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[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-107595-11]

RIN 1545-BK09

Application of Modified Carryover Basis to General Basis Rules

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that provide guidance regarding the application of the modified carryover basis rules of section 1022 of the Internal Revenue Code (Code). Specifically, the proposed regulations will modify provisions of the Treasury Regulations involving basis rules by including a reference to section 1022 where appropriate. The regulations will affect property transferred from certain decedents who died in 2010. The regulations reflect changes to the law made by the Economic Growth and Tax Relief Reconciliation Act of 2001 and the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010.

DATES: Written or electronic comments and requests for a public hearing must be received by **[INSERT DATE 90 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG-107595-11), room 5205,

Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044.

Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG-107595-11), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically via the Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov) (REG-107595-11).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Mayer R. Samuels, (202) 317-6859; concerning submissions of comments or a request for a public hearing, Oluwafunmilayo Taylor, (202) 317-6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

### **Background**

Subtitle A of title V of the Economic Growth and Tax Relief Reconciliation Act of 2001, Public Law 107-16 (EGTRRA) enacted section 2210 of the Code, which made chapter 11 (the estate tax) inapplicable to the estate of any decedent who died in 2010. Subtitle E of title V of EGTRRA enacted section 1022 regarding a modified carryover basis system applicable during 2010. On December 17, 2010, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Public Law 111-312 (TRUIRJCA) became law, and section 301(a) of TRUIRJCA retroactively reinstated the estate and generation-skipping transfer taxes. However, section 301(c) of TRUIRJCA allows the executor of the estate of a decedent who died in 2010 to elect to apply the Code as though section 301(a) of TRUIRJCA did not apply with respect to chapter 11 and with respect to property acquired or passing from the decedent (within

the meaning of section 1014(b) of the Code). Thus, section 301(c) of TRUIRJCA allows the executor of the estate of a decedent who died in 2010 to elect not to have the provisions of chapter 11 apply to the decedent's estate, but rather to have the provisions of section 1022 apply (Section 1022 Election).

Generally, under section 1014(a), the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent is the fair market value of the property at the date of the decedent's death. However, if the decedent died in 2010 and the decedent's executor, as defined in section 2203, makes the Section 1022 Election, then the basis of property in the hands of a person acquiring the property from that decedent is governed by section 1022 and not by section 1014.

Section 1022(a)(1) generally provides that property acquired from a decedent (within the meaning of section 1022(e)) is treated as having been transferred by gift. If the decedent's adjusted basis is less than or equal to the property's fair market value (FMV) determined as of the decedent's date of death, the recipient's basis is the adjusted basis of the decedent. If the decedent's adjusted basis is greater than that FMV, the recipient's basis is limited to that FMV. See section 1022(a)(2).

If the decedent's adjusted basis in the property is less than the property's FMV on the decedent's date of death, sections 1022(b) and 1022(c) allow the executor of a decedent's estate to allocate additional basis (Basis Increase) to certain assets that both are owned by the decedent (within the meaning of section 1022(d)) at death and are acquired from the decedent (within the meaning of section 1022(e)). However, the

property's total basis may not exceed the property's FMV on the date of death.

Although section 1022 was applicable only to decedents dying in calendar year 2010, basis determined pursuant to that section will continue to be relevant until all of the property whose basis is determined under that section has been sold or otherwise disposed of. Accordingly, the existing regulations need to be updated to incorporate appropriate references to basis determined under section 1022.

### **Explanation of Provisions**

These proposed regulations incorporate into the existing regulations, as appropriate, references to section 1022 to ensure that references to basis also include basis as determined under that section. Some changes involve simply inserting the words "or section 1022", "and 1022", or similar references. Others (such as §1.742-1) require the insertion of a new sentence or an example to expressly address the applicability of section 1022. A few changes (such as proposed §1.684-3) require the inclusion of a new section to provide a detailed explanation of the application of section 1022 in the particular context of the existing regulation. The proposed regulations also provide cross references for section 1022 when appropriate and make other minor, non-substantive changes. Language revisions serve solely to conform the existing regulations to the provisions of section 1022 and no additional changes are intended. The more significant changes are briefly described below.

Section 1.48-12(b)(2)(vii)(B) of the proposed regulations provides that, if a transferee's basis is determined under section 1022, any qualified rehabilitation expenditures incurred by the decedent under section 48 within the measuring period

that are treated as having been incurred by the transferee decrease the transferee's basis for purposes of the substantial rehabilitation test.

Section 1.83-4(b)(1) of the proposed regulations provides that, if property to which section 83 applies is acquired by any person while such property is substantially nonvested, such person's basis in the property reflects any adjustments to basis provided under section 1022, as well as under sections 1015 and 1016.

Sections 1.179-4(c)(1)(iv), 1.267(d)-1(a)(3), 1.336-1(b)(5)(i)(A) and 1.355-6(d)(1)(i)(A)(2) of the proposed regulations provide that property acquired from a decedent in a transaction in which the recipient's basis is determined under section 1022 is not acquired by purchase or exchange for purposes of sections 179, 267, 336, and 355(d).

Section 1.197-2(h)(5)(i) of the proposed regulations provides that the anti-churning rules of §1.197-2(h) do not apply to the acquisition of a section 197(f)(9) intangible if the acquiring taxpayer's basis in the intangible is determined under section 1022.

Section 1.306-3(e) of the proposed regulations provides that section 306 stock continues to be classified as section 306 stock if the basis of such stock is determined by reference to the decedent-stockholder's basis under section 1022. In addition, the revision of the last sentence of the existing regulation clarifies the reference to "the optional valuation date under section 1014" by changing the language to refer expressly to the election to use the alternate valuation date under section 2032.

Section 1.382-9 of the proposed regulations provides that for purposes of

§1.382-9(d)(5)(i), the definition of qualified transfer is expanded to include situations where the transferee's basis in the indebtedness is determined under section 1022.

Section 1.421-2(c)(4) of the proposed regulations provides that an option granted under an employee stock purchase plan acquires a basis, determined under section 1014 (or section 1022, if applicable), only if the transfer of the share pursuant to the exercise of such option qualifies for the special tax treatment provided by section 421(a).

Section 1.423-2(k)(2) of the proposed regulations provides that if the special rules provided under §1.423-2(k) are applicable to a share of stock upon the death of an employee, then the basis of the share in the hands of the estate or the person receiving the stock by bequest or inheritance shall be determined under section 1014 (or section 1022, if applicable).

Section 1.467-7(c)(2) of the proposed regulations provides that section 467 recapture does not apply to a disposition on death of the transferor if the basis of the property in the hands of the transferee is determined under section 1022. However, section 467 recapture does apply to property that constitutes a right to receive an item of income in respect of a decedent. Section 1.467-7(c)(4) of the proposed regulations provides that, if the transferee subsequently disposes of the property in a transaction to which §1.467-7(a) applies, the prior understated inclusion is computed by taking into account the amounts attributable to the period of the transferor's ownership of the property prior to the first disposition.

