Publication 551

Basis of Assets

(Rev. December 2022)

Volume 1 of 2

Get forms and other information faster and easier at:

- *IRS.gov* (English)
- *IRS.gov/Spanish* (Español)
- *IRS.gov/Chinese* (中文)
- *IRS.gov/Korean* (한국어)
- *IRS.gov/Russian* (Русский)
- *IRS.gov/Vietnamese* (Tiếng Việt)

Publication 551 (Rev 12-2022) Catalog Number 39339M
Department of the Treasury **Internal Revenue Service** www.irs.gov

Visit the Accessibility Page on IRS.gov

This page is intentionally left blank

Future Developments

For the latest information about developments related to Pub. 551, such as legislation enacted after this publication was published, go to *IRS.gov/Pub551*.

What's New

Uniform capitalization rules. For tax years beginning in 2022, small businesses are not subject to the uniform capitalization rules if the average annual gross receipts are $27 million or less for the 3 preceding tax years and the business isn't a tax shelter. See *Uniform Capitalization Rules*, later.

Reminder

Photographs of missing children. The Internal Revenue Service is a proud partner with the *National Center for Missing & Exploited Children® (NCMEC)*. Photographs of missing children selected by the Center may appear in this publication on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling 1-800-THE-LOST (1-800-843-5678) if you recognize a child.

Introduction

Basis is the amount of your investment in property for tax purposes. Use the basis of property to figure depreciation, amortization, depletion, and casualty losses. Also use it to figure gain or loss on the sale or other disposition of property. You must keep accurate records of all items that affect the basis of property so you can make these computations.

This publication is divided into the following sections.

- Cost Basis
- Adjusted Basis
- Basis Other Than Cost

The basis of property you buy is usually its cost. You may also have to capitalize (add to basis) certain other costs related to buying or producing the property.

Your original basis in property is adjusted (increased or decreased) by certain events. If you make improvements to the property, increase your basis. If you take deductions for depreciation or casualty losses, reduce your basis.

You can't determine your basis in some assets by cost. This includes property you receive as a gift or inheritance. It also applies to property received in an involuntary conversion and certain other circumstances.

Comments and suggestions. We welcome your comments about this publication and suggestions for future editions.

You can send us comments through *IRS.gov/FormComments* Or, you can write to the Internal Revenue Service, Tax Forms and

Publications, 1111 Constitution Ave. NW, IR-6526, Washington, DC 20224.

Although we can’t respond individually to each comment received, we do appreciate your feedback and will consider your comments and suggestions as we revise our tax forms, instructions, and publications. **Don’t** send tax questions, tax returns, or payments to the above address.

Getting answers to your tax questions. If you have a tax question not answered by this publication or the *How To Get Tax Help* section at the end of this publication, go to the IRS Interactive Tax Assistant page at *IRS.gov/ Help/ITA* where you can find topics by using the search feature or viewing the categories listed.

Getting tax forms, instructions, and publications. Go to *IRS.gov/Forms* to download current and prior-year forms, instructions, and publications.

Ordering tax forms, instructions, and publications. Go to IRS.gov/OrderForms to order current forms, instructions, and publications; call 800-829-3676 to order prior-year forms and instructions. The IRS will process your order for forms and publications as soon as possible. **Don't** resubmit requests you've already sent us. You can get forms and publications faster online.

Useful Items

You may want to see:

Publication

- ☐ **463** Travel, Gift, and Car Expenses
- ☐ **523** Selling Your Home
- ☐ **525** Taxable and Nontaxable Income
- ☐ **527** Residential Rental Property
- ☐ **530** Tax Information for Homeowners
- ☐ **535** Business Expenses

- ☐ **537** Installment Sales
- ☐ **544** Sales and Other Dispositions of Assets
- ☐ **547** Casualties, Disasters, and Thefts
- ☐ **550** Investment Income and Expenses
- ☐ **559** Survivors, Executors, and Administrators
- ☐ **587** Business Use of Your Home
- ☐ **946** How To Depreciate Property

Form (and Instructions)

- ☐ **706** United States Estate (and
- ☐ Generation-Skipping Transfer) Tax Return
- ☐ **706-A** United States Additional Estate Tax Return
- ☐ **8594** Asset Acquisition Statement

See *How To Get Tax Help* near the end of this publication for information about getting publications and forms.

