

(5) *Retired or demolished property.* Depreciation adjustments referred to in subparagraph (1) of this paragraph generally do not include adjustments in respect of retired or demolished portions of an item of section 1250 property. If a retired or demolished portion is replaced in a disposition described in section 1250(d)(4)(A) (relating to like kind exchanges and involuntary conversions), see paragraph (d)(7) of § 1.1250-3.

(6) *Exempt organization.* In respect of property disposed of by an organization which is or was exempt from income taxes (within the meaning of section 501(a), the depreciation adjustments (reflected in the adjusted basis) referred to in subparagraph (1) of this paragraph shall include only adjustments 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 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.

(e) *Additional depreciation immediately after certain acquisitions—*(1) *Zero.* If on the date a person acquires property his basis for the property is determined solely (i) by reference to its cost (within the meaning of section 1012), (ii) 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), or (iii) 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 additional depreciation for the property is zero.

(2) *Transactions referred to in section 1250(d).* In the case of property acquired in a disposition described in section 1250(d) (relating to exceptions and limitations to application of section 1250), additional depreciation shall be computed in accordance with the rules prescribed in § 1.1250-3.

(f) *Records to be kept and information to be filed—*(1) *Records to be kept.* In any case in which it is necessary to determine the additional depreciation of an item of section 1250 property, the taxpayer shall have available permanent

records of all the facts necessary to determine with reasonable accuracy the amount of such additional depreciation, including the following:

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

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

(iii) The amount and date of all adjustments to the basis of the property allowed or allowable to the taxpayer for depreciation adjustments referred to in paragraph (d)(1) of this section and the amount and date of any other adjustments by the taxpayer to the basis of the property, and

(iv) In the case of section 1250 property which has an adjusted basis reflecting depreciation adjustments referred to in paragraph (d)(1) of this section 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 subdivisions (i), (ii), and (iii) of this subparagraph with respect to such other property or such other taxpayer.

(2) *Information to be filed.* If a taxpayer acquires in a transaction (other than a like kind exchange or involuntary conversion described in section 1250(d)(4)) section 1250 property which has a basis reflecting depreciation adjustments referred to in paragraph (d)(1) of this section allowed or allowable to another taxpayer, then the taxpayer shall file with its income tax return or information return for the taxable year in which the property is acquired a statement showing all information described in subparagraph (1) of this paragraph. See section 6012 (relating to persons required to make returns of income) and part III of subchapter A of chapter 61 of the Code (relating to information returns).

[T.D. 7084, 36 FR 273, Jan. 8, 1971, as amended by T.D. 7193, 37 FR 12956, June 30, 1972]

§ 1.1250-3 Exceptions and limitations.

(a) *Exception for gifts—*(1) *General rule.* Section 1250(d)(1) provides that no gain shall be recognized under section 1250(a) upon a disposition by gift. For purposes of this paragraph, the term *gift* shall have the same meaning as in

paragraph (a) of § 1.1245-4. For reduction in amount of charitable contribution in case of a gift of section 1250 property, see section 170(e) and paragraph (c)(3) of § 1.170-1.

(2) *Disposition in part a sale or exchange and in part a gift.* Where a disposition of property is in part a sale or exchange and in part a gift, the disposition shall be subject to the provisions of § 1.1250-1 and the gain to which section 1250(a) applies, shall be computed under that section.

(3) *Treatment of property in hands of transferee.* If property is disposed of in a transaction which is a gift:

(i) The additional depreciation for the property in the hands of the transferee immediately after the disposition shall be an amount equal to (a) the amount of the additional depreciation for the property in the hands of the transferor immediately before the disposition, minus (b) the amount of any gain (in case the disposition is in part a sale or exchange and in part a gift) which would have been taken into account under section 1250(a) by the transferor upon the disposition if the applicable percentage had been 100 percent.

(ii) For purposes of computing the applicable percentage, the holding period under section 1250(e)(2) of property received as a gift in the hands of the transferee includes the transferor's holding period.

(iii) In case of a disposition which is in part a sale or exchange and in part a gift, if the adjusted basis of the property in the hands of the transferee exceeds its adjusted basis immediately before the transfer, the excess is an addition to capital account under paragraph (d)(2)(ii) of § 1.1250-5 (relating to property with 2 or more elements), and

(iv) If the property disposed of consists of two or more elements within the meaning of paragraph (c) of § 1.1250-5, see paragraph (e)(1) of § 1.1250-5 for the amount of additional depreciation and holding period for each element in the hands of the transferee.

(4) *Examples.* The provisions of this paragraph may be illustrated by the following examples:

Example 1. (i) On May 15, 1967, Smith transfers section 1250 property to his son for \$45,000. In the hands of Smith the property

had an adjusted basis of \$40,000 and a fair market value of \$70,000. Thus, the gain realized is \$5,000 (amount realized, \$45,000, minus adjusted basis, \$40,000), and Smith has made a gift of \$25,000 (fair market value, \$70,000, minus amount realized, \$45,000).

(ii) Smith's holding period for the property is 80 full months and, thus, the applicable percentage under section 1250(a)(2) is 40 percent. The additional depreciation for the property is \$10,000. Since the gain realized (\$5,000) is lower than the additional depreciation (\$10,000), Smith recognized as ordinary income under section 1250(a)(2) gain of \$2,000 (that is, applicable percentage, 40 percent, multiplied by gain realized, \$5,000) and the \$3,000 remaining portion of the gain realized may be treated as gain from the sale of property described in section 1231.

(iii) On the date the son receives the property, the additional depreciation for the property in his hands is \$5,000, that is, the additional depreciation for the property in the hands of the father immediately before the transfer (\$10,000), minus the gain which would have been recognized under section 1250(a)(2) upon the transfer if the applicable percentage had been 100 percent (\$5,000); for purposes of computing applicable percentage his holding period is his father's holding period of 80 full months; and under § 1.1015-4 his unadjusted basis for the property is \$45,000, that is, the amount he paid (\$45,000) plus the excess (zero) of his father's adjusted basis over such amount.

(iv) The son sells the property for \$80,000 on March 15, 1968, 10 full months after he received it from his father. Thus, his holding period is 90 full months (his father's holding period of 80 full months plus the 10 full months the son actually owned the property) and the applicable percentage under section 1250(a)(2) is 30 percent. Assume that no depreciation was allowed or allowable to the son. Thus, the son's adjusted basis and additional depreciation for the property on the date of the sale is the same as on the date he received it. Accordingly, the gain realized is \$35,000 (selling price of \$80,000, minus adjusted basis of \$45,000). Since the additional depreciation (\$5,000) is lower than the gain realized (\$35,000), the son recognizes as ordinary income under section 1250(a)(2) gain of \$1,500, that is, applicable percentage (30 percent) multiplied by additional depreciation (\$5,000).

Example 2. Assume the same facts as in example (1), except that the son sells the property on June 15, 1969, 25 full months after he received it from his father. Thus, his holding period is 105 full months (his father's holding period of 80 full months plus the 25 full months the son actually owned the property) and the applicable percentage under section 1250(a)(2) is 15 percent. Assume further that on the date of the sale the adjusted basis of

the property is \$39,000, and that for the period the son actually owned the property there is a deficit in additional depreciation of \$2,000. Accordingly, the gain realized is \$41,000 (selling price of \$80,000, minus adjusted basis of \$39,000), and the additional depreciation for the property is \$3,000 (that is, the additional depreciation for the property in the hands of the son on the date he received it, as determined in example (1), \$5,000, minus the amount of the deficit in additional depreciation for the period the son actually owned the property, (\$2,000). Since the additional depreciation (\$3,000) is lower than the gain realized (\$41,000), the son recognizes as ordinary income under section 1250(a)(2) gain of \$450, that is, applicable percentage (15 percent) multiplied by additional depreciation (\$3,000).

(b) *Exception for transfers at death*—(1) *General rule.* Section 1250(d)(2) provides that, except as provided in section 691 (relating to income in respect of a decedent), no gain shall be recognized under section 1250(a) upon a transfer at death. For purposes of this paragraph, the term *transfer at death* shall have the same meaning as in paragraph (b) of § 1.1245-4.

(2) *Treatment of transferee.* (i) 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 (a) on the date of death the additional depreciation for the property is zero, and (b) for purposes of computing applicable percentage the holding period of the property under section 1250(e)(1)(A) is deemed to begin on the day after the date of death.

