

Reg. Section 1.1250-3(b)

Exceptions and limitations.

(a) Exception for gifts -- (1) General rule. Section 1250(d)(1) provides that no gain shall be recognized under section 1250(a) upon a disposition by gift. For purposes of this paragraph, the term gift shall have the same meaning as in paragraph (a) of § 1.1245-4. For reduction in amount of charitable contribution in case of a gift of section 1250 property, see section 170(e) and paragraph (c)(3) of § 1.170-1.

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

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

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

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

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

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

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

Example 1. (i) On May 15, 1967, Smith transfers section 1250 property to his son for \$ 45,000. In the hands of Smith the property had an adjusted basis of \$ 40,000 and a fair market value of \$ 70,000. Thus, the gain realized is \$ 5,000 (amount realized, \$ 45,000, minus adjusted basis, \$ 40,000), and Smith has made a gift of \$ 25,000 (fair market value, \$ 70,000, minus amount realized, \$ 45,000).

(ii) Smith's holding period for the property is 80 full months and, thus, the applicable percentage under section 1250(a)(2) is 40 percent. The additional depreciation for the property is

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

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

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

Example 2. Assume the same facts as in example (1), except that the son sells the property on June 15, 1969, 25 full months after he received it from his father. Thus, his holding period is 105 full months (his father's holding period of 80 full months plus the 25 full months the son actually owned the property) and the applicable percentage under section 1250(a)(2) is 15 percent. Assume further that on the date of the sale the adjusted basis of the property is \$ 39,000, and that for the period the son actually owned the property there is a deficit in additional depreciation of \$ 2,000. Accordingly, the gain realized is \$ 41,000 (selling price of \$ 80,000, minus adjusted basis of \$ 39,000), and the additional depreciation for the property is \$ 3,000 (that is, the additional depreciation for the property in the hands of the son on the date he received it, as determined in example (1), \$ 5,000, minus the amount of the deficit in additional depreciation for the period the son actually owned the property, (\$ 2,000). Since the additional depreciation (\$ 3,000) is lower than the gain realized (\$ 41,000), the son recognizes as ordinary income under section 1250(a)(2) gain of \$ 450, that is, applicable percentage (15 percent) multiplied by additional depreciation (\$ 3,000).



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

(2) Treatment of transferee. (i) If as of the date a person acquires property from a decedent such person's basis is determined, by reason of the application of section 1014(a), solely by reference to the fair market value of the property on the date of the decedent's death or on the applicable date provided in section 2032 (relating to alternate valuation date), then (a) on the date of death the additional depreciation for the property is zero, and (b) for purposes of computing applicable percentage the holding period of the property under section 1250(e)(1)(A) is deemed to begin on the day after the date of death.

(ii) If property is acquired in a transfer at death to which section 1250(d)(2) applies, the amount of the additional depreciation for the property in the hands of the transferee immediately after the transfer shall be the amount (if any) of the additional depreciation in respect of the property allowed the transferee before the decedent's death, but only to the extent that the basis of the property (determined under section 1014(a)) is required to be reduced under the second sentence of section 1014(b)(9) (relating to adjustments to basis where property is acquired from a decedent prior to his death) by depreciation adjustments referred to in paragraph (d)(1) of § 1.1250-2 which give rise to such additional depreciation. For treatment of such property as having a special element with additional depreciation so computed, see paragraph (c)(5)(i) of § 1.1250-5 (relating to property with two or more elements). For purposes of determining applicable percentage, such special element shall have a holding period which includes the transferee's holding period for such property for the period before the decedent's death.

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

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

Example 2. H purchases section 1250 property in 1965 which he immediately conveys to himself and W, his wife, as tenants by the entirety. Under local law each spouse is entitled to one-half the income from the property. H and W file joint income tax returns for calendar years 1965, 1966, and 1967. Over the 3 years, depreciation allowed in respect of the property was \$ 4,000 (the amount allowable) of which \$ 500 is additional depreciation. One-half of these amounts are allocable to W. Thus, depreciation deductions of \$ 2,000, of which \$ 250 is additional depreciation, are allowable to W. On January 1, 1968, H dies and the entire value of the property at the date of death is included in H's gross estate. Since W's basis for the property (determined under section 1014(a)) is reduced (under the second sentence of section 1014(b)(9)) by the \$ 2,000 depreciation deductions allowed W before H's death of which \$ 250 is additional depreciation, the additional depreciation for the property in the hands of W immediately after H's death is \$ 250.

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