Cost Basis

Terms you may need to know (see Glossary):

- Business assets
- Real property
- Unstated interest

The basis of property you buy is usually its cost. The cost is the amount you pay in cash, debt obligations, other property, or services. Your cost also includes amounts you pay for the following items.

- Sales tax.
- Freight.
- Installation and testing.
- Excise taxes.

- Legal and accounting fees (when they must be capitalized).
- Revenue stamps.
- Recording fees.
- Real estate taxes (if assumed for the seller).

You may also have to capitalize (add to basis) certain other costs related to buying or producing property.

Loans with low or no interest. If you buy property on a time-payment plan that charges little or no interest, the basis of your property is your stated purchase price, minus the amount considered to be unstated interest. You generally have unstated interest if your interest rate is less than the applicable federal rate. For more information, see *Unstated Interest and Original Issue Discount* in Pub. 537.

Purchase of a business. When you purchase a trade or business, you generally purchase all assets used in the business operations, such as land, buildings, and machinery. Allocate the price among the various assets, including any section 197 intangibles. See *Allocating the Basis*, later.

Stocks and Bonds

The basis of stocks or bonds you buy is generally the purchase price plus any costs of purchase, such as commissions and recording or transfer fees. If you get stocks or bonds other than by purchase, your basis is usually determined by the fair market value (FMV) or the previous owner's adjusted basis of the stock.

You must adjust the basis of stocks for certain events that occur after purchase. See *Stocks and Bonds* in chapter 4 of Pub. 550 for more information on the basis of stock.

Identifying stock or bonds sold. If you can adequately identify the shares of stock or the bonds you sold, their basis is the cost or other basis of the particular shares of stock or bonds. If you buy and sell securities at various times in varying quantities and you can't adequately identify the shares you sell, the basis of the securities you sell is the basis of the securities you acquired first. For more information about identifying securities you sell, see *Stocks and Bonds* under *Basis of Investment Property* in chapter 4 of Pub. 550.

Mutual fund shares. If you sell mutual fund shares acquired at different times and prices, you can choose to use an average basis. For more information, see Pub. 550.

Real Property

Real property, also called real estate, is land and generally anything built on or attached to it. If you buy real property, certain fees and other expenses become part of your cost basis in the property.

Real estate taxes. If you pay real estate taxes the seller owed on real property you bought, and the seller didn't reimburse you, treat those taxes as part of your basis. You can't deduct them as taxes.

If you reimburse the seller for taxes the seller paid for you, you can usually deduct that amount as an expense in the year of purchase. Don't include that amount in the basis of the property. If you didn't reimburse the seller, you must reduce your basis by the amount of those taxes.

Settlement costs. Your basis includes the settlement fees and closing costs for buying property. You can't include in your basis the fees and costs for getting a loan on property. A fee for buying property is a cost that must be paid even if you bought the property for cash.

The following items are some of the settlement fees or closing costs you can include in the basis of your property.

- Abstract fees (abstract of title fees).
- Charges for installing utility services.
- Legal fees (including title search and preparation of the sales contract and deed).
- Recording fees.
- Surveys.
- Transfer taxes.
- Owner's title insurance.
- Any amounts the seller owes that you agree to pay, such as back taxes or interest, recording or mortgage fees, charges for improvements or repairs, and sales commissions.

Settlement costs don't include amounts placed in escrow for the future payment of items such as taxes and insurance.

The following items are some settlement fees and closing costs you can't include in the basis of the property.