(ii) If property is acquired in a transfer at death to which section 1250(d)(2) applies, the amount of the additional depreciation for the property in the hands of the transferee immediately after the transfer shall be the amount (if any) of the additional depreciation in respect of the property allowed the transferee before the decedent's death, but only 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) by depreciation adjustments referred to in paragraph (d)(1) of § 1.1250-2 which give rise to such additional depreciation. For treatment of such property as having a special element with additional depreciation so computed, see paragraph (c)(5)(i) of § 1.1250-5 (relating to property with two or more elements). For purposes of determining applicable percentage, such special element shall have a holding period which includes the transferee's holding period for such property for the period before the decedent's death.

(3) *Examples.* The provisions of this paragraph may be illustrated by the following examples:

Example 1. On March 6, 1966, Smith dies owning an item of section 1250 property. On March 7, 1968, the executor distributes the property to Smith's son pursuant to a specific bequest of the property in Smith's will. Under section 1014(a)(2) and paragraph (a)(2) of § 1.1014-4, the unadjusted basis of the property in the hands of the son is its fair market value on March 6, 1966 (the date Smith died), and the son is considered to have acquired the property on such date. Under section 1250(e)(1)(A), the son's holding period for the property begins on March 7, 1966 (the day after the day he is considered to have acquired the property). Thus, on March 7, 1968 (the date the property was distributed to the son), the holding period for the property is 24 full months, and the applicable percentage under section 1250(a)(2) is 96 percent. On such date, the additional depreciation for the property includes any additional depreciation in respect of the property for the period the property was possessed by the estate.

Example 2. H purchases section 1250 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 allowed in respect of the property was \$4,000 (the amount allowable) of which \$500 is additional depreciation. One-half of these amounts are allocable to W. Thus, depreciation deductions of \$2,000, of which \$250 is additional depreciation, are allowable 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 of which \$250 is additional depreciation, the additional depreciation for the

property in the hands of W immediately after H's death is \$250.

(c) *Limitation for certain tax-free transactions*—(1) *General.* Section 1250(d)(3) provides that upon a transfer of property described in subparagraph (2) of this paragraph, the amount of gain taken into account by the transferor under section 1250(a) shall not exceed the amount of gain recognized to the transferor on the transfer (determined without regard to section 1250). For purposes of this subparagraph, in case of a transfer of both section 1250 property and nonsection 1250 property in one transaction, the amount realized from the disposition of the section 1250 property shall be deemed to consist of that portion of the fair market value of each property acquired which bears the same ratio to the fair market value of such acquired property as the amount realized from the disposition of the section 1250 property bears to the total amount realized. The preceding sentence shall be applied solely for purposes of computing the portion of the total gain (determined without regard to section 1250) which shall be recognized as ordinary income under section 1250(a). Section 1250(d)(3) does not apply to a disposition of property to an organization (other than a cooperative described in section 521) which is exempt from the tax imposed by chapter 1 of the Code.

(2) *Transfers covered.* The transfers described in this subparagraph are transfers of property in which the basis of the property in the hands of the transferee is determined by reference to its basis in the hands of the transferor by reason of the application of any of the following provisions:

(i) Section 332 (relating to distributions in complete liquidation of an 80 percent or more controlled subsidiary corporation). For application of section 1250(d)(3) to such a complete liquidation, the principles of paragraph (c)(3) of § 1.1245-4 shall apply.

(ii) Section 351 (relating to transfer to a corporation controlled by transferor).

(iii) Section 361 (relating to exchanges pursuant to certain corporate reorganizations).

(iv) Section 371(a) (relating to exchanges pursuant to certain receivership and bankruptcy proceedings).

(v) Section 374(a) (relating to exchanges pursuant to certain railroad reorganizations).

(vi) Section 721 (relating to transfers to a partnership in exchange for a partnership interest).

(vii) Section 731 (relating to distributions by a partnership to a partner). For special carryover basis rule, see section 1250(d)(6)(A) and paragraph (f)(1) of this section.

(3) *Treatment of property in hands of transferee.* In the case of a transfer described in subparagraph (2) (other than subdivision (vii) thereof) of this paragraph:

(i) The additional depreciation for the property in the hands of the transferee immediately after the disposition shall be an amount equal to (a) the amount of the additional depreciation for the property in the hands of the transferor immediately before the disposition, minus (b) the amount of additional depreciation necessary to produce an amount equal to the gain taken into account under section 1250(a) by the transferor upon the disposition (taking into account the applicable percentage for the property),

(ii) For purposes of computing applicable percentage, the holding period under section 1250(e)(2) of the property in the hands of the transferee includes the transferor's holding period,

(iii) If the adjusted basis of the property in the hands of the transferee exceeds its adjusted basis immediately before the transferee, the excess is an addition to capital account under paragraph (d)(2)(ii) of § 1.1250-5 (relating to property with 2 or more elements), and

(iv) If the property disposed of consists of 2 or more elements within the meaning of paragraph (c) of § 1.1250-5, see paragraph (e)(1) of § 1.1250-5 for the amount of additional depreciation and the holding period for each element in the hands of the transferee.

(4) *Examples.* The provisions of this paragraph may be illustrated by the following examples:

Example 1. (i) Green transfers section 1250 property on March 1, 1968, to a corporation,

which is not exempt from taxation, in exchange for cash of \$9,000 and stock in the corporation worth \$91,000, in a transaction qualifying under section 351. Thus, the amount realized is \$100,000 (\$9,000 plus \$91,000). The property has an applicable percentage under section 1250(a)(2) of 60 percent, an adjusted basis of \$40,000, and additional depreciation of \$20,000. The gain realized is \$60,000, that is, amount realized (\$100,000) minus adjusted basis (\$40,000). Since the additional depreciation (\$20,000) is lower than the gain realized (\$60,000), the amount of gain which would be treated as ordinary income under section 1250(a)(2) would be \$12,000 (60 percent of \$20,000) if the limitation provided in section 1250(d)(3) did not apply. Since under section 351(b) gain in the amount of \$9,000 would be recognized to the transferor without regard to section 1250, the limitation provided in section 1250(d)(3) limits the gain taken into account by the transferor under section 1250(a)(2) to \$9,000.

(ii) The amount of additional depreciation for the property in the hands of the transferee immediately after the transfer is \$5,000, that is, the amount of additional depreciation before the transfer (\$20,000) minus the amount of additional depreciation necessary to produce an amount equal to the gain recognized under section 1250(a)(2) upon the transfer (\$15,000, that is, \$9,000 of gain recognized divided by 60 percent, the applicable percentage). (If the property is subsequently disposed of, and for the period after the initial transfer there is additional depreciation in respect of the property, then at the time of the subsequent disposition the additional depreciation will exceed \$5,000. If, however, for the period after the initial transfer there was a deficit in additional depreciation, then at the time of the subsequent disposition the additional depreciation would be less than \$5,000.)

Example 2. (i) Assume the same facts as in example (1) except that the additional depreciation is \$10,000. Since additional depreciation (\$10,000) is lower than the gain realized (\$60,000), the amount of gain which would be treated as ordinary income under section 1250(a)(2) would be \$6,000 (60 percent of \$10,000) if the limitation provided in section 1250(d)(3) did not apply. Since under section 351(b) gain in the amount of \$9,000 would be recognized to the transferor without regard to section 1250, the limitation under section 1250(d)(3) does not prevent treatment of the entire \$6,000 as ordinary income under section 1250(a)(2). The \$3,000 remaining portion of the \$9,000 gain may be treated as gain from the sale of property described in section 1231.

(ii) Immediately after the transfer, the amount of additional depreciation is zero, that is, the amount of additional depreciation before the transfer (\$10,000) minus the amount of additional depreciation necessary

to produce an amount equal to the gain taken into account under section 1250(a)(2) upon the transfer (\$10,000) that is, \$6,000 divided by 60 percent.

