

limited to \$4,000. Immediately after the distribution, the amount of adjustments reflected in the adjusted basis of the property is \$2,000 (that is, potential section 1245 income of the partnership, \$6,000, minus gain recognized to the partnership under section 751(b), \$4,000). Thus, if the adjusted basis of the machine in the hands of C were \$11,333 (see, for example, the computation in paragraph (d)(2) of example (6) of paragraph (g) of § 1.751-1), the recomputed basis of the machine would be \$13,333 (\$11,333 plus \$2,000).

(g) [Reserved]

(h) *Timber property subject to amortization under section 194*—(1) *In general.* For purposes of section 1245(a)(2), in determining the recomputed basis of property with respect to which a deduction under section 194 was allowed for any taxable year, a taxpayer shall not take into account amortization deductions claimed under section 194 to the extent such deductions are attributable to the amortizable basis (within the meaning of section 194(c)(2)) of the taxpayer acquired before the tenth taxable year preceding the taxable year in which gain with respect to the property is recognized.

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

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

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

§ 1.1245-5 Adjustments to basis.

In order to reflect gain recognized under section 1245(a)(1), the following

adjustments to the basis of property shall be made:

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

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

Example: Jones exchanges property A, which is section 1245 property with an adjusted basis of \$10,000, for property B, which has a fair market value of \$9,000, and property C, which has a fair market value of \$3,500, in a like kind exchange as to which no gain would be recognized under section 1031(a). Upon the exchange \$2,500 gain is recognized under section 1245(a)(1), since property C is not section 1245 property. See section 1245(b)(4). Under the rules of section 1031(d), the basis of the properties received in the exchange is \$12,500 (i.e., the basis of property transferred, \$10,000, plus the amount of gain recognized, \$2,500), of which the amount allocated to property C is \$3,500 (the fair market value thereof), and the residue, \$9,000, is allocated to property B.

(b) *Sections 1071 and 1081 transactions.*

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

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

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

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

(a) *General.* The provisions of section 1245 apply notwithstanding any other provision of subtitle A of the Code. Thus, unless an exception or limitation under section 1245(b) applies, gain under section 1245(a)(1) is recognized notwithstanding any contrary non-recognition provision or income characterizing provision. For example,

since section 1245 overrides section 1231 (relating to property used in the trade or business), the gain recognized under section 1245(a)(1) upon a disposition will be treated as ordinary income and only the remaining gain, if any, from the disposition may be considered as gain from the sale or exchange of a capital asset if section 1231 is applicable. See example (2) of paragraph (b)(2) of § 1.1245-1. For effect of section 1245 on basis provisions of the Code, see § 1.1245-5.

(b) *Nonrecognition sections overridden.* The nonrecognition provisions of subtitle A of the Code which section 1245 overrides include, but are not limited to, sections 267(d), 311(a), 336, 337, 501(a), 512(b)(5), and 1039. See section 1245(b) for the extent to which section 1245(a)(1) overrides sections 332, 351, 361, 371(a), 374(a), 721, 731, 1031, 1033, 1071, and 1081 (b)(1) and (d)(1)(A). For limitation on amount of adjustments reflected in adjusted basis of property disposed of by an organization exempt from income taxes (within the meaning of section 501(a)), see paragraph (a)(8) of § 1.1245-2.

(c) *Normal retirement of asset in multiple asset account.* Section 1245(a)(1) does not require recognition of gain upon normal retirements of section 1245 property in a multiple asset account as long as the taxpayer's method of accounting, as described in paragraph (e)(2) of § 1.167(a)-8 (relating to accounting treatment of asset retirements), does not require recognition of such gain.

(d) *Installment method.* (1) Gain from a disposition to which section 1245(a)(1) applies may be reported under the installment method if such method is otherwise available under section 453 of the Code. In such case, the income (other than interest) on each installment payment shall be deemed to consist of gain to which section 1245(a)(1) applies until all such gain has been reported, and the remaining portion (if any) of such income shall be deemed to consist of gain to which section 1245(a)(1) does not apply. For treatment of amounts as interest on certain deferred payments, see section 483.

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

Example: Jones contracts to sell an item of section 1245 property for \$10,000 to be paid in 10 equal payments of \$1,000 each, plus a sufficient amount of interest so that section 483 does not apply. He properly elects under section 453 to report under the installment method gain of \$2,000 to which section 1245(a)(1) applies and gain of \$1,000 to which section 1231 applies. Accordingly, \$300 of each of the first 6 installment payments and \$200 of the seventh installment payment is ordinary income under section 1245(a)(1), and \$100 of the seventh installment payment and \$300 of each of the last 3 installment payments is gain under section 1231.

(e) *Exempt income.* The fact that section 1245 provides for recognition of gain as ordinary income does not change into taxable income any income which is exempt under section 115 (relating to income of states, etc.), 892 (relating to income of foreign governments), or 894 (relating to income exempt under treaties).

(f) *Treatment of gain not recognized under section 1245.* Section 1245 does not prevent gain which is not recognized under section 1245 from being considered as gain under another provision of the Code, such as, for example, section 311(c) (relating to liability in excess of basis), section 341(f) (relating to collapsible corporations), section 357(c) (relating to liabilities in excess of basis), section 1238 (relating to amortization in excess of depreciation), or section 1239 (relating to gain from sale of depreciable property between certain related persons). Thus, for example, if section 1245 property, which has an adjusted basis of \$1,000 and a recomputed basis of \$1,500, is sold for \$1,750 in a transaction to which section 1239 applies, \$500 of the gain would be recognized under section 1245(a)(1) and the remaining \$250 of the gain would be treated as ordinary income under section 1239.

[T.D. 6832, 30 FR 8584, July 7, 1965, as amended by T.D. 7084, 36 FR 269, Jan. 8, 1971; T.D. 7400, 41 FR 5101, Feb. 4, 1976]

§ 1.1247-1 Election by foreign investment companies to distribute income currently.

(a) *Election by foreign investment company—(1) In general.* If a registered foreign investment company (as defined in paragraph (b) of this section) elects,