1. Casualty insurance premiums.
2. Rent for occupancy of the property before closing.
3. Charges for utilities or other services related to occupancy of the property before closing.
4. Charges connected with getting a loan. The following are examples of these charges.
   a. Points (discount points, loan origination fees).
   b. Mortgage insurance premiums.
   c. Loan assumption fees.

d. Cost of a credit report.

e. Fees for an appraisal required by a lender.

5. Fees for refinancing a mortgage.

If these costs relate to business property, items (1) through (3) are deductible as business expenses. Items (4) and (5) must be capitalized as costs of getting a loan and can be deducted over the period of the loan.

Points. If you pay points to obtain a loan (including a mortgage, second mortgage, line of credit, or a home equity loan), don't add the points to the basis of the related property. Generally, you deduct the points over the term of the loan. For more information on how to deduct points, see *Points* in chapter 4 of Pub. 535.

Points on home mortgage. Special rules may apply to points you and the seller pay when you obtain a mortgage to purchase your main home. If certain requirements are met, you can deduct the points in full for the year in which they're paid. Reduce the basis of your home by any seller-paid points. For more information, see *Points* in Pub. 936, Home Mortgage Interest Deduction.

Assumption of mortgage. If you buy property and assume (or buy subject to) an existing mortgage on the property, your basis includes the amount you pay for the property plus the amount to be paid on the mortgage.

Example. If you buy a building for $20,000 cash and assume a mortgage of $80,000 on it, your basis is $100,000.

Constructing assets. If you build property or have assets built for you, your expenses for this construction are part of your basis. Some of these expenses include the following costs.

- Land.
- Labor and materials.

- Architect's fees.
- Building permit charges.
- Payments to contractors.
- Payments for rental equipment.
- Inspection fees.

In addition, if you own a business and use your employees, material, and equipment to build an asset, don't deduct the following expenses. You must include them in the asset's basis.

- Employee wages paid for the construction work, reduced by any employment credits allowed.
- Depreciation on equipment you own while it's used in the construction.
- Operating and maintenance costs for equipment used in the construction.
- The cost of business supplies and materials used in the construction.

Don't include the value of your own labor, or any other labor you didn't pay for, in the basis of any property you construct.

Business Assets

Terms you may need to know (see Glossary):

- Amortization
- Capitalization
- Depletion
- Depreciation
- Fair market value (FMV)
- Going concern value
- Goodwill
- Intangible property
- Modified Accelerated Cost Recovery System (MACRS) property

- Personal property
- Recapture
- Section 179 deduction
- Section 197 intangibles
- Tangible property

If you purchase property to use in your business, your basis is usually its actual cost to you. If you construct, create, or otherwise produce property, you must capitalize the costs as your basis. In certain circumstances, you may be subject to the uniform capitalization rules (discussed next).

Uniform Capitalization Rules

The uniform capitalization rules specify the costs you add to basis in certain circumstances.

Activities subject to the rules. You must use the uniform capitalization rules if you do any of the following in your trade or business or activity carried on for profit. However, see *Exceptions*

below.

- Produce real or tangible personal property for use in the business or activity.
- Produce real or tangible personal property for sale to customers.
- Acquire property for resale.

You produce property if you construct, build, install, manufacture, develop, improve, create, raise, or grow the property. Treat property produced for you under a contract as produced by you up to the amount you pay or costs you otherwise incur for the property. Tangible personal property includes films, sound recordings, video tapes, books, or similar property.

Under the uniform capitalization rules, you must capitalize all direct costs and an allocable part of most indirect costs you incur due to your production or resale activities. To capitalize means to include certain expenses in the basis of property you produce or in your inventory costs rather than deduct them as a current expense. You recover these costs through deductions for depreciation, amortization, or cost of goods sold when you use, sell, or otherwise dispose of the property.

Any cost you can't use to figure your taxable income for any tax year isn't subject to the uniform capitalization rules.

Example. If you incur a business meal expense for which your deduction would be limited to 50% of the cost of the meal, that amount is subject to the uniform capitalization rules. The nondeductible part of the cost isn't subject to the uniform capitalization rules.