Example 3. (i) Miller transfers section 1250 property after December 31, 1969, to a corporation, which is not exempt from taxation, in exchange for cash of \$9,000 and stock in the corporation worth \$31,000, in a transaction qualifying under section 351. Thus, the amount realized is \$40,000 (\$9,000 plus \$31,000). The property has an applicable percentage under paragraph (d)(1)(i)(e) of this section of 100 percent and an applicable percentage under paragraph (d)(2) of this section of 50 percent. The adjusted basis of the property on the date of the transfer is \$24,000, and the gain realized is \$16,000 (that is, amount realized, \$40,000, minus adjusted basis, \$24,000). The additional depreciation attributable to periods after December 31, 1969, is \$8,000 and the additional depreciation attributable to periods before January 1, 1970, is \$12,000. Since the additional depreciation attributable to periods after December 31, 1969 (\$8,000), is lower than the gain realized (\$16,000), the amount of gain which would be recognized as ordinary income under section 1250(a)(1) would be \$8,000 (100 percent of \$8,000) if the limitation provided in section 1250(d)(3) did not apply. In addition, gain is recognized under section 1250(a)(2) since there is a remaining potential gain of \$8,000 (that is, gain realized, \$16,000, minus additional depreciation attributable to periods after December 31, 1969 (\$8,000)). Since the remaining potential gain (\$8,000) is lower than the additional depreciation attributable to periods before January 1, 1970 (\$12,000), the amount of gain which would be recognized under section 1250(a)(2) would be \$4,000 (50 percent of \$8,000) if the limitation in section 1250(d)(3) did not apply. Since under section 351(b) gain in the amount of \$9,000 would be recognized to the transferor without regard to section 1250, the limitation in section 1250(d)(3) limits the gain taken into account by the transferor under section 1250(a) to \$9,000. Since the section 1250(a)(1) gain is considered as recognized first under paragraph (a)(1)(iii) of § 1.1250-1, of the \$9,000 of gain recognized, \$8,000 is recognized under section 1250(a)(1) and \$1,000 is recognized under section 1250(a)(2).

(ii) The amount of additional depreciation for the property in the hands of the transferee immediately after the transfer is \$10,000, the amount of additional depreciation immediately before the transfer (\$20,000), minus the sum of (a) the amount of additional depreciation necessary to produce an amount equal to the gain recognized under section 1250(a)(1) upon the transfer, \$8,000 (that is, gain recognized under section 1250(a)(1), \$8,000, divided by 100 percent, the applicable percentage under section 1250(a)(1)), plus (b) the amount of additional

depreciation necessary to produce an amount equal to the gain recognized under section 1250(a)(2) upon the transfer, \$2,000 (that is, gain recognized under section 1250(a)(2), \$1,000, divided by 50 percent, the applicable percentage under section 1250(a)(2)). Of this amount, zero (that is, \$8,000 minus \$8,000) is attributable to periods after December 31, 1969, and \$10,000 (\$12,000 minus \$2,000) is attributable to periods before January 1, 1970.

(d) *Limitation for like kind exchanges and involuntary conversions*—(1) *Limitation on gain.* (i) Under section 1250(d)(4)(A), if property is disposed of and gain (determined without regard to section 1250) is not recognized in whole or in part under section 1031 (relating to like kind exchanges) or section 1033 (relating to involuntary conversions), then the amount of gain taken into account by the transferor under section 1250(a) shall not exceed the greater of the two limitations set forth in subdivisions (ii) and (iii) of this subparagraph. Immediately after the transfer the basis of the acquired property shall be determined under subparagraph (2), (3), or (4) (whichever is applicable) of this paragraph, and its additional depreciation shall be computed under subparagraph (5) of this paragraph. The holding period of the acquired property for purposes of computing applicable percentage, which is determined under section 1250(e)(1), does not include the holding period of the property disposed of. In the case of a disposition of section 1250 property and other property in one transaction, see subparagraph (6) of this paragraph. In case of a disposition described in section 1250(d)(4)(A) of a portion of this item of property, see subparagraph (7) of this paragraph.

(ii) For purposes of this subparagraph, the first limitation is the sum of:

(a) The amount of gain recognized on the disposition under section 1031 or 1033 (determined without regard to section 1250), plus

(b) An amount equal to the cost of any stock purchased in a corporation which (without regard to section 1250) would result in nonrecognition of gain under section 1033(a)(3)(A).

(iii) For purposes of this subparagraph, the second limitation is the excess (if any) of:

(a) The amount of gain which would (without regard to section 1250(d)(4)) be taken into account under section 1250(a), over

(b) The fair market value (or cost in the case of a transaction described in section 1033(a)(3)) of the section 1250 property acquired in the transaction.

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

Example: A taxpayer receives \$96,000 of insurance proceeds upon the destruction of section 1250 property by fire. If section 1250(d)(4)(A) did not apply to the disposition, \$16,000 of gain would be recognized under section 1250(a). In acquisitions qualifying under section 1033(a)(3)(A), he uses \$90,000 of the proceeds to purchase property similar or related in service or use to the property destroyed, of which \$42,000 is for one item of section 1250 property and \$48,000 is for one piece of land, and \$5,000 of the proceeds to purchase stock in the acquisition of control of a corporation owning property similar or related in service or use to the property destroyed. The taxpayer properly elects under section 1033(a)(3)(A) and the regulations thereunder to limit recognition of gain (determined without regard to section 1250) to \$1,000, that is, the excess of the amount realized from the conversion (\$96,000) over the cost of the property acquired in acquisitions qualifying under section 1033(a)(3)(A) (\$95,000, that is, \$90,000 plus \$5,000). The amount of gain recognized under section 1250(a) is \$6,000, determined in the following manner:

The first limitation:

(a) Amount of gain recognized under section 1033(a)(3), determined without regard to section 1250(a)	\$1,000
(b) Fair market value of stock in a corporation which qualifies under section 1033(a)(3)(A)	5,000
(c) Sum of (a) plus (b)	6,000

The second limitation:

(d) Amount of gain which would be recognized under section 1250(a) if section 1250(d)(4) did not apply	16,000
(e) Cost of section 1250 property acquired in transaction	42,000
(f) Excess of (d) over (e)	0

Since the first limitation (\$6,000) exceeds the second limitation (zero), the amount of gain recognized under section 1250(a) is \$6,000. The balance (\$10,000) of the gain realized (\$16,000) is not recognized.

(2) *Basis of property purchased upon involuntary conversion into money.* (i) If section 1250 property is purchased in a compulsory or involuntary conversion to which section 1033(a)(3) applies, and

if by reason of the application of section 1250(d)(4)(A) all or part of the gain computed under section 1250(a) is not taken into account, then the basis of the section 1250 property and other purchased property shall be determined under the rules prescribed in this subparagraph. See section 1250(d)(4)(D).

(ii) The total basis of all purchased property, the acquisition of which results in the nonrecognition of any part of the gain realized upon the transaction, shall be (a) its cost, reduced by (b) the portion of the total gain realized which was not recognized. To the extent that section 1250(d)(4)(A)(i) prevents the purchase of stock from resulting in nonrecognition of gain, the basis of purchased stock is its cost.

(iii) If purchased property consists of both section 1250 property and other property, the total basis computed under subdivision (ii) of this subparagraph shall be allocated between the section 1250 property (treated as a class) and the other property (treated as a class) in proportion to their respective costs, except that for purposes of this subdivision (but not subdivision (iv) of this subparagraph) the cost of the section 1250 property shall be deemed to be the excess of (a) its actual cost, over (b) the gain not taken into account under section 1250(a) by reason of the application of section 1250(d)(4)(A).

(iv) If the property acquired consists of more than one item of section 1250 property (or of more than one item of other property), the total basis of the section 1250 property (or of the other property), as computed under subdivisions (ii) and (iii) of this subparagraph, shall be allocated to each item of section 1250 property (or other property) in proportion to their respective actual costs.

(v) The provisions of this subparagraph may be illustrated by the following examples:

Example 1. Assume the same facts as in the example in subparagraph (1)(iv) of this paragraph. Assume further that the portion of the gain realized which was not recognized under section 1033(a)(3) or 1250(a) upon the transaction is \$60,000, of which the gain computed under section 1250(a) which is not taken into account by reason of the application of section 1250(d)(4)(A) is \$10,000, that is, the excess of the gain which would have been

recognized under section 1250(a) if section 1250(d)(4)(A) did not apply (\$16,000) over the gain recognized under section 1250(a) (\$6,000). In such example \$95,000 of proceeds were used to purchase property in acquisitions qualifying under section 1033(a)(3)(A) of which \$42,000 was for section 1250 property, \$48,000 for land, and \$5,000 for stock in a corporation. The basis of each acquired property is determined in the following manner:

(a) Under subdivision (ii) of this subparagraph, the total basis of the acquired properties (other than the stock) is \$30,000, that is, their cost (\$90,000, of which \$42,000 is for section 1250 property and \$48,000 is for land), reduced by the portion of the total gain realized which was not recognized (\$60,000).

(b) Under subdivision (iii) of this subparagraph, such total basis is allocated between the section 1250 property and the land in proportion to their respective costs, and for this purpose the cost of the section 1250 property is considered to be \$32,000, that is, its actual cost (\$42,000) minus the gain not recognized under section 1250(a) by reason of the application of section 1250(d)(4)(A) (\$10,000). Thus, the basis of the section 1250 property is \$12,000 (32/80 of \$30,000), and the basis of the land is \$18,000 (48/80 of \$30,000).

(c) The basis of the purchased stock is its cost of \$5,000. See last sentence of subdivision (ii) of this subparagraph.