Section 1.617-3(d)(5)(ii)(b) of the proposed regulations provides that the amount

of the adjusted exploration expenditures for mining property in the hands of the transferee immediately after a disposition of property that is subject to section 1022 is equal to the amount of the adjusted exploration expenditures for mining property in the hands of the transferor immediately before the disposition, minus the amount of any gain taken into account under section 617(d). In addition, under §1.617-4(c)(1)(i), no gain is recognized on the gift of mining property. For purposes of determining gain from the disposition of certain mining property, the term “gift” is expanded to include disposition of property with a basis that is determined under section 1022.

Section 684 generally requires gain to be recognized on any transfer of appreciated property by a U.S. person to a foreign non-grantor trust or foreign estate. For decedents dying in 2010, section 684 also applies to certain transfers of property by reason of death to nonresident aliens. Gain is determined by reference to the fair market value of the property over the adjusted basis of such property in the hands of the transferor. Section 1.684-3(c) currently provides that, in the case of a transfer of property by reason of death of a U.S. transferor to a foreign non-grantor trust, no gain recognition is required if the basis of the property in the hands of the trust is determined under section 1014(a).

Section 1.684-3(c) of the proposed regulations provides that this rule is modified to clarify the application of section 684 to transfers of property by reason of death of U.S. transferor decedents dying in 2010. If the executor of a U.S. decedent does not make a Section 1022 Election, the proposed regulations confirm that the general exception to gain recognition will apply. If the executor of a U.S. decedent does make a

Section 1022 Election, the proposed regulations provide, consistent with Rev. Proc. 2011-41 (2011-35 IRB 188 (August 29, 2011)) (see §601.601(d)(2)(ii)(b) of this chapter) and Notice 2011-66 (2011-35 IRB 184 (August 29, 2011)) (see §601.601(d)(2)(ii)(b) of this chapter), that there is gain recognition. Any basis increase that the executor allocates under section 1022 will reduce the amount of gain in that property for purposes of section 684.

Section 1.742-1(a) of the proposed regulations provides that the basis of a partnership interest acquired from a decedent who died in 2010, and whose executor made a Section 1022 Election, is the lower of the adjusted basis of the decedent or fair market value of the interest at the date of decedent's death. The basis of property acquired from a decedent may be further increased under section 1022(b) and/or 1022(c), but not above the fair market value of the interest on the date of the decedent's death.

Section 1.995-4(d)(2) of the proposed regulations provides that the period during which a shareholder of stock in a DISC has held stock includes the period he is considered to have held it by reason of the application of section 1223 and, if his basis is determined in whole or in part under the provisions of section 1022, the holding period of the decedent.

Section 1.1014-4(a) of the proposed regulations provides that the basis of property acquired from a decedent, including basis determined under section 1022, is uniform in the hands of every person having possession or enjoyment of the property at any time, whether obtained under the will or other instrument or under the laws of



descent and distribution.

Section 1.1014-5(b) of the proposed regulations provides that, in determining gain or loss from the sale or other disposition of a term interest in property the adjusted basis of which is determined pursuant to section 1022, that part of the adjusted uniform basis assignable under the rules of §1.1014-5(a) to the interest sold or otherwise disposed of is disregarded to the extent and in the manner provided by section 1001(e).

Section 1.1223-1(b) of the proposed regulations provides that the holding period under section 1223 of the recipient of property acquired from a decedent who died in 2010, and whose executor made a Section 1022 Election, includes the period that the property was held by the decedent.

Sections 1.1245-2(c)(2)(ii)(d) and 1.1245-3(a)(3) of the proposed regulations provide that, if section 1245 property is acquired from a decedent who died in 2010 and whose executor made a Section 1022 Election, the amount of the adjustments reflected in the adjusted basis of the property in the hands of the transferee immediately after the transfer is equal to the amount of the adjustments reflected in the adjusted basis of the property in the hands of the transferor immediately before the transfer, minus the amount of any gain taken into account under section 1245(a)(1) by the transferor upon the transfer. Further, even though property is not of a character subject to the allowance for depreciation in the hands of the taxpayer, the property is section 1245 property if the taxpayer's basis in the property is determined under section 1022 and the property was of a character subject to the allowance for depreciation in the hands of the decedent.

Section 1.1245-4(a)(1) of the proposed regulations provides that no gain is recognized under section 1245(a)(1) upon a transfer of section 1245 property from a decedent whose executor made the Section 1022 Election.

Section 1.1250-4(c)(5) of the proposed regulations provides that the holding period under section 1250(e) for the recipient of property acquired from a decedent who died in 2010, and whose executor made a Section 1022 Election, includes the period that the property was held by the decedent.

Section 1.1254-2(a)(1) of the proposed regulations provides that no gain is recognized under section 1254(a)(1) upon a transfer of natural resource recapture property from a decedent who died in 2010 and whose executor made a Section 1022 Election.

Sections 1.1254-3(b), 1.1254-4(e)(4), and 1.1254-5(c)(2)(iv) of the proposed regulations provide that, for purposes of determining the amount of section 1254 costs from the disposition of natural resource recapture property, the term "gift" is expanded to include the transfer of property with a basis that is determined under section 1022.

Section 1.1296-1(d)(4) of the proposed regulations provides that the basis of stock of a passive foreign investment company for which a section 1296 election was in effect as of the date of the decedent's death that is acquired from a decedent is the lower of the adjusted basis of the stock in the hands of the decedent immediately before his death or the basis that would have been determined under section 1014 or section 1022, as applicable, without regard to this paragraph.

Section 1.1312-7(b) of the proposed regulations provides that the taxpayer with

respect to whom the erroneous treatment occurred must be a taxpayer who had title to the property at the time of the erroneously treated transaction and from whom, mediately or immediately, the taxpayer with respect to whom the determination is made derived title, if the basis of the property in the hands of the taxpayer with respect to whom the determination is made is determined under section 1022.

### **Proposed Effective/Applicability Date**

These regulations are proposed to apply on and after the date the regulations are published as final regulations in the **Federal Register**.

### **Special Analyses**

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and, because these regulations do not impose a collection of information requirement on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

### **Comments and Requests for a Public Hearing**

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. All comments will be

available at [www.regulations.gov](http://www.regulations.gov) or upon request for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

**Drafting Information**

The principal author of these regulations is Mayer R. Samuels, Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and the Treasury Department participated in their development.

**List of Subjects in 26 CFR Part 1**

Income taxes, Reporting and recordkeeping requirements.

**Proposed Amendments to the Regulations**

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

**PART 1--INCOME TAXES**

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Par. 2. Section 1.48-12 is amended by revising the last sentence of paragraph

(b)(2)(vii)(B) and adding paragraph (g) to read as follows:

§1.48-12 Qualified rehabilitated building; expenditures incurred after December 31, 1981.

\* \* \* \* \*

(b) \* \* \*

(2) \* \* \*

(vii) \* \* \*

(B) \* \* \* If a transferee's basis is determined under section 1014 or section 1022, any expenditures incurred by the decedent within the measuring period that are treated as having been incurred by the transferee under paragraph (c)(3)(ii) of this section shall decrease the transferee's basis for purposes of the substantial rehabilitation test.

\* \* \* \* \*

(g) Effective/applicability date. This section applies on and after the date these regulations are published as final regulations in the **Federal Register**. For rules before the date these regulations are published as final regulations in the **Federal Register**, see §1.48-12 as contained in 26 CFR (revised as of the April 1 preceding the date these regulations are published as final regulations in the **Federal Register**).

Par. 3. Section 1.83-4 is amended by revising the last sentence of paragraph (b)(1) and adding paragraph (d) to read as follows:

§1.83-4 Special rules.

\* \* \* \* \*

(b) \* \* \*

(1) \* \* \* Such basis shall also reflect any adjustments to basis provided under sections 1015, 1016, and 1022.

\* \* \* \* \*

(d) Effective/applicability date. The provisions in this section are applicable for taxable years beginning on or after July 21, 1978. The provisions of paragraph (b)(1) of this section relating to section 1022 are effective on and after the date these regulations are published as final regulations in the **Federal Register**.

Par. 4. Section 1.179-4 is amended by revising the first sentence of paragraph (c)(1)(iv) to read as follows:

§1.179-4 Definitions.

\* \* \* \* \*

(c) \* \* \*

(1) \* \* \*

(iv) The property is not acquired by purchase if the basis of the property in the hands of the person acquiring it is determined in whole or in part by reference to the adjusted basis of such property in the hands of the person from whom acquired, is determined under section 1014(a), relating to property acquired from a decedent, or is determined under section 1022, relating to the basis of property acquired from certain decedents who died in 2010. \* \* \*

\* \* \* \* \*

Par. 5. Section 1.179-6 is amended by:

- a. Revising the section heading and the first sentence of paragraph (a).
- b. Adding paragraph (d).

The revision and addition read as follows:

§1.179-6 Effective/applicability dates.

(a) \* \* \* Except as provided in paragraphs (b), (c), and (d) of this section, the provisions of §§1.179-1 through 1.179-5 apply for property placed in service by the taxpayer in taxable years ending after January 25, 1993. \* \* \*

\* \* \* \* \*

(d) Application of §1.179-4(c)(1)(iv). The provisions of §1.179-4(c)(1)(iv) relating to section 1022 are effective on and after the date these regulations are published as final regulations in the **Federal Register**.

Par. 6. Section 1.197-2 is amended by revising paragraphs (h)(5)(i) and (h)(12)(viii) and adding paragraph (l)(5) to read as follows:

§1.197-2 Amortization of goodwill and certain other intangibles.

\* \* \* \* \*

(h) \* \* \*

(5) \* \* \*

(i) The acquisition of a section 197(f)(9) intangible if the acquiring taxpayer's basis in the intangible is determined under section 1014(a) or 1022; or

\* \* \* \* \*

(12) \* \* \*

(viii) Operating rule for transfers upon death. For purposes of this paragraph (h)(12), if the basis of a partner's interest in a partnership is determined under section 1014(a) or 1022, such partner is treated as acquiring such interest from a person who is not related to such partner, and such interest is treated as having previously been held by a person who is not related to such partner.

\* \* \* \* \*

(l) \* \* \*

(5) Application of section 1022. The provisions of §1.197-2 relating to section 1022 are effective on and after the date these regulations are published as final

regulations in the **Federal Register**.

Par. 7. Section 1.267(d)-1 is amended by revising paragraph (a)(3) to read as follows:

§1.267(d)-1 Amount of gain where loss previously disallowed.

(a) \* \* \*

(3) The benefit of the general rule is available only to the original transferee but does not apply to any original transferee (for example, a donee or a person acquiring property from a decedent where the basis of property is determined under section 1014 or 1022) who acquired the property in any manner other than by purchase or exchange.

\* \* \* \* \*

Par. 8. Section 1.267(d)-2 is amended by revising the section heading and adding a sentence to the end of the paragraph to read as follows:

§1.267(d)-2 Effective/applicability dates.

\* \* \* The provisions of §1.267(d)-1(a)(3) relating to section 1022 are effective on and after the date these regulations are published as final regulations in the **Federal Register**.

Par. 9. Section 1.273-1 is revised to read as follows:

§1.273-1 Life or terminable interests.

(a) In general. Amounts paid as income to the holder of a life or a terminable interest acquired by gift, bequest, or inheritance shall not be subject to any deduction for shrinkage (whether called by depreciation or any other name) in the value of such interest due to the lapse of time. In other words, the holder of such an interest so



acquired may not set up the value of the expected future payments as corpus or principal and claim deduction for shrinkage or exhaustion thereof due to the passage of time. For the treatment generally of distributions to beneficiaries of an estate or trust, see Subparts A, B, C, and D (section 641 and following), Subchapter J, Chapter 1 of the Code, and corresponding regulations. For basis of property acquired from a decedent and by gifts and transfers in trust, see sections 1014, 1015, and 1022, and corresponding regulations.

(b) Effective/applicability date. The provisions in this section are applicable for taxable years beginning on or after September 16, 1958. The provisions of this section relating to section 1022 are effective on and after the date these regulations are published as final regulations in the **Federal Register**.

Par. 10. Section 1.306-3 is amended by removing the last sentence of paragraph (e) and adding two sentences in its place to read as follows:

§1.306-3 Section 306 stock defined.

\* \* \* \* \*

(e) \* \* \* Section 306 stock ceases to be so classified if the basis of such stock is determined by reference to its fair market value on the date of the decedent-stockholder's death under section 1014 or the optional valuation date under section 2032. Section 306 stock continues to be so classified if the basis of such stock is determined under section 1022.

\* \* \* \* \*

Par. 11. Section 1.306-4 is added to read as follows:

§1.306-4 Effective/applicability date.

The provisions of §§1.306-1 through 1.306-3 are applicable on or after June 22, 1954. The provisions of §1.306-3 relating to section 1022 are effective on and after the date these regulations are published as final regulations in the **Federal Register**.

Par. 12. Section 1.336-1 is amended by revising paragraph (b)(5)(i)(A) to read as follows:

§1.336-1 General principles, nomenclature, and definitions for a section 336(e) election.