More information. For more information about these rules, see the regulations under section 263A of the Internal Revenue Code and Pub. 538, Accounting Periods and Methods.

Exceptions. For tax years beginning in 2022, you're not subject to the uniform capitalization rules if your average annual gross receipts are $27 million or less for the 3 preceding tax years and you're not a tax shelter. See section 263A(i).

In addition, the following are not subject to the uniform capitalization rules.

- Property you produce that you don't use in your trade, business, or activity conducted for profit.
- Qualified creative expenses you pay or incur as a freelance (self-employed) writer, photographer, or artist that are otherwise deductible on your tax return.

- Property you produce under a long-term contract, except for certain home construction contracts.
- Research and experimental expenses deductible under section 174 of the Internal Revenue Code.
- Before 2018, costs for personal property acquired for resale if your (or your predecessor's) average annual gross receipts for the 3 previous tax years don't exceed $10 million.

For other exceptions to the uniform capitalization rules, see section 1.263A-1(b) of the regulations.

For information on the special rules that apply to costs incurred in the business of farming, see chapter 6 in Pub. 225, Farmer's Tax Guide.

Intangible Assets

Intangible assets include goodwill, patents, copyrights, trademarks, trade names, and franchises. The basis of an intangible asset is usually the cost to buy or create it. If you acquire multiple assets, for example, an ongoing business for a lump sum, see *Allocating the Basis*, later, to figure the basis of the individual assets. The basis of certain intangibles can be amortized. See chapter 8 of Pub. 535 for information on the amortization of these costs.

Patents. The basis of a patent you get for an invention is the cost of development, such as research and experimental expenditures, drawings, working models, and attorneys' and governmental fees. If you deduct the research and experimental expenditures as current business expenses, you can't include them in the basis of the patent. The value of the inventor's time spent on an invention isn't part of the basis.

Copyrights. If you're an author, the basis of a copyright will usually be the cost of getting the copyright plus copyright fees, attorneys' fees, clerical assistance, and the cost of plates that remain in your possession. Don't include the value of your time as the author, or any other person's time you didn't pay for.

Franchises, trademarks, and trade names. If you buy a franchise, trademark, or trade name, the basis is its cost, unless you can deduct your payments as a business expense.

Allocating the Basis

If you buy multiple assets for a lump sum, allocate the amount you pay among the assets you receive. You must make this allocation to figure your basis for depreciation and gain or loss on a later disposition of any of these assets. See *Trade or Business Acquired* below.

Group of Assets Acquired

If you buy multiple assets for a lump sum, you and the seller may agree to a specific allocation of the purchase price among the assets in the sales contract. If this allocation is based on the value of each asset and you and the seller have adverse tax interests, the allocation will generally be accepted. However, see *Trade or Business Acquired* next.

Trade or Business Acquired

If you acquire a trade or business, allocate the consideration paid to the various assets acquired. Generally, reduce the consideration paid by any cash and general deposit accounts (including checking and savings accounts) received. Allocate the remaining consideration to the other business assets received in proportion to (but not more than) their FMV in the following order.

1. Certificates of deposit, U.S. government securities, foreign currency, and actively traded personal property, including stock and securities.
2. Accounts receivable, other debt instruments, and assets you mark to market at least annually for federal income tax purposes.
3. Property of a kind that would properly be included in inventory if on hand at the end of the tax year or property held primarily for sale to customers in the ordinary course of business.
4. All other assets except section 197 intangibles, goodwill, and going concern value.
5. Section 197 intangibles except goodwill and going concern value.

6. Goodwill and going concern value (whether or not they qualify as section 197 intangibles).

Agreement. The buyer and seller may enter into a written agreement as to the allocation of any consideration or the FMV of any of the assets. This agreement is binding on both parties unless the IRS determines the amounts are not appropriate.

Reporting requirement. Both the buyer and seller involved in the sale of business assets must report to the IRS the allocation of the sales price among section 197 intangibles and the other business assets. Use Form 8594 to provide this information. The buyer and seller should each attach Form 8594 to their federal income tax return for the year in which the sale occurred.