Example 2. Assume the same facts as in example (1) except that the section 1250 property purchased for \$42,000 consists of 2 items of such property (\$10,500 for C, and \$31,500 for D), and that the land purchased for \$48,000 consists of 2 pieces of land (\$12,000 for X, and \$36,000 for Y). Under subdivision (iv) of this subparagraph, the total basis for each class of property is allocated between the individual properties of such class in proportion to their respective actual costs. Thus, the total basis of \$12,000, as determined in example (1), for the section 1250 property is allocated as follows:

To C: \$12,000×(\$10,500/\$42,000)	\$3,000
To D: \$12,000×(\$31,500/\$42,000)	9,000
Total	12,000

The total basis of \$18,000, as determined in example (1), for the land is allocated as follows:

To X: \$18,000×(\$12,000/\$48,000)	\$4,500
To Y: \$18,000×(\$36,000/\$48,000)	13,500
Total	18,000

(3) *Basis of property acquired upon involuntary conversion into similar property.* If property is involuntarily converted into property similar or related in service or use in a transaction to which section 1033(a)(1) applies, and if by reason of the application of section

1250(d)(4)(A) all or part of the gain computed under section 1250(a) is not taken into account, then:

(i) The total basis of the acquired property shall be determined under the first sentence of section 1033(c), and

(ii) If more than one item of property is acquired, such total basis shall be allocated to the individual items of property acquired in accordance with the principles prescribed in subparagraph (2) (iii) and (iv) of this paragraph, except that an amount equivalent to the fair market value of each item of property on the date acquired shall be treated as its actual cost.

(4) *Basis of property acquired in like kind exchange.* If section 1250 property is transferred in an exchange described in section 1031 (a) or (b), and if by reason of the application of section 1250(d)(4)(A) all or part of the gain computed under section 1250(a) is not taken into account, then:

(i) The total basis of the property (including nonsection 1250 property) acquired of the type permitted to be received under section 1031 without recognition of gain or loss shall be determined under section 1031(d), and

(ii) If more than one item of property of such type was received, such total basis shall be allocated to the individual items of property of such type in accordance with the principles prescribed in subparagraph (2) (iii) and (iv) of this paragraph, except that an amount equivalent to the fair market value of each such item of property on the date received shall be treated as its actual cost.

(5) *Additional depreciation for property acquired in like kind exchange or involuntary conversion.* (i) If property is disposed of in a transaction described in section 1031 or 1033, and if by reason of the application of section 1250(d)(4)(A) all or part of the gain computed under section 1250(a) is not taken into account, then the additional depreciation for the acquired property immediately after the transaction (as computed under section 1250(d)(4)(E)) shall be an amount equal to the amount of gain computed under section 1250(a) which was not taken into account by reason of the application of section 1250(d)(4)(A).

(ii) In case more than one item of section 1250 property is acquired in the transaction, the additional depreciation computed under subdivision (i) of this subparagraph shall be allocated to each such item of section 1250 property in proportion to their respective adjusted bases.

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

Example 1. (a) On January 15, 1969, section 1250 property X is condemned and proceeds of \$100,000 are received. On such date, X's adjusted basis is \$25,000, the additional depreciation is \$10,000, and the applicable percentage under section 1250(a)(2) is 70 percent. Since the additional depreciation (\$10,000) is less than the gain realized (\$75,000, that is, \$100,000 minus \$25,000) the amount of gain computed under section 1250(a)(2) (without regard to section 1250(d)(4)(A)) is \$7,000, that is, 70 percent of \$10,000.

(b) On March 1, 1969, all the proceeds are used to purchase section 1250 property Y in a transaction qualifying under section 1033(a)(3)(A) for nonrecognition of gain. Accordingly, the gain not recognized by reason of the application of section 1033(a)(3)(A) is \$75,000, of which \$7,000 is gain computed under section 1250(a)(2) which is not taken into account by reason of the application of section 1250(d)(4)(A). See subparagraph (1) of this paragraph.

(c) Immediately after the transaction, Y's basis is \$25,000, that is, its cost (\$100,000) minus the total gain realized which was not recognized (\$75,000), and the additional depreciation (as computed under section 1250(d)(4)(E)) is \$7,000, that is, the amount of gain not taken into account under section 1250(a)(2) by reason of the application of section 1250(d)(4)(A).

(d) On December 15, 1969, before any depreciation deductions were allowed or allowable in respect of Y, Y is sold for \$90,000. Under section 1250(e)(1), the holding period of Y is 9 months, and thus, under section 1250(a)(2), the applicable percentage is 100 percent. Since the additional depreciation (\$7,000) is less than the gain realized (\$65,000, that is \$90,000 minus \$25,000), the amount of gain recognized under section 1250(a)(2) as ordinary income is \$7,000, that is, 100 percent of \$7,000.

Example 2. Assume the same facts as in example (1), except that property Y was purchased on June 15, 1962, and that 90 full months thereafter, or December 15, 1969, it is sold for \$35,000. Thus the applicable percentage under section 1250(a)(2) is 30 percent. Assume further that at the time of such sale Y's adjusted basis is \$5,000 and additional depreciation in respect of Y for periods after it was acquired is \$2,500. Thus, the additional

Internal Revenue Service, Treasury

§ 1.1250-3

depreciation at the time of the sale is \$9,500, that is, the sum of the additional depreciation in respect of Y attributable to X as computed under section 1250(d)(4)(E) in (c) of example (1) (\$7,000), plus the additional depreciation attributable to periods after Y was acquired (\$2,500). Since the additional depreciation (\$9,500) is less than the gain realized (\$30,000, that is, \$35,000 minus \$5,000), the gain recognized under section 1250(a)(2) as ordinary income is \$2,850, that is, 30 percent of \$9,500.

(6) *Single disposition of section 1250 property and property of different class.*

(i) For purposes of this subparagraph:

(a) Section 1250 property, section 1245 property (as defined in section 1245(a)(3)), and other property shall each be treated as a separate class of property, and

(b) The term *qualifying property* means property which may be acquired without recognition of gain under the applicable provision of section 1031 or 1033 (applied without regard to section 1250 or 1245) upon the disposition of property.

(ii) If upon a sale of section 1250 property gain would be recognized under section 1250(a) and if such section 1250 property together with property of a different class or classes are disposed of in one transaction in which gain is not recognized in whole or in part under section 1031 or 1033 (without regard to sections 1245 and 1250), then:

(a) The total amount realized shall be allocated between the different classes of property disposed of in proportion to their respective fair market values,

(b) The amount realized upon the disposition of property of a class shall be deemed to consist of so much of the fair market value of qualifying property of the same class acquired as is not in excess of the amount realized from the property of such class disposed of,

(c) The remaining portion (if any) of the amount realized upon the disposition of property of such class shall be deemed to consist of so much of the fair market value of any other property acquired as is not in excess of such remaining portion, and

(d) For purposes of applying (c) of this subdivision, the fair market value of acquired property shall be taken into account only once and in such manner as the taxpayer determines.

(iii) The amounts determined under this subparagraph in respect of property shall apply for all purposes of the Code.

(iv) The application of this subparagraph may be illustrated by the following example:

Example: (a) Green owns property consisting of land and a fully equipped factory building thereon. The property is condemned and proceeds of \$100,000 are received. If the property were sold for \$100,000, gain of \$40,000 would be recognized of which \$10,000 would be recognized as ordinary income under section 1250(a). Proceeds of \$95,000 are used to purchase property similar or related in service or use to the condemned property and under section 1033(a)(3)(A) (without regard to sections 1245 and 1250) recognition of gain is limited to \$5,000. The fair market values by classes of the property disposed of, and of the property acquired, are summarized in the table below:

	Fair market value of property	
	Disposed of	Acquired
Section 1245 property	\$35,000	\$55,000
Section 1250 property	45,000	28,000
Land	20,000	12,000
Cash .....	.....	5,000
	100,000	100,000

(b) The allocations under subdivision (ii) of this subparagraph are summarized in the table below:

Property disposed of	Property acquired			Cash Remaining
	Sec. 1245 Property	Sec. 1250 Property	Land	
\$35,000 of section 1245 property	\$35,000	.....	.....	.....
\$45,000 of section 1250 property	¹ 17,000	\$28,000	.....	.....
\$20,000 of land	¹ 3,000	.....	\$12,000	¹ \$5,000
Total	55,000	28,000	12,000	5,000

¹ Determined by taxpayer pursuant to subdivision (ii)(d) of this subparagraph.