\* \* \* \* \*

(b) \* \* \*

(5) \* \* \*

(i) \* \* \*

(A) The basis of the stock in the hands of the purchaser is not determined in whole or in part by reference to the adjusted basis of such stock in the hands of the person from whom the stock is acquired, is not determined under section 1014(a) (relating to property acquired from a decedent), or is not determined under section 1022 (relating to the basis of property acquired from certain decedents who died in 2010);

\* \* \* \* \*

Par. 13. Section 1.336-5 is amended by revising the section heading and adding a sentence to the end of the paragraph to read as follows:

§1.336-5 Effective/applicability dates.

\* \* \* The provisions of §1.336-1(b)(5)(i)(A) relating to section 1022 are effective

on and after the date these regulations are published as final regulations in the **Federal Register**.

Par. 14. Section 1.355-6 is amended by revising paragraphs (d)(1)(i)(A)(2) and (g) to read as follows:

§1.355-6 Recognition of gain on certain distributions of stock or securities in controlled corporation.

\* \* \* \* \*

(d) \* \* \*

(1) \* \* \*

(i) \* \* \*

(A) \* \* \*

(2) Under section 1014(a) or 1022; and

\* \* \* \* \*

(g) Effective/applicability dates. This section applies to distributions occurring after December 20, 2000, except that they do not apply to any distributions occurring pursuant to a written agreement that is (subject to customary conditions) binding on December 20, 2000, and at all later times. The provisions of paragraph (d)(1)(i)(A)(2) of this section relating to section 1022 are effective on and after the date these regulations are published as final regulations in the **Federal Register**.

Par. 15. Section 1.382-9 is amended by revising paragraphs (d)(5)(ii)(D) and (d)(6)(i) to read as follows:

§1.382-9 Special rules under section 382 for corporations under the jurisdiction of a court in a title 11 or similar case.

\* \* \* \* \*

(d) \* \* \*

(5) \* \* \*

(ii) \* \* \*

(D) The transferee's basis in the indebtedness is determined under section 1014, 1015, or 1022 or with reference to the transferor's basis in the indebtedness;

\* \* \* \* \*

(6) Effective/applicability date--(i) In general. This paragraph (d) applies to ownership changes occurring on or after March 17, 1994. The provisions of paragraph (d)(5)(ii)(D) of this section relating to section 1022 are effective on and after the date these regulations are published as final regulations in the **Federal Register**.

\* \* \* \* \*

Par. 16. Section 1.421-2 is amended by:

- a. Revising paragraphs (c)(4)(i)(a) and (c)(4)(ii).
- b. Revising paragraph (f) heading and adding paragraph (f)(3).

The revisions and addition read as follows:

§1.421-2 General rules.

\* \* \* \* \*

(c) \* \* \*

(4)(i)(a) In the case of the death of an optionee, the basis of any share of stock acquired by the exercise of an option under this paragraph (c), determined under section 1011, shall be increased by an amount equal to the portion of the basis of the

option attributable to such share. For example, if a statutory option to acquire 10 shares of stock has a basis of \$100, the basis of one share acquired by a partial exercise of the option, determined under section 1011, would be increased by 1/10th of \$100, or \$10. The option acquires a basis, determined under section 1014(a) or under section 1022, if applicable, only if the transfer of the share pursuant to the exercise of such option qualifies for the special tax treatment provided by section 421(a). To the extent the option is so exercised, in whole or in part, it will acquire a basis equal to its fair market value (or the basis as determined under section 1022, if applicable) at the date of the employee's death or, if an election is made under section 2032, its value at its applicable valuation date. In certain cases, the basis of the share is subject to the adjustments provided by paragraphs (c)(4)(i)(b) and (c) of this section, but such adjustments are only applicable in the case of an option that is subject to section 423(c).

\* \* \* \* \*

(ii) If a statutory option is not exercised by the estate of the individual to whom the option was granted, or by the person who acquired such option by bequest or inheritance or by reason of the death of such individual, the option shall be considered to be property that constitutes a right to receive an item of income in respect of a decedent to which the rules of sections 691 and 1014(c) (or section 1022(f), if applicable) apply.

\* \* \* \* \*

(f) Effective/applicability date. \* \* \*

\* \* \* \* \*

(3) Application of section 1022. The provisions of §1.421-2(c) relating to section 1022 are effective on and after the date these regulations are published as final regulations in the **Federal Register**.

Par. 17. Section 1.423-2 is amended by:

- a. Revising the third sentence of paragraph (k)(2).
- b. Adding a sentence to the end of paragraph (l).

The revision and addition read as follows:

§1.423-2 Employee stock purchase plan defined.

\* \* \* \* \*

(k) \* \* \*

(2) \* \* \* If the special rules provided in this paragraph (k) are applicable to a share of stock upon the death of an employee, then the basis of the share in the hands of the estate or the person receiving the stock by bequest or inheritance shall be determined under section 1014 or under section 1022, if applicable, and shall not be increased by reason of the inclusion upon the decedent's death of any amount in the decedent's gross income under this paragraph (k). \* \* \*

\* \* \* \* \*

(l) \* \* \* The provisions of §1.423-2 relating to section 1022 are effective on and after the date these regulations are published as final regulations in the **Federal Register**.

Par. 18. Section 1.424-1 is amended by revising the last sentence of paragraph (c)(2) and adding paragraph (g)(3) to read as follows:

§1.424-1 Definitions and special rules applicable to statutory options.

\* \* \* \* \*

(c) \* \* \*

(2) \* \* \* For determination of basis in the hands of the survivor where joint ownership is terminated by the death of one of the owners, see section 1014 or section 1022, if applicable.

\* \* \* \* \*

(g) \* \* \*

(3) Application of section 1022. The provisions of §1.424-1(c)(2) relating to section 1022 are effective on and after the date these regulations are published as final regulations in the **Federal Register**.

Par. 19. Section 1.467-7 is amended by revising paragraph (c)(2) and revising the first sentence of paragraph (c)(4) to read as follows:

§1.467-7 Section 467 recapture and other rules relating to dispositions and modifications.

\* \* \* \* \*

(c) \* \* \*

(2) Dispositions at death. Paragraph (a) of this section does not apply to a disposition if the basis of the property in the hands of the transferee is determined under section 1014(a) or section 1022. However, see paragraph (c)(4) of this section for dispositions of property subject to section 1022 by transferees. This paragraph (c)(2) does not apply to property that constitutes a right to receive an item of income in

respect of a decedent. See sections 691, 1014(c), and 1022(f).

\* \* \* \* \*

(4) \* \* \* If the recapture amount with respect to a disposition of property (the first disposition) is limited under paragraph (c)(1), (c)(2) (if the basis of the property in the hands of the transferee is determined under section 1022), or (c)(3) of this section and the transferee subsequently disposes of the property in a transaction to which paragraph (a) of this section applies, the prior understated inclusion determined under paragraph (b)(2) of this section is computed by taking into account the amounts attributable to the period of the transferor's ownership of the property prior to the first disposition. \* \* \*

\* \* \* \* \*

Par. 20. Section 1.467-9 is amended by revising the section heading and adding paragraph (f) to read as follows:

§1.467-9 Effective/applicability dates and automatic method changes for certain agreements.

\* \* \* \* \*

(f) Application of section 1022. The provisions of §1.467-7(c) relating to section 1022 are effective on and after the date these regulations are published as final regulations in the **Federal Register**.

Par. 21. Section 1.617-3 is amended by revising paragraph (d)(5)(ii)(b) to read as follows:

§1.617-3 Recapture of exploration expenditures.



\* \* \* \* \*

(d) \* \* \*

(5) \* \* \*

(ii) \* \* \*

(b) The transactions referred to in paragraph (d)(5)(ii)(a) of this section are:

(1) A disposition that is in part a sale or exchange and in part a gift;

(2) A disposition that is described in section 617(d) through the incorporation by reference of the provisions of section 1245(b)(3) (relating to certain tax free transactions); or

(3) A transfer at death where basis of property in the hands of the transferee is determined under section 1022.

\* \* \* \* \*

Par. 22. Section 1.617-4 is amended by revising the second sentence of paragraph (c)(1)(i) to read as follows:

§1.617-4 Treatment of gain from disposition of certain mining property.

\* \* \* \* \*

(c) \* \* \*

(1)(i) \* \* \* For purposes of this paragraph (c), the term “gift” means, except to the extent that paragraph (c)(1)(ii) of this section applies, a transfer of mining property that, in the hands of the transferee, has a basis determined under the provisions of section 1015(a) or 1015(d) (relating to basis of property acquired by gift) or section 1022 (relating to the basis of property acquired from certain decedents who died in

2010). \* \* \*

\* \* \* \* \*

Par. 23. Section 1.617-5 is added to read as follows:

§1.617-5 Effective/applicability date.

Sections 1.617-3 and 1.617-4 apply on and after the date these regulations are published as final regulations in the **Federal Register**. For rules before the date these regulations are published as final regulations in the **Federal Register**, see §§1.617-3 and 1.617-4 as contained in 26 CFR (revised as of the April 1 preceding the date these regulations are published as final regulations in the **Federal Register**).

Par. 24. Section 1.684-3 is amended by revising paragraph (c) to read as follows:

§1.684-3 Exceptions to general rule of gain recognition.

\* \* \* \* \*

(c) Certain transfers at death--(1) Section 1014 basis. The general rule of gain recognition under §1.684-1 shall not apply to any transfer of property to a foreign trust or foreign estate or, in the case of a transfer of property by a U.S. transferor decedent dying in 2010, to a foreign trust, foreign estate, or a nonresident alien, by reason of death of the U.S. transferor, if the basis of the property in the hands of the transferee is determined under section 1014(a).

(2) Section 1022 basis election. For U.S. transferor decedents dying in 2010, the general rule of gain recognition under §1.684-1 shall apply to any transfer of property by reason of death of the U.S. transferor if the basis of the property in the hands of the

foreign trust, foreign estate, or the nonresident alien individual is determined under section 1022. The gain on the transfer shall be calculated as set out under §1.684-1(a), except that adjusted basis will reflect any increases allocated to such property under section 1022.

\* \* \* \* \*

Par. 25. Section 1.684-5 is revised to read as follows:

§1.684-5 Effective/applicability dates.

(a) Sections 1.684-1 through 1.684-4 apply to transfers of property to foreign trusts and foreign estates after August 7, 2000, except as provided in paragraph (b) of this section.

(b) In the case a U.S. transferor decedent dying in 2010, §1.684-3(c) applies to transfers of property to foreign trusts, foreign estates, and nonresident aliens after December 31, 2009, and before January 1, 2011.

Par. 26. Section 1.691(a)-3 is amended by revising the last two sentences of paragraph (a) and adding paragraph (c) to read as follows:

§1.691(a)-3 Character of gross income.

(a) \* \* \* The provisions of section 1014(a), relating to the basis of property acquired from a decedent, and section 1022, relating to the basis of property acquired from certain decedents who died in 2010, do not apply to these amounts in the hands of the estate and such persons. See sections 1014(c) and 1022(f).

\* \* \* \* \*

(c) Effective/applicability dates. The last two sentences of paragraph (a) of this

section apply on and after the date these regulations are published as final regulations in the **Federal Register**. For rules before the date these regulations are published as final regulations in the **Federal Register**, see §1.691(a)-3 as contained in 26 CFR (revised as of the April 1 preceding the date these regulations are published as final regulations in the **Federal Register**).

Par. 27. Section 1.742-1 is revised to read as follows:

§1.742-1 Basis of transferee partner's interest.

(a) In general. The basis to a transferee partner of an interest in a partnership shall be determined under the general basis rules for property provided by part II (section 1011 and following), Subchapter O, Chapter 1 of the Internal Revenue Code. Thus, the basis of a purchased interest will be its cost. Generally, the basis of a partnership interest acquired from a decedent is the fair market value of the interest at the date of his death or at the alternate valuation date, increased by his estate's or other successor's share of partnership liabilities, if any, on that date, and reduced to the extent that such value is attributable to items constituting income in respect of a decedent (see section 753 and §§1.706-1(c)(3)(v) and 1.753-1(b)) under section 691. See section 1014(c). However, the basis of a partnership interest acquired from a decedent is determined under section 1022 if the decedent died in 2010 and the decedent's executor elected to have section 1022 apply to the decedent's estate. For basis of contributing partner's interest, see section 722. The basis so determined is then subject to the adjustments provided in section 705.

(b) Effective/applicability date. This section applies on and after the date these

regulations are published as final regulations in the **Federal Register**. For rules before the date these regulations are published as final regulations in the **Federal Register**, see §1.742-1 as contained in 26 CFR (revised as of the April 1 preceding the date these regulations are published as final regulations in the **Federal Register**).

Par. 28. Section 1.743-1 is amended by revising paragraphs (k)(2)(ii) and (l) to read as follows:

§1.743-1 Optional adjustment to basis of partnership property.

\* \* \* \* \*

(k) \* \* \*

(2) \* \* \*

(ii) Special rule. A transferee that acquires, on the death of a partner, an interest in a partnership with an election under section 754 in effect for the taxable year of the transfer, must notify the partnership, in writing, within one year of the death of the deceased partner. The written notice to the partnership must be signed under penalties of perjury and must include the names and addresses of the deceased partner and the transferee, the taxpayer identification numbers of the deceased partner and the transferee, the relationship (if any) between the transferee and the transferor, the deceased partner's date of death, the date on which the transferee became the owner of the partnership interest, the fair market value of the partnership interest on the applicable date of valuation set forth in section 1014 or section 1022, the manner in which the fair market value of the partnership interest was determined, and the carryover basis as adjusted under section 1022 (if applicable).

\* \* \* \* \*

(l) Effective/applicability date. The provisions in this section apply to transfers of partnership interests that occur on or after December 15, 1999. The provisions of this section relating to section 1022 are effective on and after the date these regulations are published as final regulations in the **Federal Register**.

Par. 29. Section 1.755-1 is amended by:

- a. Revising paragraphs (a)(4)(i)(C) and the first sentence of (b)(4)(i).
- b. Revising the heading of paragraph (e) and paragraph (e)(2).

The revisions read as follows:

§1.755-1 Rules for allocation of basis.

(a) \* \* \*

(4) \* \* \*

(i) \* \* \*

(C) Income in respect of a decedent. Solely for the purpose of determining partnership gross value under this paragraph (a)(4)(i), where a partnership interest is transferred as a result of the death of a partner, the transferee's basis in its partnership interest is determined without regard to section 1014(c) or section 1022(f), and is deemed to be adjusted for that portion of the interest, if any, that is attributable to items representing income in respect of a decedent under section 691.

\* \* \* \* \*

(b) \* \* \*

(4) \* \* \*

(i) \* \* \* Where a partnership interest is transferred as a result of the death of a partner, under section 1014(c) or section 1022(f), the transferee's basis in its partnership interest is not adjusted for that portion of the interest, if any, that is attributable to items representing income in respect of a decedent under section 691.

\* \* \*

\* \* \* \* \*

(e) Effective/applicability dates. \* \* \*

(2) Special rules. Paragraphs (a) and (b)(3)(iii) of this section apply to transfers of partnership interests and distributions of property from a partnership that occur on or after June 9, 2003. The provisions of paragraphs (a)(4)(i)(C) and (b)(4)(i) of this section relating to section 1022 are effective on and after the date these regulations are published as final regulations in the **Federal Register**.

Par. 30. Section 1.995-4 is amended by revising the first sentence of paragraph (d)(2) and adding paragraph (f) to read as follows:

§1.995-4 Gain on disposition of stock in a DISC.

\* \* \* \* \*

(d) \* \* \*

(2) \* \* \* For purposes of this section, the period during which a shareholder has held stock includes the period he is considered to have held it by reason of the application of section 1223 and, if his basis is determined in whole or in part under the provisions of section 1014(d) (relating to special rule for DISC stock acquired from decedent) or section 1022 (relating to property acquired from certain decedents who

died in 2010), the holding period of the decedent. \* \* \*

\* \* \* \* \*

(f) Effective/applicability date. This section applies on and after the date these regulations are published as final regulations in the **Federal Register**. For rules before the date these regulations are published as final regulations in the **Federal Register**, see §1.995-4 as contained in 26 CFR (revised as of the April 1 preceding the date these regulations are published as final regulations in the **Federal Register**).

Par. 31. Section 1.1001-1 is amended by revising the last sentence of paragraph (a), revising paragraph (f)(1), and adding paragraph (f)(5) to read as follows:

§1.1001-1 Computation of gain or loss.

(a) \* \* \* Section 1001(e) and paragraph (f) of this section prescribe the method of computing gain or loss upon the sale or other disposition of a term interest in property the adjusted basis (or a portion) of which is determined pursuant, or by reference, to section 1014 (relating to the basis of property acquired from a decedent), section 1015 (relating to the basis of property acquired by gift or by a transfer in trust), or section 1022 (relating to the basis of property acquired from certain decedents who died in 2010).

\* \* \* \* \*

(f) \* \* \*

(1) General rule. Except as otherwise provided in paragraph (f)(3) of this section, for purposes of determining gain or loss from the sale or other disposition after October 9, 1969, of a term interest in property (as defined in paragraph (f)(2) of this section), a



taxpayer shall not take into account that portion of the adjusted basis of such interest that is determined pursuant, or by reference, to section 1014 (relating to the basis of property acquired from a decedent), section 1015 (relating to the basis of property acquired by gift or by a transfer in trust), or section 1022 (relating to the basis of property acquired from certain decedents who died in 2010) to the extent that such adjusted basis is a portion of the adjusted uniform basis of the entire property (as defined in §1.1014-5). Where a term interest in property is transferred to a corporation in connection with a transaction to which section 351 applies and the adjusted basis of the term interest:

(i) Is determined pursuant to sections 1014, 1015, or 1022; and

(ii) Is also a portion of the adjusted uniform basis of the entire property, a subsequent sale or other disposition of such term interest by the corporation will be subject to the provisions of section 1001(e) and this paragraph (f) to the extent that the basis of the term interest so sold or otherwise disposed of is determined by reference to its basis in the hands of the transferor as provided by section 362(a). See paragraph (f)(2) of this section for rules relating to the characterization of stock received by the transferor of a term interest in property in connection with a transaction to which section 351 applies. That portion of the adjusted uniform basis of the entire property that is assignable to such interest at the time of its sale or other disposition shall be determined under the rules provided in §1.1014-5. Thus, gain or loss realized from a sale or other disposition of a term interest in property shall be determined by comparing the amount of the proceeds of such sale with that part of the adjusted basis of such

interest that is not a portion of the adjusted uniform basis of the entire property.

\* \* \* \* \*

(5) Effective/applicability date. This section applies on and after the date these regulations are published as final regulations in the **Federal Register**. For rules before the date these regulations are published as final regulations in the **Federal Register**, see §1.1001-1 as contained in 26 CFR (revised as of the April 1 preceding the date these regulations are published as final regulations in the **Federal Register**).

\* \* \* \* \*

Par.32. Section 1.1014-1 is amended by revising paragraph (a) and adding paragraph (d) to read as follows:

§1.1014-1 Basis of property acquired from a decedent.

(a) General rule. The purpose of section 1014 is, in general, to provide a basis for property acquired from a decedent that is equal to the value placed upon such property for purposes of the Federal estate tax. Accordingly, the general rule is that the basis of property acquired from a decedent is the fair market value of such property at the date of the decedent's death, or, if the decedent's executor so elects, at the alternate valuation date prescribed in section 2032, or in section 811(j) of the Internal Revenue Code (Code) of 1939. However, the basis of property acquired from certain decedents who died in 2010 is determined under section 1022, if the decedent's executor made an election under section 301(c) of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Public Law 111-312 (124 Stat. 3296, 3300 (2010)). See section 1022. Property acquired from a decedent

includes, principally, property acquired by bequest, devise, or inheritance, and, in the case of decedents dying after December 31, 1953, property required to be included in determining the value of the decedent's gross estate under any provision of the Code of 1954 or the Code of 1939. The general rule governing basis of property acquired from a decedent, as well as other rules prescribed elsewhere in this section, shall have no application if the property is sold, exchanged, or otherwise disposed of before the decedent's death by the person who acquired the property from the decedent. For general rules on the applicable valuation date where the executor of a decedent's estate elects under section 2032, or under section 811(j) of the Code of 1939, to value the decedent's gross estate at the alternate valuation date prescribed in such sections, see §1.1014-3(e).

\* \* \* \* \*

(d) Effective/applicability date. This section applies on and after the date these regulations are published as final regulations in the **Federal Register**. For rules before the date these regulations are published as final regulations in the **Federal Register**, see §1.1014-1 as contained in 26 CFR (revised as of the April 1 preceding the date these regulations are published as final regulations in the **Federal Register**).

Par. 33. Section 1.1014-4 is amended by revising the first sentence of paragraph (a)(1), revising the second sentence of paragraph (a)(2), and adding paragraph (d) to read as follows:

§1.1014-4 Uniformity of basis; adjustment to basis.

(a) \* \* \*

(1) The basis of property acquired from a decedent, as determined under section 1014(a) or section 1022, is uniform in the hands of every person having possession or enjoyment of the property at any time under the will or other instrument or under the laws of descent and distribution. \* \* \*

(2) \* \* \* Accordingly, there is a common acquisition date for all titles to property acquired from a decedent within the meaning of section 1014 or section 1022, and, for this reason, a common or uniform basis for all such interests. \* \* \*

\* \* \* \* \*

(d) Effective/applicability date. This section applies on and after the date these regulations are published as final regulations in the **Federal Register**. For rules before the date these regulations are published as final regulations in the **Federal Register**, see §1.1014-4 as contained in 26 CFR (revised as of the April 1 preceding the date these regulations are published as final regulations in the **Federal Register**).

Par. 34. Section 1.1014-5 is amended by revising paragraph (b), adding and reserving paragraph (d), and adding paragraph (e) to read as follows:

§1.1014-5 Gain or loss.

\* \* \* \* \*

(b) Sale or other disposition of certain term interests. In determining gain or loss from the sale or other disposition after October 9, 1969, of a term interest in property (as defined in §1.1001-1(f)(2)) the adjusted basis of which is determined pursuant, or by reference, to section 1014 (relating to the basis of property acquired from a decedent), section 1015 (relating to the basis of property acquired by gift or by a transfer in trust),

or section 1022 (relating to the basis of property acquired from certain decedents who died in 2010), that part of the adjusted uniform basis assignable under the rules of paragraph (a) of this section to the interest sold or otherwise disposed of shall be disregarded to the extent and in the manner provided by section 1001(e) and §1.1001-1(f).

\* \* \* \* \*

(d) [Reserved]

(e) Effective/applicability date. This section applies on and after the date these regulations are published as final regulations in the **Federal Register**. For rules before the date these regulations are published as final regulations in the **Federal Register**, see §1.1014-5 as contained in 26 CFR (revised as of the April 1 preceding the date these regulations are published as final regulations in the **Federal Register**).

Par. 35. Section 1.1223-1 is amended by adding a sentence to the end of paragraph (b) and adding paragraph (l) to read as follows:

§1.1223-1 Determination of period for which capital assets are held.

\* \* \* \* \*

(b) \* \* \* Similarly, the period for which property acquired from a decedent who died in 2010 was held by the decedent must be included in determining the period during which the property was held by the recipient, if the recipient's basis in the property is determined under section 1022.

\* \* \* \* \*

(l) Effective/applicability date. This section applies on and after the date these

regulations are published as final regulations in the **Federal Register**. For rules before the date these regulations are published as final regulations in the **Federal Register**, see §1.1223-1 as contained in 26 CFR (revised as of the April 1 preceding the date these regulations are published as final regulations in the **Federal Register**).

Par. 36. Section 1.1245-2 is amended by revising paragraph (c)(2)(ii) and adding paragraph (d) to read as follows:

§1.1245-2 Definition of recomputed basis.

\* \* \* \* \*

(c) \* \* \*

(2) \* \* \*

(ii) The transactions referred to in paragraph (c)(2)(i) of this section are:

(a) A disposition that is in part a sale or exchange and in part a gift (see §1.1245-4(a)(3));

(b) A disposition (other than a disposition to which section 1245(b)(6)(A) applies) that is described in section 1245(b)(3) (relating to certain tax-free transactions);

(c) An exchange described in §1.1245-4(e)(2) (relating to transfers described in section 1081(d)(1)(A)); or

(d) A transfer at death where the basis of property in the hands of the transferee is determined under section 1022.

\* \* \* \* \*

(d) Effective/applicability date. This section applies on and after the date these regulations are published as final regulations in the **Federal Register**. For rules before

the date these regulations are published as final regulations in the **Federal Register**, see §1.1245-2 as contained in 26 CFR (revised as of the April 1 preceding the date these regulations are published as final regulations in the **Federal Register**).

Par. 37. Section 1.1245-3 is amended by revising paragraph (a)(3) and adding paragraph (d) to read as follows:

§1.1245-3 Definition of section 1245 property.

(a) \* \* \*

(3) Even though property may not be of a character subject to the allowance for depreciation in the hands of the taxpayer, such property may nevertheless be section 1245 property if the taxpayer's basis for the property is determined by reference to its basis in the hands of a prior owner of the property and such property was of a character subject to the allowance for depreciation in the hands of such prior owner, or if the taxpayer's basis for the property is determined by reference to the basis of other property that in the hands of the taxpayer was property of a character subject to the allowance for depreciation, or if the taxpayer's basis for the property is determined under section 1022 and such property was of a character subject to the allowance for depreciation in the hands of the decedent. Thus, for example, if a father uses an automobile in his trade or business during a period after December 31, 1961, and then gives the automobile to his son as a gift for the son's personal use, the automobile is section 1245 property in the hands of the son.

\* \* \* \* \*

(d) Effective/applicability date. This section applies on and after the date these

regulations are published as final regulations in the **Federal Register**. For rules before the date these regulations are published as final regulations in the **Federal Register**, see §1.1245-3 as contained in 26 CFR (revised as of the April 1 preceding the date these regulations are published as final regulations in the **Federal Register**).

Par. 38. Section 1.1245-4 is amended by revising the second sentence of paragraph (a)(1) and adding paragraph (i) to read as follows:

§1.1245-4 Exceptions and Limitations.

(a) \* \* \*

(1) \* \* \* For purposes of this paragraph (a), the term “gift” means, except to the extent that paragraph (a)(3) of this section applies, a transfer of property that, in the hands of the transferee, has a basis determined under the provisions of section 1015(a) or 1015(d) (relating to basis of property acquired by gifts) or section 1022 (relating to basis of property acquired from certain decedents who died in 2010). \* \* \*

\* \* \* \* \*

(i) Effective/applicability date. This section applies on and after the date these regulations are published as final regulations in the **Federal Register**. For rules before the date these regulations are published as final regulations in the **Federal Register**, see §1.1245-4 as contained in 26 CFR (revised as of the April 1 preceding the date these regulations are published as final regulations in the **Federal Register**).

Par. 39. Section 1.1250-4 is amended by adding paragraphs (c)(5) and (h) to read as follows:

§1.1250-4 Holding period.



\* \* \* \* \*

(c) \* \* \*

(5) A transfer at death where the basis of the property in the hands of the transferee is determined under section 1022.

\* \* \* \* \*

(h) Effective/applicability date. This section applies on and after the date these regulations are published as final regulations in the **Federal Register**. For rules before the date these regulations are published as final regulations in the **Federal Register**, see §1.1250-4 as contained in 26 CFR (revised as of the April 1 preceding the date these regulations are published as final regulations in the **Federal Register**).

Par. 40. Section 1.1254-2 is amended by revising the second sentence of paragraph (a)(1) to read as follows:

§1.1254-2 Exceptions and limitations.

(a) \* \* \*

(1) \* \* \* For purposes of this paragraph (a), the term “gift” means, except to the extent that paragraph (a)(2) of this section applies, a transfer of natural resource recapture property that, in the hands of the transferee, has a basis determined under the provisions of section 1015(a) or 1015(d) (relating to basis of property acquired by gift) or section 1022 (relating to the basis of property acquired from certain decedents who died in 2010). \* \* \*

\* \* \* \* \*

Par. 41. Section 1.1254-3 is amended by revising paragraphs (b)(2)(ii) and (iii)

and adding paragraph (b)(2)(iv) to read as follows:

§1.1254-3 Section 1254 costs immediately after certain acquisitions.

\* \* \* \* \*

(b) \* \* \*

(2) \* \* \*

(ii) A transaction described in section 1041(a);

(iii) A disposition described in §1.1254-2(c)(3) (relating to certain tax-free transactions); or

(iv) A transfer at death where basis of property in the hands of the transferee is determined under section 1022.

\* \* \* \* \*

Par. 42. Section 1.1254-4 is amended by revising paragraph (e)(4) introductory text to read as follows:

§1.1254-4 Special rules for S corporations and their shareholders.

\* \* \* \* \*

(e) \* \* \*

(4) \* \* \* If stock is acquired in a transfer that is a gift, in a transfer that is a part sale or exchange and part gift, in a transfer that is described in section 1041(a), or in a transfer at death where the basis of property in the hands of the transferee is determined under section 1022, the amount of section 1254 costs with respect to the property held by the corporation in the acquiring shareholder's hands immediately after the transfer is an amount equal to--

\* \* \* \* \*

Par.43. Section 1.1254-5 is amended by revising paragraph (c)(2)(iv) introductory text to read as follows:

§1.1254-5 Special rules for partnerships and their partners.

\* \* \* \* \*

(c) \* \* \*

(2) \* \* \*

(iv) \* \* \* If an interest in a partnership is transferred in a transfer that is a gift, in a transfer that is a part sale or exchange and part gift, in a transfer that is described in section 1041(a), or in a transfer at death where the basis of property in the hands of the transferee is determined under section 1022, the amount of the transferee partner's section 1254 costs with respect to property held by the partnership immediately after the transfer is an amount equal to--

\* \* \* \* \*

Par. 44. Section 1.1254-6 is revised to read as follows:

§1.1254-6 Effective/applicability date.

(a) Sections 1.1254-1 through 1.1254-3 and 1.1254-5 are effective with respect to any disposition of natural resource recapture property occurring after March 13, 1995. The rule in §1.1254-1(b)(2)(iv)(A)(2), relating to a nonoperating mineral interest carved out of an operating mineral interest with respect to which an expenditure has been deducted, is effective with respect to any disposition occurring after March 13, 1995, of property (within the meaning of section 614) that is placed in service by the taxpayer

after December 31, 1986. Section 1.1254-4 applies to dispositions of natural resource recapture property by an S corporation (and a corporation that was formerly an S corporation) and dispositions of S corporation stock occurring on or after October 10, 1996. Sections 1.1254-2(d)(1)(ii), 1.1254-3(b)(1)(i), (b)(1)(ii), (d)(1)(i), and (d)(1)(ii) are effective for dispositions of property occurring on or after October 10, 1996.

(b) The provisions of §§1.1254-2(a)(1), 1.1254-3(b)(2), 1.1254-4(e)(4), and 1.1254-5(c)(2)(iv) that relate to section 1022 are effective on and after the date these regulations are published as final regulations in the **Federal Register**.

Par. 45. Section 1.1296-1 is amended by revising paragraphs (d)(4) and (j) to read as follows:

§1.1296-1 Mark to market election for marketable stock.

\* \* \* \* \*

(d) \* \* \*

(4) Stock acquired from a decedent. In the case of stock of a PFIC that is acquired by bequest, devise, or inheritance (or by the decedent's estate) and with respect to which a section 1296 election was in effect as of the date of the decedent's death, notwithstanding section 1014 or section 1022, the basis of such stock in the hands of the person so acquiring it shall be the adjusted basis of such stock in the hands of the decedent immediately before his death (or, if lesser, the basis that would have been determined under section 1014 or section 1022 without regard to this paragraph (d)).

\* \* \* \* \*

(j) Effective/applicability date. The provisions in this section are applicable for taxable years beginning on or after May 3, 2004. The provisions of paragraph (d)(4) of this section relating to section 1022 are effective on and after the date these regulations are published as final regulations in the **Federal Register**.

Par. 46. Section 1.1312-7 is amended by revising paragraph (b) and adding paragraph (d) to read as follows:

§1.1312-7 Basis of property after erroneous treatment of a prior transaction.

\* \* \* \* \*

(b)(1) For this section to apply, the taxpayer with respect to whom the erroneous treatment occurred must be:

(i) The taxpayer with respect to whom the determination is made; or

(ii) A taxpayer who acquired title to the property in the erroneously treated transaction and from whom, mediately or immediately, the taxpayer with respect to whom the determination is made derived title in such a manner that he will have a basis ascertained by reference to the basis in the hands of the taxpayer who acquired title to the property in the erroneously treated transaction; or

(iii) A taxpayer who had title to the property at the time of the erroneously treated transaction and from whom, mediately or immediately, the taxpayer with respect to whom the determination is made derived title, if the basis of the property in the hands of the taxpayer with respect to whom the determination is made is determined under section 1015(a) (relating to the basis of property acquired by gift) or section 1022 (relating to the basis of property acquired from certain decedents who died in 2010).

(2) No adjustment is authorized with respect to the transferor of the property in a transaction upon which the basis of the property depends, when the determination is with respect to the original transferee or a subsequent transferee of the original transferee.

\* \* \* \* \*

(d) Effective/applicability date. This section applies on and after the date these regulations are published as final regulations in the **Federal Register**. For rules before the date these regulations are published as final regulations in the **Federal Register**, see §1.1312-7 as contained in 26 CFR (revised as of the April 1 preceding the date these regulations are published as final regulations in the **Federal Register**).

John Dalrymple,

Deputy Commissioner for Services and Enforcement.

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