More information. See *Sale of a Business* in chapter 2 of Pub. 544 for more information.

Land and Buildings

If you buy buildings and the land on which they stand for a lump sum, allocate the basis of the property among the land and the buildings so you can figure the depreciation allowable on the buildings.

Figure the basis of each asset by multiplying the lump sum by a fraction. The numerator is the FMV of that asset and the denominator is the FMV of the whole property at the time of purchase. If you're not certain of the FMV of the land and buildings, you can allocate the basis based on their assessed values for real estate tax purposes.

Demolition of building. Add demolition costs and other losses incurred for the demolition of any building to the basis of the land on which the demolished building was located. Don't claim the costs as a current deduction.

Modification of building. A modification of a building won't be treated as a demolition if both the following conditions are satisfied.

- 75% or more of the existing external walls of the building are retained in place as internal or external walls.
- 75% or more of the existing internal structural framework of the building is retained in place.

If the building is a certified historic structure, the modification must also be part of a certified rehabilitation.

If these conditions are met, add the costs of the modifications to the basis of the building.

Subdivided lots. If you buy a tract of land and subdivide it, you must determine the basis of each lot. This is necessary because you must figure the gain or loss on the sale of each individual lot. As a result, you don't recover your entire cost in the tract until you have sold all of the lots.

To determine the basis of an individual lot, multiply the total cost of the tract by a fraction. The numerator is the FMV of the lot and the denominator is the FMV of the entire tract.

Future improvement costs. If you're a developer and sell subdivided lots before the development work is completed, you can (with IRS consent) include in the basis of the properties sold an allocation of the estimated future cost for common improvements. See Revenue Procedure 92-29, 1992-1 C.B. 748, for more information, including an explanation of the procedures for getting consent from the IRS.

Use of erroneous cost basis. If you made a mistake in figuring the cost basis of subdivided lots sold in previous years, you can't correct the mistake for years for which the statute of limitations (generally, 3 tax years) has expired. Figure the basis of any remaining lots by allocating the correct original cost basis of the entire tract among the original lots.

Example. You bought a tract of land to which you assigned a cost of $15,000. You subdivided the land into 15 building lots of equal size and equitably divided your basis so that each lot had a basis of $1,000. You treated the sale of each lot as a separate transaction and figured gain or loss separately on each sale.

Several years later, you determine that your original basis in the tract was $22,500 and not $15,000. You sold eight lots using $8,000 of basis in years for which the statute of limitations has expired. You now can take $1,500 of basis into account for figuring gain or loss only on the sale of each of the remaining seven lots ($22,500 basis divided among all 15 lots). You can't refigure the basis of the eight lots sold in tax years barred by the statute of limitations.

Adjusted Basis

Before figuring gain or loss on a sale, exchange, or other disposition of property, or figuring allowable depreciation, depletion, or amortization, you must usually make certain adjustments to the basis of the property. The result of these adjustments to the basis is the adjusted basis.

Table 1. **Examples of Increases and Decreases to Basis**

Increases to Basis	**Decreases to Basis**
Capital improvements: Putting an addition on your home Replacing an entire roof Paving your driveway	Exclusion from income of subsidies for energy conservation measures Casualty or theft loss deductions and insurance reimbursements

Installing central air conditioning Rewiring your home	
Assessments for local improvements: Water connections Sidewalks Roads	Certain vehicle credits Section 179 deduction
Casualty losses: Restoring damaged property Legal fees: Cost of defending and perfecting a title Zoning costs	Depreciation Nontaxable corporate distributions

Increases to Basis

Increase the basis of any property by all items properly added to a capital account. These include the cost of any improvements having a useful life of more than 1 year.

Rehabilitation expenses also increase basis. However, you must subtract any rehabilitation credit allowed for these expenses before you add them to your basis. If you have to recapture any of the credit, increase your basis by the re-captured amount.