(c) Upon the disposition of the section 1245 property, only section 1245 property is acquired, and thus gain (if any) would not be recognized under section 1245(a)(1). See section 1245(b)(4). Upon the disposition of the section 1250 property gain under section 1250(a) would not be recognized by reason of the application of section 1250(d)(4)(A). See subparagraph (1) of this paragraph. If the gain realized on the disposition of the land is not less than \$5,000, then under section 1033(a)(3)(A) the gain recognized would be \$5,000, that is, an amount equal to the portion of the proceeds from the disposition of the land (\$5,000) not invested in qualifying property.

(7) *Disposition of portion of property.* A disposition described in section 1250(d)(4)(A) of a portion of an item of property gives rise to an addition to capital account described in the last sentence of paragraph (d)(2)(i) of § 1.1250-5 (relating to property with 2 or more elements). If the addition to capital account is a separate improvement within the meaning of paragraph (d) of § 1.1250-5, and thus an element, then immediately after the addition is made the amount of additional depreciation for such separate improvement shall be computed under subparagraph (5) of this paragraph by treating such portion and such addition as separate properties. If the addition is not a separate improvement, then immediately after the addition is made such property is considered under paragraph (c)(5)(ii) of § 1.1250-5 as having a special element with the same amount of additional depreciation so computed. For purposes of computing applicable percentage, the holding period of the separate improvement or special element (as the case may be), which is determined under section 1250(e)(1), does not include the holding period of the property disposed of.

(e) *Sections 1071 and 1081 transactions*—(1) *General.* This paragraph prescribes regulations under section 1250(d)(5) which apply in the case of a disposition of section 1250 property in a transaction in which gain (determined without regard to section 1250) is not recognized in whole or in part by reason of the application of section 1071 (relating to gain from sale or exchange to effectuate policies of FCC) or section 1081 (relating to gain from sale or exchange in obedience to order of SEC).

(2) *Involuntary conversion treatment under section 1071.* If section 1250 property is disposed of and gain (determined without regard to section 1250) is not recognized in whole or in part solely by reason of an election under the first sentence of section 1071(a) to treat the transaction as an involuntary conversion, the consequences of the transaction shall be determined under the principles of paragraph (d) of this section.

(3) *Basis reduction under sections 1071 or 1082(a)(2).* (i) If section 1250 property is disposed of and gain (determined without regard to section 1250) is not recognized in whole or in part by reason of a reduction in basis of property pursuant to an election under section 1071(a) or the application of section 1082(a)(2), then the amount of gain taken into account by the transferor under section 1250(a) shall not exceed the sum of:

(a) The amount of gain recognized on such disposition (determined without regard to section 1250), plus

(b) In case involuntary conversion treatment was also elected under section 1071(a), an amount equal to the cost of any stock purchased in a corporation which (without regard to section 1250) would result in nonrecognition of gain under section 1033(a)(3), as modified by section 1071(a), plus

(c) The portion of the gain computed under section 1250(a) (without regard to this paragraph) which is neither taken into account under (a) or (b) of this subdivision nor applied under subdivision (ii) of this subparagraph to reduce the basis of section 1250 property.

(ii)(a) The amount of gain computed under section 1250(a) (without regard to this paragraph) which is not taken into account under subdivision (i) (a) or (b) of this subparagraph shall be applied to the amount by which the basis of the section 1250 property was reduced under section 1071(a) or 1082(a)(2), as the case may be, before other gain (which is not gain computed under section 1250(a)) is so applied.

(b) If the basis of more than one item of section 1250 property was so reduced, the gain applied under (a) of this subdivision to all such section 1250 properties shall be applied to such items in

proportion to the amounts of their respective basis reductions.

(c) Any gain not applied under (a) of this subdivision shall be applied to the amount by which the basis of the non-section 1250 property was reduced.

(iii) If gain computed under section 1250 is applied under subdivision (ii) of this subparagraph to reduce the basis of section 1250 property, the amount so applied shall be treated as additional depreciation in respect of such section 1250 property. For treatment of such section 1250 property as having a special element with additional depreciation consisting of such amount, see paragraph (c)(5)(i) of § 1.1250-5. For purposes of computing applicable percentage, such special element shall have a holding period beginning on the day after the date as of which the property's basis was so reduced.

(4) *Section 1081(d)(1)(A) transaction.* No gain shall be recognized under section 1250(a) upon an exchange of property as to which gain is not recognized (without regard to section 1250) because of the application of section 1081(d)(1)(A) (relating to transfers within system group). For treatment of property in the hands of a transferee, the principles of paragraph (c)(3) of this section shall apply.

(f) *Property distributed by a partnership to a partner—(1) General.* For purposes of section 1250 (d)(3) and (e)(2), the basis of section 1250 property distributed by a partnership to a partner shall be determined by reference to the adjusted basis of such property to the partnership. Thus, if section 731 applies to a distribution of section 1250 property by a partnership to a partner, then even though the partner's basis is not determined for other purposes by reference to the partnership's basis, (i) the amount of gain taken into account by the partnership under section 1250(a) is limited by section 1250(d)(3) to the amount of gain recognized to the partnership upon the distribution (determined without regard to section 1250), and (ii) the holding period of the property in the hands of the partner shall, under section 1250(e)(2), include the holding period of the property in the hands of the partnership. For non-application of section 1250(d)(3) to a disposition to an organization (other

than a cooperative described in section 521) which is exempt from the tax imposed by chapter 1 of the Code, see paragraph (c)(1) of this section.

(2) *Treatment of property distributed by partnership.* (i) If section 1250 property is distributed by a partnership to a partner in a distribution in which no part of the partnership's *potential section 1250 income* in respect of the property was recognized as ordinary income to the partnership under paragraph (b)(2)(ii) of § 1.751-1, the additional depreciation for the property in the hands of the distributee attributable to periods before the distribution shall be an amount equal to the total potential section 1250 income of the partnership in respect of the property immediately before the distribution, recomputed as if the applicable percentage for the property had been 100 percent. Under paragraph (c)(4) of § 1.751-1, the potential section 1250 income is, in effect, the gain to which section 1250(a) would have applied if the property had been sold by the partnership immediately before the distribution at its fair market value at such time.

(ii) If upon the distribution any potential section 1250 income in respect of the property was recognized to the partnership under paragraph (b)(2)(ii) of § 1.751-1, then after the distribution the additional depreciation shall be an amount equal to (a) the total potential section 1250 income in respect of the property, as recomputed in subdivision (i) of this subparagraph, minus (b) the amount of potential section 1250 income which would have been recognized to the partnership under paragraph (b)(2)(ii) of § 1.751-1 if the applicable percentage for the property had been 100 percent.

(iii) If the partner's basis for the property immediately after the transaction exceeds the partnership's adjusted basis for the property immediately before the transaction, the excess may be an addition to capital account under paragraph (d)(2)(ii) of § 1.1250-5 (relating to property with two or more elements).

(3) *Examples.* The provisions of subparagraphs (1) and (2) of this paragraph may be illustrated by the following examples:

Example 1. (i) A partnership distributes a building to Smith on January 1, 1969, in a complete liquidation of his partnership interest to which section 736(a) does not apply. On the date of the distribution, the partnership's holding period for the property is 40 full months and, accordingly, the applicable percentage under section 1250(a)(2) is 80 percent. On such date, the partnership's additional depreciation for the building (\$6,250) is lower than the excess (\$40,000) of its fair market value (\$140,000) over adjusted basis (\$100,000). Thus, under paragraph (c)(4) of § 1.751-1, the partnership's potential section 1250 income in respect of the building is \$5,000 (80 percent of \$6,250). Assume that section 751(b) does not apply to the distribution. Accordingly, no gain would be recognized to the partnership under section 731(b) (without regard to the application of section 1250). Smith's basis for his partnership interest was \$150,000, and under section 732(b) Smith's basis for the building is equal to his basis for his partnership interest. Thus, Smith's basis for the building is not determined by reference to the partnership's basis for the building. Nevertheless, under subparagraph (1) of this paragraph, no gain is recognized to the partnership under section 1250(a)(2) and Smith's holding period for the property includes the partnership's holding period.

(ii) Six full months after Smith received the building in the distribution, or July 1, 1969, he sells it for \$153,000. Assume that no depreciation was allowed or allowable to Smith for the building, and that the special rules under § 1.1250-5 for property with two or more elements do not apply. Since Smith's holding period for the building includes its holding period in the hands of the partnership, his holding period is 46 full months (40 full months for the partnership plus 6 full months for Smith) and the applicable percentage under section 1250(a)(2) is 74 percent.

