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[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9811]

RIN 1545-BK09

Application of Modified Carryover Basis to General Basis Rules

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final Regulations.

SUMMARY: This document contains final regulations regarding the application of the modified carryover basis rules of section 1022 of the Internal Revenue Code (Code).

Specifically, the final regulations 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: Effective Date: The regulations are effective on **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

Applicability Date: The regulations are applicable on **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

FOR FURTHER INFORMATION CONTACT: Mayer R. Samuels at (202) 317-6859 (not

a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to 26 CFR part 1 under various provisions of the Code in response to statutory changes made by the Economic Growth and Tax Relief Reconciliation Act of 2001, Public Law 107-16 (EGTRRA) and the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Public Law 111-312 (TRUIRJCA).

Section 501(a) of EGTRRA enacted section 2210 of the Code, which made chapter 11 (the estate tax) inapplicable to the estate of any decedent who died after 2009. Section 542 of EGTRRA also enacted section 1022. While section 1014 generally provides that the recipient's basis in property passing from a decedent is the fair market value of the property on the decedent's date of death, section 1022 sets forth a modified carryover basis system applicable after 2009 generally providing that the recipient's basis in property acquired from a decedent is the lesser of the decedent's adjusted basis in the property or the fair market value of the property on the decedent's date of death. Section 901(a) of EGTRRA, known as the "sunset clause", provided that all provisions of and amendments made by EGTRRA do not apply to estates of decedents dying, gifts made, or generation-skipping transfers after December 31, 2010. The sunset clause effectively limited the application of sections 501(a) and 542 of EGTRRA to 2010.

Section 301(a) of TRUIRJCA, which became law on December 17, 2010,

retroactively reinstated the estate tax and repealed section 1022 with respect to the estates of decedents who died in 2010. However, section 301(c) of TRUIRJCA allowed the executor of the estate of a decedent who died in 2010 to elect to apply the Code and regulations thereunder 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 allowed 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 (a Section 1022 Election).

To provide executors with guidance regarding the making of a Section 1022 Election and certain other collateral issues arising from the determination of basis under section 1022, on August 29, 2011, the Treasury Department and the IRS issued Notice 2011-66 (2011-35 IRB 184) and Revenue Procedure 2011-41 (2011-35 IRB 188). 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 in a transaction in which gain or loss is recognized. Accordingly, on May 11, 2015, the Treasury Department and the IRS published in the **Federal Register** (80 FR 26873) a notice of proposed rulemaking (REG-107595-11, 2015-21 IRB 986) proposing amendments to existing regulations under various sections of the Code to take into account the application of the modified carryover basis rules of section 1022. The IRS received written comments responding to the notice of proposed rulemaking.

No public hearing was requested or held.

After consideration of the comments received on the proposed regulations, this Treasury decision adopts the proposed regulations without modification as final regulations. However, the final regulations adopt certain nonsubstantive, clarifying changes. The comments received on the proposed regulations are discussed in the remainder of this preamble.

Summary of Comments

One commenter noted that the proposed regulations proposed to amend §1.742-1 to provide that 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 made a Section 1022 Election with respect to the decedent's estate. The commenter noted that there was no similar amendment proposed to be made to §1.1367-1(j), relating to the basis of stock of an S corporation where a portion of the value of the stock is attributable to items constituting income in respect of a decedent (IRD). The commenter recommended that the final regulations amend §1.1367-1(j) with language referencing section 1022.

After considering this comment, the Treasury Department and the IRS have determined that no change is necessary. Section 1.1367-1(j) states, "[t]he basis determined under section 1014 of any stock in an S corporation is reduced by the portion of the value of the stock that is attributable to items constituting income in respect of a decedent." This regulation section, with its required basis adjustment for IRD, is limited to situations in which section 1014 applies. Section 1.1367-1(j) does not

apply when a Section 1022 Election is made because there is no basis adjustment under section 1022 to the date of death value of S corporation stock. Without an adjustment to date of death value, no further adjustment to the basis of S corporation stock is required to account for IRD. Therefore, the final regulations do not adopt this comment.