If you make additions or improvements to business property, keep separate accounts for them. Also, you must depreciate the basis of each according to the depreciation rules that would apply to the underlying property if you had placed it in service at the same time you placed the addition or improvement in service. For more information, see Pub. 946.

The following items increase the basis of property.

- The cost of extending utility service lines to the property.
- Impact fees.
- Legal fees, such as the cost of defending and perfecting title.
- Legal fees for obtaining a decrease in an assessment levied against property to pay for local improvements.
- Zoning costs.
- The capitalized value of a redeemable ground rent.

Assessments for Local Improvements

Increase the basis of property by assessments for items such as paving roads and building ditches that increase the value of the property assessed. Don't deduct them as taxes. How-ever, you can deduct as taxes charges for maintenance, repairs, or interest charges related to the improvements.

Example. Your city changes the street in front of your store into an enclosed pedestrian mall and assesses you and other affected land-owners for the cost of the conversion. Add the assessment to your property's basis. In this ex-ample, the assessment is a depreciable asset.

Deducting vs. Capitalizing Costs

Don't add to your basis costs you can deduct as current expenses. For example, amounts paid for incidental repairs or maintenance that are deductible as business expenses can't be added to basis. However, you can choose either to deduct or to capitalize certain other costs. If you capitalize these costs, include them in your basis. If you deduct them, don't include them in your basis. See *Uniform Capitalization Rules*, earlier.

The costs you can choose to deduct or to capitalize include the following.

- Carrying charges, such as interest and taxes, that you pay to own property, except carrying charges that must be capitalized under the uniform capitalization rules.
- Research and experimentation costs.
- Intangible drilling and development costs for oil, gas, and geothermal wells.
- Exploration costs for new mineral deposits.
- Mining development costs for a new mineral deposit.
- Costs of establishing, maintaining, or in-creasing the circulation of a newspaper or other periodical.
- Costs of removing architectural and transportation barriers to people with

disabilities and the elderly. If you claim the disabled access credit, you must reduce the amount you deduct or capitalize by the amount of the credit.

For more information about deducting or capitalizing costs, see chapter 7 in Pub. 535.

Decreases to Basis

The following are some items that reduce the basis of property.

Section 179 deduction.

Deduction under section 179D for certain energy efficient commercial building property.

Nontaxable corporate distributions.

- Deductions previously allowed (or allowable) for amortization, depreciation, and depletion.
- Exclusion of subsidies for energy conservation measures.
- Certain vehicle credits.

- Residential energy credits.
- Postponed gain from sale of home.
- Investment credit (part or all) taken.
- Advanced manufacturing investment credit taken.
- Casualty and theft losses and insurance reimbursement.
- Certain canceled debt excluded from income.
- Rebates treated as adjustments to the sales price.
- Easements.
- Gas-guzzler tax.
- Adoption tax benefits.
- Credit for employer-provided child care.
- Partial disposition of MACRS property, whether you elect to recognize the

partial disposition or are required to recognize it.

Some of these items are discussed next.

Casualties and Thefts

If you have a casualty or theft loss, decrease the basis in your property by any insurance or other reimbursement and by any deductible loss not covered by insurance.

If you dispose of a portion of MACRS property because of a loss sustained from a casualty event, decrease the basis in the property by any insurance or other reimbursement and by any deductible loss on the disposed portion of the property that isn't covered by insurance. The deductible loss is generally the decrease in the FMV of the property resulting from the casualty event, but is limited to the adjusted basis of the disposed portion of the MACRS property.

You must increase your basis in the property by the amount you spend on repairs that substantially prolong the life of the property, increase its value, or adapt it to a different use. To make this determination, compare the repaired property to the property before the casualty. If the amount you spent didn't otherwise improve the property, then it's deductible as a repair and doesn't affect basis. For more information on casualty and theft losses, see Pub. 547.

Easements

The amount you receive for granting an easement is generally considered to be a sale of an interest in real property. It reduces the basis of the affected part of the property. If the amount received is more than the basis of the part of the property affected by the easement, reduce your basis in that part to zero and treat the excess as a recognized gain.