(iii) Since no potential section 1250 income was recognized to the partnership under paragraph (b)(2)(ii) of § 1.751-1, the additional depreciation for the building attributable to periods before the distribution is determined under the provisions of subparagraph (2)(i) of this paragraph. Under such provisions, the potential section 1250 income to the partnership, which was actually \$5,000 (that is, 80 percent of \$6,250), is recomputed as if the applicable percentage were 100 percent, and thus such additional depreciation is \$6,250 (that is, 100 percent of \$6,250). Since no depreciation was allowed or allowable for the building in Smith's hands, the additional depreciation for the building attributable to Smith's total holding period (46 full months) is \$6,250. Since the gain realized (\$3,000, that is, amount realized, \$153,000, minus adjusted basis, \$150,000), is lower than the additional depreciation (\$6,250), the gain recognized to Smith under section 1250(a)(2) is \$2,220 (that is, 74 percent of \$3,000).

Example 2. Assume the facts as in example (1) except that as a result of the distribution the partnership recognizes under paragraph (b)(2)(ii) of § 1.751-1 potential section 1250 income of \$1,000 (that is, 80 percent of \$1,250). The additional depreciation attributable to periods before the distribution, as determined under the provisions of subparagraph (2)(ii) of this paragraph, is \$5,000, that is, (a) the total potential section 1250 income in respect of the property, recomputed in example (1) as if the applicable percentage were 100 percent (\$6,250), minus (b) the amount of potential section 1250 income which would have been recognized to the partnership under paragraph (b)(2)(ii) of § 1.751-1 if the applicable percentage for the property had been 100 percent (\$1,250, that is, 100 percent of \$1,250).

(4) *Treatment of partnership property after certain transactions.* 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 1250 property (or a portion thereof) from a distributee who relinquishes his interest in such property (or portion), then after the date of such purchase the following rules shall apply:

(i) If only a portion of the property is treated as purchased, there shall be excluded from the additional depreciation for the remaining portion any additional depreciation in respect of the purchased portion for periods before such purchase.

(ii) In respect of the purchased property (or portion), (a) as of the date of purchase the amount of additional depreciation shall be zero, and (b) for purposes of computing applicable percentage the holding period shall begin on the day after the date of such purchase.

(5) *Cross reference.* See paragraph (f) of § 1.1250-1 for the amount of additional depreciation for 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.

(g) *Disposition of principal residence—*
(1) *In general.* (i) Section 1250(d)(7)(A) provides that section 1250(a) shall not apply to a disposition of property by a taxpayer to the extent the property is used by the taxpayer as his principal

residence (within the meaning of section 1034(a) and the regulations thereunder, relating to a sale or exchange of residence). Thus, for example, if a doctor sells a house, of which one portion was used as his principal residence within the meaning of section 1034(a) and the other portion was properly subject to the allowance for depreciation as property used in his trade or business, then, by reason of the application of section 1250(d)(7)(A), section 1250(a) does not apply in respect of the disposition of the portion used as his principal residence. The provisions of this subparagraph shall apply regardless of whether section 1034 applies. Thus, for example, if section 1034 did not apply to the sale because the doctor did not invest in a new principal residence within the period specified in section 1034, nevertheless section 1250(a) would not apply to the disposition of the portion used as a principal residence.

(ii) Section 1250(d)(7)(B) provides that section 1250(a) shall not apply to a disposition of section 1250 property by a taxpayer who, in respect of the property, satisfies the age and ownership requirements of section 121 (relating to exclusion from gross income of gain on sale or exchange of residence of individual who has attained age 65), but only to the extent the taxpayer satisfies the use requirements of section 121 in respect of such property. Thus, if a taxpayer has attained the age of 65 before the date on which he disposes of section 1250 property, and if during the 8-year period ending on the date of the disposition the property has been owned and used by the taxpayer solely as his principal residence for periods aggregating 5 years or more, then section 1250(a) does not apply in respect to the disposition. This result would not be changed even if the taxpayer does not or cannot make the election provided for in section 121 and even if section 121 applies to only a portion of the gain because the adjusted sales price exceeds the \$20,000 limitation in section 121(b)(1). If, however, only a portion of the property has been used as his principal residence for such periods aggregating 5 years or more, then, by reason of the application of section 1250(d)(7)(B), section 1250(a) is inapplicable only to the portion so used. For

special rules for determining whether the age, ownership, and use requirements of section 121 are treated as satisfied, and for the manner of applying such requirements, see section 121(d) and the regulations thereunder.

(2) *Concurrent operation of section 1250(d)(7) with other provisions.* Upon the disposition of a principal residence, gain computed under section 1250(a) may not be recognized in whole or in part by reason of the application of both the provisions of section 1250(d)(7) and the provisions of one of the other exceptions or limitations enumerated in section 1250(d). Thus, for example, if an entire house is transferred as a gift, and if section 1250(d)(7) applies to only a portion of the house, then section 1250(d)(1) excepts the disposition of the entire house from the application of section 1250(a).

(3) *Special rule.* If by reason of section 1250(d)(7) a disposition is partially excepted from the application of section 1250(a), and if no other paragraph of section 1250(d) excepts the disposition entirely from such application, then the gain to which section 1250(a) applies shall be an amount which bears the same ratio to (i) the gain computed under section 1250(a) (without regard to section 1250(d)(7)), as (ii) the fair market value of the portion of the property to which the exception in section 1250(d)(7) does not apply, bears to (iii) the total fair market value of the property. Thus, for example, if under paragraph (a)(2) of this section gain of \$300 would be recognized as ordinary income under section 1250(a) (without regard to section 1250(d)(7)) upon a combined sale and gift of section 1250 property, and if the property has a fair market value of \$25,000 of which \$10,000 is properly allocable to a portion not used as a principal residence, then the amount of gain recognized as ordinary income under section 1250(a) would be \$120 (10/25 of \$300).

(4) *Treatment of property in hands of transferee.* If property is disposed of in a transaction to which section 1250(d)(7) applies, and if its basis in the hands of the transferee is determined by reference to its basis in the hands of the transferor by reason of the application of section 1250(d)(1) (relating to gifts) or section 1250(d)(3) (relating to

certain tax-free transactions), then the treatment of the property in the hands of the transferee shall be determined under paragraph (a)(3) or (c)(3) (whichever is applicable) of this section.

(5) *Treatment of property acquired in like kind exchange or involuntary conversion.* If property is disposed of in a transaction to which section 1250(d)(7) (relating to principal residence) and section 1250(d)(4) (relating to like kind exchanges and involuntary conversions) apply, then:

(i) The basis of the property acquired shall be determined under the applicable provisions of paragraph (d) (2), (3), or (4) of this section, applied as if all gain computed under section 1250(a) (except any gain not recognized solely by reason of the application of section 1250(d)(7)) were not taken into account by reason of section 1250(d)(4)(A).

(ii) The additional depreciation for the property acquired shall be determined in the manner prescribed in paragraph (d)(5) of this section, so applied, and

(iii) For purposes of computing the applicable percentage, the holding period of the acquired property shall be determined under section 1250(e)(1).

(6) *Treatment of property acquired in section 1034 transaction.* If a principal residence is disposed of in a transaction to which section 1250(d)(7) applies, and if by reason of the application of section 1034 (relating to sale or exchange of residence) the basis of property acquired in the transaction is determined by reference to the basis in the hands of the taxpayer of the property disposed of, then:

(i) The additional depreciation for the acquired property immediately after the transaction shall be an amount equal to (a) the amount of the additional depreciation for the property disposed of, minus (b) the amount of any gain which would have been taken into account under section 1250(a) by the transferor upon the disposition if the applicable percentage for the property had been 100 percent.

(ii) For purposes of computing the applicable percentage, the holding period of the acquired property includes the holding period of the disposed of property (see section 1250(e)(3)).

(iii) If the adjusted basis of the acquired property exceeds the adjusted basis immediately before the transfer of the property disposed of, the excess is an addition to capital account under paragraph (d)(2)(ii) of § 1.1250-5 (relating to property with more than one element), and

(iv) If the property disposed of consisted of two or more elements within the meaning of paragraph (c) of § 1.1250-5, see paragraph (e)(3) of § 1.1250-5 for the amount of additional depreciation and the holding period for each element in the hands of the transferee.

(h) *Limitation for disposition of qualified low-income housing—(1) Limitation on gain.* (i) Under section 1250(d)(8)(A), if section 1250 property is disposed of and gain (determined without regard to section 1250) is not recognized in whole or in part under section 1039 (relating to certain sales of low-income housing projects), then the amount of gain recognized by the transferor under section 1250(a) shall not exceed the greater of:

(a) The amount of gain recognized under section 1039 (determined without regard to section 1250), or

(b) The excess, if any, of the amount of gain which would, but for section 1250(d)(8)(A), be taken into account under section 1250(a), over the cost of the section 1250 property acquired in the transaction.

For purposes of this paragraph the term *qualified housing project, approved disposition, reinvestment period, and net amount realized* shall have the same meaning as in section 1039 and § 1.1039-1.

(ii) The principles of this subparagraph may be illustrated by the following examples:

Example 1. (i) Taxpayer A owns a qualified housing project and makes an approved disposition of the project on January 1, 1971. The net amount realized upon the disposition is \$550,000, of which \$475,000 is attributable to section 1250 property. The adjusted basis of the section 1250 property is \$250,000 and the gain realized on the disposition of section 1250 property is \$225,000. The additional depreciation for the property is \$100,000, the applicable percentage is 48 percent, and if section 1250(d)(8)(A) did not apply to the disposition, \$48,000 of gain would be recognized under section 1250(a). Within the reinvestment period, A purchases a replacement qualified housing project at a cost

of \$525,000, of which \$425,000 is attributable to section 1250 property. A properly elects under section 1039(a) and the regulations thereunder to limit the recognition of gain (determined without regard to section 1250) to \$25,000, that is, the excess of the net amount realized (\$550,000) over the cost of the replacement housing project (\$525,000).

(ii) The amount of gain recognized under section 1250(a) is limited to \$25,000, that is, the greater of (a) the amount of gain recognized without regard to section 1250(a) (\$25,000), or (b) the excess of (1) the amount of gain which would be taken into account under section 1250(a) if section 1250(d)(8)(A) did not apply (\$225,000), over (2) the cost of the replacement section 1250 property (\$425,000), or zero.

Example 2. The facts are the same as in example (1) except that only \$180,000 of the cost of the replacement housing project is attributable to section 1250 property. Thus, the gain recognized under section 1250(a) is limited to \$45,000, the greater of (a) the excess of (1) the amount of gain which would be taken into account under section 1250(a) if section 1250(d)(8)(A) did not apply (\$225,000), over (2) the cost of the replacement section 1250 property (\$180,000), or (b) the amount of gain recognized without regard to section 1250 (\$25,000).

(2) *Replacement project consisting of more than one element.* (i) If (a) section 1250 property is disposed of, (b) any portion of the gain which would have been recognized under section 1250(a) is not recognized by reason of section 1250(d)(8)(A), and (c) the cost of the replacement section 1250 property constructed, reconstructed, or acquired during the reinvestment period exceeds the net amount realized attributable to the section 1250 property disposed of, then the section 1250 property shall consist of two elements. For purposes of this paragraph, the *reinvestment element* is that portion of the section 1250 property constructed, reconstructed, or acquired during the reinvestment period the cost of which does not exceed the net amount realized attributable to the section 1250 property disposed of, reduced by any gain recognized with respect to such property. The *additional cost element* is that portion of the section 1250 property constructed, reconstructed, or acquired during the reinvestment period whose cost exceeds the net amount realized attributable to the section 1250 property disposed of.

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

Example 1. (i) Taxpayer B disposes of a qualified housing project consisting of section 1250 property with an adjusted basis of \$500,000 and land with a basis of \$100,000. The amount realized on the disposition is \$750,000 of which \$650,000 is attributable to the section 1250 property. B constructs a replacement housing project at a cost of \$1,000,000 of which \$850,000 is attributable to section 1250 property. B elects in accordance with the provisions of section 1039(a) and the regulations there under not to recognize the \$150,000 gain realized.

(ii) Under section 1250(d)(8)(A) no gain is recognized under section 1250(a). The replacement section 1250 property consists of the two elements. The reinvestment element has a cost of \$650,000, i.e., that portion of the replacement section 1250 property the cost of which does not exceed the amount realized attributable to the section 1250 property disposed of (\$650,000), reduced by any gain recognized with respect to such property (zero). The additional cost element has a cost of \$200,000, that is, the excess of the cost of the replacement section 1250 property (\$850,000) over the amount realized attributable to the section 1250 property disposed of (\$650,000).

(3) *Basis of property acquired.* (i) If section 1250 property is disposed of and gain (determined without regard to section 1250) is not recognized in whole or in part under section 1039 (relating to certain sales of low-income housing projects), then the basis of the section 1250 property and other property acquired in the transaction shall be determined in accordance with the rules of this subparagraph. Generally, the basis of the property acquired in a transaction to which section 1039(a) applies is its cost reduced by the amount of any gain not recognized attributable to the property disposed of (see section 1039(d)). In a case where the replacement section 1250 property constructed, reconstructed, or acquired within the reinvestment period is treated as consisting of more than one element under section 1250(d)(8)(e), the aggregate basis of the property determined under section 1039(d) shall be allocated as follows: first, to the reinvestment element of the section 1250 property, in an amount equal to the amount determined under section 1250(d)(8)(E)(i) reduced by the amount of any gain not recognized attributable

to the section 1250 property disposed of; second, to the other replacement property (other than section 1250 property) in an amount equal to the amount of its cost reduced (but not below zero) by any remaining amount of gain not recognized; and finally, to the additional cost element of the section 1250 property, in an amount equal to the amount determined under section 1250(d)(8)(E)(ii) reduced by any amount of gain not recognized which has not been taken into account in determining the basis of the reinvestment element and the other replacement property that is not section 1250 property. See paragraph (h)(2) of this section for definition of the terms *reinvestment element* and *additional cost element*.

(ii) The principles of this subparagraph may be illustrated by the following examples:

Example 1. The facts are the same as in example (1) of subparagraph (1)(ii) of this paragraph. The basis of the replacement section 1250 property is \$225,000, the amount of the reinvestment element (\$425,000) minus the gain not recognized attributable to the section 1250 property disposed of (\$200,000).

Example 2. Taxpayer C disposes of a qualified housing project on January 1, 1971. The adjusted basis for the project is \$3,800,000, of which \$3,000,000 is attributable to section 1250 property and \$800,000 is attributable to land. The amount realized on the disposition is \$5,000,000, of which \$4,000,000 is attributable to the section 1250 property and \$1,000,000 is attributable to the land. The gain realized upon the disposition is \$1,200,000, that is, amount realized (\$5,000,000) minus adjusted basis (\$3,800,000), of which \$1,000,000 is attributable to the section 1250 property disposed of. Within the reinvestment period, C purchases another qualified housing project at a cost of \$5,500,000, of which \$4,000,000 is attributable to section 1250 property and \$1,500,000 is attributable to other property. C makes an election under section 1039(a) and the regulations thereunder and none of the \$1,200,000 gain realized on the disposition is recognized (determined without regard to section 1250). Under section 1250(d)(8)(A), none of the gain realized is recognized under section 1250(a). The basis of the replacement section 1250 property is \$3,000,000, that is, the amount of the reinvestment element (\$4,000,000) less the amount of gain not recognized attributable to section 1250 property disposed of (\$1,000,000). The basis of the other property acquired is \$1,300,000, that is, its cost (\$1,500,000) reduced by the remaining gain not recognized (\$200,000).

Example 3. The facts are the same as in example (2) except that the cost of the replacement section 1250 property is \$4,500,000 and the cost of the other property is \$1,000,000. Thus, the replacement section 1250 property consists of two elements under section 1250(d)(8)(E). The reinvestment element (section 1250(d)(8)(E)(i)) has a basis of \$3,000,000, that is \$4,000,000 (that portion of the section 1250 property acquired the cost of which does not exceed the net amount realized attributable to the section 1250 property disposed of), reduced by \$1,000,000 (the gain not recognized attributable to the section 1250 property disposed of). The basis of the other property is \$800,000, that is, its cost (\$1,000,000) reduced by the remaining gain not recognized (\$200,000). The additional cost element (section 1250(d)(8)(E)(ii)) has a basis of \$500,000, that is, the portion of the section 1250 property acquired the cost of which exceeds the net amount realized attributable to the section 1250 property disposed of. This amount (\$500,000) is not reduced by any amount of gain not recognized because all of the gain not recognized has already been taken into account in determining the basis of the reinvestment element and the other replacement property that is not section 1250 property.

(4) *Additional depreciation for property acquired.* (i) If a qualified housing project is disposed of in a transaction to which section 1039(a) applies, the additional depreciation for the replacement property immediately after the transaction shall be an amount equal to (a) the amount of additional depreciation for the property disposed of, minus (b) the amount of additional depreciation necessary to produce the amount of gain recognized under section 1250(a). Thus, if no gain is recognized upon a disposition of a qualified housing project, the additional depreciation for the property acquired will be the same as for the property disposed of. On the other hand, if upon disposition of a project, gain of \$40,000 was recognized under section 1250(a), and if the additional depreciation for the project and the applicable percentage were \$100,000 and 80 percent, respectively, the additional depreciation for the replacement housing project would be \$50,000, that is, \$100,000 minus \$50,000, the amount of additional depreciation necessary to produce \$40,000 of recognized gain where the applicable percentage is 80 percent.

(ii) If the property acquired in the transaction consists of more than one

element of section 1250 property by reason of section 1250(d)(8)(E), the additional depreciation under subdivision (i) of this subparagraph shall be allocated solely to the reinvestment element.

(5) *Additional limitation.* If, in a transaction to which section 1039(a) applies, gain is recognized by the taxpayer, the amount of gain recognized which is attributable to section 1250 property disposed of is, under section 1250(d)(8)(F)(i), limited to an amount equal to the net amount realized attributable to the section 1250 property disposed of reduced by the greater of (i) the adjusted basis of the section 1250 property disposed of, or (ii) the cost of the section 1250 property acquired. The limitation of section 1250(d)(8)(F)(i) may be illustrated by the following example:

Example: Taxpayer D owns property constituting a qualified housing project under section 1039(b)(1). In an approved disposition, the project is sold for \$225,000. The net amount realized on the disposition is \$225,000 of which \$175,000 is attributable to the section 1250 property disposed of. The adjusted basis of such property is \$150,000 and thus the gain realized upon the disposition of the section 1250 property is \$25,000. Assume that the total gain realized upon disposition of the project is \$45,000. Within the reinvestment period, D purchases another qualified housing project at a cost of \$200,000, of which \$160,000 is attributable to section 1250 property. D elects, in accordance with section 1039(a) and the regulations thereunder, to limit the recognition of gain to \$25,000, that is, the net amount realized (\$225,000), minus the cost of the replacement housing project (\$200,000). Under this subparagraph, \$15,000 of the \$25,000 gain recognized is attributable to the section 1250 property disposed of, that is, the net amount realized attributable to the section 1250 property disposed of (\$175,000), reduced by \$160,000, the greater of the adjusted basis of the section 1250 property disposed of (\$150,000) or the cost of the section 1250 property acquired (\$160,000).

(6) *Allocation rule.* (i) If, in a transaction to which paragraph (h)(1) of this section applies, the section 1250 property disposed of is treated as consisting of more than one element by reason of the application of section 1250(d)(8)(E) with respect to a prior transaction, then the amount of gain recognized, the net amount realized, and the additional depreciation with respect to

each such element shall be allocated to the elements of the replacement section 1250 property in accordance with the provisions of this subparagraph.

(ii) The portion of the net amount realized upon such a disposition which shall be allocated to each element of the section 1250 property disposed of is that amount which bears the same ratio to the net amount realized attributable to all the section 1250 property disposed of in the transaction as the additional depreciation for that element bears to the total additional depreciation for all elements disposed of. If any gain is recognized upon disposition of the section 1250 property, such gain shall be allocated to each element in the same proportion as the gain realized for that element bears to the gain realized for all elements disposed of. The additional depreciation for each reinvestment element of the replacement section 1250 property shall be the same as for the corresponding element of the property disposed of, decreased by the amount of additional depreciation necessary to produce the amount of gain recognized for such element. The additional depreciation for any additional cost element shall be zero.

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

Example: Taxpayer E disposes of a qualified housing project in an approved disposition. The net amount realized is \$1,090,000 of which \$900,000 is attributable to section 1250 property. The section 1250 property consists of (1) a reinvestment element with an adjusted basis of \$300,000, additional depreciation of \$100,000, and an applicable percentage of 50 percent, and (2) an additional cost element with an adjusted basis of \$200,000, additional depreciation of \$50,000, and an applicable percentage of 80 percent. Gain of \$400,000 is realized on the disposition of the section 1250 property, that is, amount realized (\$900,000) minus adjusted basis (\$500,000). Within the reinvestment period, E purchases another qualified housing project at a cost of \$1,000,000 of which \$840,000 is attributable to section 1250 property. E elects, in accordance with section 1039 and the regulations thereunder, to limit recognition of gain (determined without regard to section 1250) to \$90,000, that is, the excess of the net amount realized (\$1,090,000) over the cost of the replacement project (\$1,000,000). Under section 1250(d)(8)(A), the amount of gain recognized under section 1250(a) is limited to \$90,000 (see subparagraph (l) of this paragraph). Under

section 1250(d)(8)(F)(ii) and this subparagraph, \$600,000 of the \$900,000 net amount realized attributable to the section 1250 property is allocated to the reinvestment element, that is, additional depreciation for the element (\$100,000) over total additional depreciation (\$150,000) times the net amount realized (\$900,000). The remaining \$300,000 is allocated to the additional cost element. Thus, the gain realized attributable to the reinvestment element is \$300,000, that is, net amount realized (\$600,000) minus adjusted basis (\$300,000). The gain realized attributable to the additional cost element is \$100,000, that is, net amount realized (\$300,000) minus adjusted basis (\$200,000). Under subparagraph (5) of this paragraph, the gain recognized attributable to the section 1250 property is limited to \$60,000, that is, the net amount realized attributable to the section 1250 property disposed of (\$900,000) minus the greater of the adjusted basis of such property (\$500,000) or the cost of the section 1250 property acquired in the transaction (\$840,000). Under section 1250(d)(8)(F)(ii) and this subparagraph, \$45,000 of the \$60,000 gain recognized is attributable to the reinvestment element, that is, \$60,000 multiplied by a fraction whose numerator is the gain realized attributable to the reinvestment element (\$300,000) and whose denominator is the total gain realized attributable to all the section 1250 property (\$400,000). The remaining \$15,000 of the gain recognized is attributable to the additional cost element. The new property acquired has no additional cost element. The reinvestment element of the new property acquired consists of 2 subelements corresponding to the reinvestment element and additional cost element of the property disposed of. The subelement corresponding to the reinvestment element has additional depreciation of \$10,000, that is, its additional depreciation immediately before the disposition (\$100,000), minus \$90,000, the amount of additional depreciation necessary to produce \$45,000 of section 1250(a) gain where the applicable percentage is 50 percent. The subelement corresponding to the additional cost element has additional depreciation of \$31,250, that is, its additional depreciation immediately before the disposition (\$50,000), minus \$18,750, the amount of additional depreciation necessary to produce \$15,000 of section 1250(a) gain where the applicable percentage is 80 percent.

[T.D. 7084, 36 FR 275, Jan. 8, 1971, as amended by T.D. 7193, 37 FR 12957, June 30, 1972; T.D. 7400, 41 FR 5101, Feb. 4, 1976; 41 FR 7095, Feb. 17, 1976]

§ 1.1250-4 Holding period.

(a) *General.* In general, for purposes only of determining the applicable per-

centage (as defined in section 1250(1)(C) and (2)(B)) of section 1250 property, the holding period of the property shall be determined under the rules of section 1250(e) and this section and not under the rules of section 1223. If the property is treated as consisting of two or more elements (within the meaning of paragraph (c)(1) of § 1.1250-5), see paragraph (a)(2)(ii) of § 1.1250-5 for application of this section to determination of holding period of each element. Section 1250(e) does not affect the determination of the amount of additional depreciation in respect of section 1250 property.

(b) *Beginning of holding period.* (1) For the purpose of determining the applicable percentage, in the case of property acquired by the taxpayer (other than by means of a transaction referred to in paragraph (c) or (d) of this section), the holding period of the property shall begin on the day after the date of its acquisition. See section 1250(e)(1)(A). Thus, for example, if a taxpayer purchases section 1250 property on January 1, 1965, the holding period of the property begins on January 2, 1965. If he sells the property on October 1, 1966, the holding period on the day of the sale is 21 full months, and, accordingly, the applicable percentage is 99 percent. This result would not be changed even if the property initially had been used solely as the taxpayer's residence for a portion of the 21-month period. If, however, the property were sold on September 30, 1966, the holding period would be only 20 full months.

(2) For the purpose of determining the applicable percentage in the case of property constructed, reconstructed, or erected by the taxpayer, the holding period of the property shall begin on the first day of the month during which the property is placed in service. See section 1250(e)(1)(B). Thus, for example, if a taxpayer constructs section 1250 property and places it in service on January 15, 1965, its holding period begins on January 1, 1965. If the taxpayer sells the property on December 31, 1966, its holding period on the day of sale is 24 full months, and, accordingly, the applicable percentage is 96 percent. For purposes of this subparagraph, property is placed in service on the date on which it is first used, whether in a