A commenter noted that the proposed regulations only propose amendments to finalized regulations, and not to proposed regulations or temporary regulations. That commenter specifically requested guidance with respect to proposed regulation §1.465-69(a) (which provides that a successor to a decedent's amount at risk in an activity is increased by the amount by which the successor's basis in the activity is increased under section 1014) and temporary regulation §16A.1255-2(b)(2) (which provides that if, as of the date a person acquires section 126 property from a decedent, the basis of the property is determined under section 1014, then on that date the aggregate of excludable portions under section 126 in the hands of such transferee is zero). This Treasury decision cannot modify provisions of the proposed or temporary regulations referenced by the commenter without adopting those provisions as final or temporary regulations. The Treasury Department and the IRS continue to study these areas, and therefore are not prepared to adopt modifications to the proposed or temporary regulations referenced by the commenter at this time. Accordingly, the final regulations do not adopt this comment. However, the Treasury Department and the IRS expect that, if those proposed or temporary regulations are adopted as final or temporary regulations in the future, such regulations will be updated as appropriate to account for

the existence of section 1022.

Another commenter asked why the preamble to the proposed regulations omitted any discussion of the revisions made to regulations under six particular sections of the Code, and requested an explanation as to why changes to those regulatory provisions were considered less significant than the changes for which an explanation was given. Generally, the Treasury Department and the IRS included descriptions of the proposed changes in that preamble that involved more than a mere insertion of a reference to section 1022 in addition to an existing reference to section 1014. In such cases, it was determined that an explanation or clarification of the substance or effect of the proposed revision would be helpful. In the case of the proposed amendments to regulations under the six Code sections mentioned by the commenter, the only change proposed was the mere insertion of references to section 1022 in addition to existing references to section 1014. Accordingly, the Treasury Department and the IRS determined that no further explanation of those changes was necessary.

A commenter also asked why the proposed regulations did not incorporate the treatment of items under the various Code sections addressed in Revenue Procedure 2011-41, 2011-35 IRB 188. That revenue procedure provides a safe harbor that determines the effect on the application of various Code sections of a Section 1022 Election. The provisions relating to that safe harbor are available only if the executor of the estate makes a Section 1022 Election and takes no position contrary to a provision in that revenue procedure. Nothing in these final regulations changes or invalidates the provisions of Revenue Procedure 2011-41, so the safe harbor will remain available to

qualifying taxpayers. Consequently, it is unnecessary to incorporate the revenue procedure into these regulations.

Special Analyses

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact assessment is not required. The Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply to these final regulations because the final regulations do not impose a collection of information requirement on small entities. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business, and no comments were received.

Drafting Information

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

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is 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 **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. For rules before **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, see §1.48-12 as contained in 26 CFR part 1 revised as of April 1, 2016.

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 **[INSERT DATE OF PUBLICATION 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 property acquired from certain decedents who died in 2010. * * *

* * * * *

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

1. Revising the section heading and the first sentence of paragraph (a).

2. 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 **[INSERT DATE OF PUBLICATION 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(h)(5)(i) and (h)(12)(viii) relating to section 1022 are effective on and after **[INSERT DATE OF PUBLICATION 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 **[INSERT DATE OF PUBLICATION 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 the regulations thereunder. For basis of property acquired from a decedent and by gifts and transfers in trust, see sections 1014, 1015, and 1022, and the regulations thereunder.

(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 **[INSERT DATE OF PUBLICATION 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 **[INSERT DATE OF PUBLICATION 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 **[INSERT DATE OF PUBLICATION 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 **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

Par. 15. Section 1.382-1 is amended by revising the entry for §1.382-9(d)(6) 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) ***

(6) Effective/applicability date.