Vehicle Credits

Unless you elect not to claim the qualified vehicle credit, the alternative motor vehicle credit, or the qualified plug-in electric drive motor vehicle credit, you may have to reduce the basis of each qualified vehicle by certain amounts reported. For more information on available credits, see Form 8834, Qualified Electric Vehicle Credit; Form 8910, Alternative Motor Vehicle Credit; Form 8936, Qualified Plug-in Electric Drive Motor Vehicle Credit; and the related instructions.

Gas-Guzzler Tax

Decrease the basis in your car by the gas-guzzler (fuel economy) tax if you begin using the car within 1 year of the date of its first sale for ultimate use. This rule also applies to someone who later buys the car and begins using it not more than 1 year after the original sale for ultimate use. If the car is imported, the 1-year period begins on the date of entry or withdrawal of the car from the warehouse if that date is later than the date of the first sale for ultimate use.

Section 179 Deduction

If you take the section 179 deduction for all or part of the cost of qualifying business property, decrease the basis of the property by the deduction. For more information about the section 179 deduction, see Pub. 946.

Exclusion of Subsidies for Energy Conservation Measures

You can exclude from gross income any subsidy you received from a public utility company for the purchase or installation of any energy conservation measure for a dwelling unit. Reduce the basis of the property for which you received the subsidy by the excluded amount. For more information on this subsidy, see Pub. 525.

Depreciation

Decrease the basis of property by the depreciation you deducted, or could have deducted, on your tax returns under the method of depreciation you chose. If you took less depreciation than you could have under the method chosen, decrease the basis by the amount you could have taken under that method. If you didn't take a depreciation deduction, reduce the basis by the full amount of the depreciation you could have taken.

Unless a timely election is made not to deduct the special depreciation allowance for property placed in service after September 10, 2001, decrease the property's basis by the special depreciation allowance you deducted or could have deducted.

If you deducted more depreciation than you should have, decrease your basis by the amount equal to the depreciation you should have deducted plus the part of the excess depreciation you deducted that actually reduced your tax liability for the year.

In decreasing your basis for depreciation, take into account the amount deducted on your tax returns as depreciation and any depreciation capitalized under the uniform capitalization rules.

For information on figuring depreciation, see Pub. 946.

If you're claiming depreciation on a business vehicle, see Pub. 463. If the car isn't used more than 50% for business during the tax year, you may have to recapture excess depreciation. Include the excess depreciation in your gross income and add it to your basis in the property. For information on the computation of excess depreciation, see chapter 4 in Pub. 463.

Canceled Debt Excluded From Income

If a debt you owe is canceled or forgiven, other than as a gift or bequest, you must generally include the canceled amount in your gross income for tax purposes. A debt includes any indebtedness for which you're liable or which attaches to property you hold.

You can exclude canceled debt from income in the following situations.

1. Debt canceled in a bankruptcy case or when you're insolvent.
2. Qualified farm debt.
3. Qualified real property business debt (provided you're not a C corporation).

If you exclude from income canceled debt under situation (1) or (2), you may have to reduce the basis of your depreciable and nondepreciable property. However, in situation (3), you must reduce the basis of your depreciable property by the excluded amount.

For more information about canceled debt in a bankruptcy case or during insolvency, see Pub. 908, Bankruptcy Tax Guide. For more information about canceled debt that is qualified farm debt, see chapter 3 in Pub. 225. For more information about qualified real property business debt, see chapter 5 in Pub. 334, Tax Guide for Small Business.

Postponed Gain From Sale of Home

If you postponed gain from the sale of your main home before May 7, 1997, you must reduce the basis of your new home by the postponed gain. For more information on the rules for the sale of a home, see Pub. 523.

Adoption Tax Benefits

If you claim an adoption credit for the cost of improvements you added to the basis of your home, decrease the basis of your home by the credit allowed. This also applies to amounts you received under an employer's adoption assistance program and excluded from income. For more information, see Form 8839, