

into account amortization deductions claimed under section 194 to the extent such deductions are attributable to the amortizable basis (within the meaning of section 194(c)(2)) of the taxpayer acquired before the tenth taxable year preceding the taxable year in which gain with respect to the property is recognized.

(2) *Example.* The principles of paragraph (h)(1) of this section are illustrated by the following example:

*Example:* Assume A owns qualified timber property (as defined in section 194(c)(1)) with a basis of \$30,000. In 1981, A incurs \$12,000 of qualifying reforestation expenditures and elects to amortize the maximum \$10,000 of such expenses under section 194. The \$10,000 of deductions are taken during the 8-year period from 1981 to 1988. If A sells the property in 1990 for \$60,000 a gain of \$28,000 (\$60,000—adjusted basis of \$32,000) is recognized on the sale. Since the sale took place within 10 years of the taxable year in which the reforestation expenditures were made, \$10,000 of the gain is treated as ordinary income, and the remaining \$18,000 of gain would be capital gain, if it otherwise qualifies for capital gain treatment. In order to avoid ordinary income treatment of the gain attributable to the reforestation expenditures incurred in 1981, A would have to wait until 1992 to dispose of the property.

[T.D. 6832, 30 FR 8581, July 7, 1965, as amended by T.D. 7084, 36 FR 268, Jan. 8, 1971; T.D. 7207, 37 FR 20799, Oct. 14, 1972; T.D. 7728, 45 FR 72650, Nov. 3, 1980; T.D. 7927, 48 FR 55851, Dec. 16, 1983]

#### § 1.1245-5 Adjustments to basis.

In order to reflect gain recognized under section 1245(a)(1), the following adjustments to the basis of property shall be made:

(a) *Property acquired in like kind exchange or involuntary conversion.* (1) If property is acquired in a transaction to which section 1245(b)(4) applies, its basis shall be determined under the rules of section 1031(d) or 1033(c).

(2) The provisions of this paragraph may be illustrated by the following example:

*Example:* Jones exchanges property A, which is section 1245 property with an adjusted basis of \$10,000, for property B, which has a fair market value of \$9,000, and property C, which has a fair market value of \$3,500, in a like kind exchange as to which no gain would be recognized under section 1031(a). Upon the exchange \$2,500 gain is rec-

ognized under section 1245(a)(1), since property C is not section 1245 property. See section 1245(b)(4). Under the rules of section 1031(d), the basis of the properties received in the exchange is \$12,500 (i.e., the basis of property transferred, \$10,000, plus the amount of gain recognized, \$2,500), of which the amount allocated to property C is \$3,500 (the fair market value thereof), and the residue, \$9,000, is allocated to property B.

(b) *Sections 1071 and 1081 transactions.*

(1) If property is acquired in a transaction to which section 1071 and paragraph (e)(1) of § 1.1245-4 (relating to limitation for section 1071 transactions, etc.) apply, its basis shall be determined in accordance with the principles of paragraph (a) of this section.

(2) If the basis of property, other than section 1245 property, is reduced pursuant to either an election under section 1071 or the application of section 1082(a)(2), then the basis of the property shall be increased to the extent of the gain recognized under section 1245(a)(1) by reason of the application of paragraph (e)(1)(iii) of § 1.1245-4.

[T.D. 6832, 30 FR 8584, July 7, 1965]

#### § 1.1245-6 Relation of section 1245 to other sections.

(a) *General.* The provisions of section 1245 apply notwithstanding any other provision of subtitle A of the Code. Thus, unless an exception or limitation under section 1245(b) applies, gain under section 1245(a)(1) is recognized notwithstanding any contrary nonrecognition provision or income characterizing provision. For example, since section 1245 overrides section 1231 (relating to property used in the trade or business), the gain recognized under section 1245(a)(1) upon a disposition will be treated as ordinary income and only the remaining gain, if any, from the disposition may be considered as gain from the sale or exchange of a capital asset if section 1231 is applicable. See example (2) of paragraph (b)(2) of § 1.1245-1. For effect of section 1245 on basis provisions of the Code, see § 1.1245-5.

(b) *Nonrecognition sections overridden.* The nonrecognition provisions of subtitle A of the Code which section 1245 overrides include, but are not limited to, sections 267(d), 311(a), 336, 337,