Par. 16. 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 **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

* * * * *

Par. 17. Section 1.421-2 is amended by:

1. Revising paragraphs (c)(4)(i)(a) and (c)(4)(ii).
2. Revising the heading of paragraph (f) 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 paragraph (c) of this section relating to section 1022 are effective on and after **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

Par. 18. Section 1.423-2 is amended by:

1. Revising the third sentence of paragraph (k)(2).
2. 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 this section relating to section 1022 are effective on and after **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

Par. 19. 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 paragraph (c)(2) of this section relating to section 1022 are effective on and after **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

Par. 20. 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) or (c)(3) of this section, or under paragraph (c)(2) of this section because the basis of the property in the hands of the transferee is determined under section 1022, 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. 21. 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)(2) and (4) relating to section 1022 are effective on and after **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

Par. 22. 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. 23. 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. 24. 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 **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. For rules before **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, see §§1.617-3 and 1.617-4 as contained in 26 CFR part 1 revised as of April 1, 2016.

Par. 25. 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. 26. 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. 27. 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 **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. For rules before **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, see §1.691(a)-3 as contained in 26 CFR part 1 revised as of April 1, 2016.

Par. 28. 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 **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. For rules before **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, see §1.742-1 as contained in 26 CFR part 1 revised as of April 1, 2016.

Par. 29. 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 **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

Par. 30. Section 1.755-1 is amended by:

1. Revising paragraphs (a)(4)(i)(C) and the first sentence of (b)(4)(i).
2. 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 **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

Par. 31. 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 **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. For rules before **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, see §1.995-4 as contained in 26 CFR part 1 revised as of April 1, 2016.

Par. 32. Section 1.1001-1 is amended by revising the last sentence of paragraph (a), revising paragraph (f)(1), and adding paragraph (i) 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.

* * * * *

(i) Effective/applicability date. Except as provided in paragraphs (g) and (h) of this section, this section applies on and after **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. For rules before **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, see §1.1001-1 as contained in 26 CFR part 1 revised as of April 1, 2016.

Par.33. 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 **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. For rules before **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, see §1.1014-1 as contained in 26 CFR part 1 revised as of April 1, 2016.

Par. 34. 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 **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. For rules before **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, see §1.1014-4 as contained in 26 CFR part 1 revised as of April 1, 2016.

Par. 35. Section 1.1014-5 is amended by revising paragraph (b) to read as follows:

§1.1014-5 Gain or loss.

* * * * *

(b) Sale or other disposition of certain term interests--(1) In general. 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).

(2) Effective/applicability date. The provisions of paragraph (b)(1) of this section relating to section 1022 are effective on and after **[INSERTDATE OF PUBLICATION IN THE FEDERAL REGISTER]**. For rules before **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, see §1.1014-5 as contained in 26 CFR part 1 revised as of April 1, 2016.

Par. 36. 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 **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. For rules before **[INSERT DATE OF**

PUBLICATION IN THE FEDERAL REGISTER], see §1.1223-1 as contained in 26 CFR part 1 revised as of April 1, 2016.

Par. 37. 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 **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. For rules before **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, see §1.1245-2 as contained in 26 CFR part 1 revised as of April 1, 2016.

Par. 38. 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 **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. For rules before **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, see §1.1245-3 as contained in 26 CFR part 1 revised as of April 1, 2016.

Par. 39. 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 **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. For rules before **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, see §1.1245-4 as contained in 26 CFR part 1 revised as of April 1, 2016.

Par. 40. 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 **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. For rules before **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, see §1.1250-4 as contained in 26 CFR part 1 revised as of April 1, 2016.

Par. 41. 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. 42. 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. 43. 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. 44. 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. 45. 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) and 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 **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

Par. 46. 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 **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

Par. 47. 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 **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. For rules before **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**, see §1.1312-7 as contained in 26 CFR part 1 revised as of April 1, 2016.

John Dalrymple,
Deputy Commissioner for Services and Enforcement.

Approved: November 11, 2016.

Mark J. Mazur,
Assistant Secretary of the Treasury (Tax Policy).

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