deduction allowed Corporation A for 1953 had resulted in a reduction of A's taxes, the adjustment to the basis of the building for depreciation for 1953 would reflect the entire \$4,000 deduction. In such case, the adjusted basis of the building as of January 1, 1954, would be \$86,083 in example (2), and \$90,000 in example (3).

*Example 5.* The facts are the same as in example (2), except that for the year 1950 all of the \$4,000 amount allowed Corporation A as a

deduction for depreciation for that year resulted in a reduction of A's taxes. In such case, the adjustments to the basis of the building remain the same as those set forth in example (2).

*Example 6.* The facts are the same as in example (3), except that for the year 1950 all of the \$4,000 amount allowed Corporation A as a deduction for depreciation resulted in a reduction of A's taxes. In such case, the adjusted basis of the building as of January 1, 1954, is \$90,123, computed as follows:

Taxable year	Adjustments to basis as of beginning of taxable year	Adjusted basis on January 1	Remaining life on January 1	Depreciation allowable	Depreciation allowed
1950 .....	.....	\$100,000	50	\$2,000	\$4,000
1951 .....	\$4,000	96,000	49	1,959	4,000
1952 .....	5,959	94,041	48	1,959	4,000
1953 .....	7,918	92,082	47	1,959	4,000
1954 .....	9,877	90,123			

(j) *Effective date.* [Reserved]. For further guidance, see §1.1016-3T(j)(1) and (2).

[T.D. 6500, 25 FR 11910, Nov. 26, 1960; 25 FR 14021, Dec. 31, 1960, as amended by T.D. 9105, 69 FR 12, Jan. 2, 2004]

**§ 1.1016-3T Exhaustion, wear and tear, obsolescence, amortization, and depletion for periods since February 28, 1913 (temporary).**

(a) through (g) [Reserved]. For further guidance, see §1.1016-3(a) through (g).

(h) *Application to a change in method of accounting.* For purposes of determining whether a change in depreciation or amortization for property subject to section 167, 168, 197, 1400I, 1400L(b), or 1400L(c), or to section 168 prior to its amendment by the Tax Reform Act of 1986 (100 Stat. 2121) (former section 168) is a change in method of accounting under section 446(e) and the regulations under section 446(e), section 1016(a)(2) does not permanently affect a taxpayer's lifetime income.

(i) [Reserved]. For further guidance, see §1.1016-3(i).

(j) *Effective date—(1) In general.* Except as provided in paragraph (j)(2) of this section, this section applies on or after December 30, 2003. For the applicability of regulations before December 30, 2003, see §1.1016-3 in effect prior to December 30, 2003 (§1.1016-3 as contained in 26 CFR part 1 edition revised as of April 1, 2003).

(2) *Depreciation or amortization changes.* Paragraph (h) of this section applies to a change in depreciation or amortization for property subject to section 167, 168, 197, 1400I, 1400L(b), or 1400L(c), or former section 168 for taxable years ending on or after December 30, 2003.

(3) The applicability of this section expires on or before December 29, 2006.

[T.D. 9105, 69 FR 12, Jan. 2, 2004; 69 FR 5273, Feb. 4, 2004]

**§ 1.1016-4 Exhaustion, wear and tear, obsolescence, amortization, and depletion; periods during which income was not subject to tax.**

(a) Adjustments to basis must be made for exhaustion, wear and tear, obsolescence, amortization, and depletion to the extent actually sustained in respect of:

(1) Any period before March 1, 1913,

(2) Any period since February 28, 1913, during which the property was held by a person or organization not subject to income taxation under chapter 1 of the Code or prior income tax laws,

(3) Any period since February 28, 1913, and before January 1, 1958, during which the property was held by a person subject to tax under part I, subchapter L, chapter 1 of the Code, or prior income tax law, to the extent that section 1016(a)(2) does not apply, and

(4) Any period since February 28, 1913, during which such property was held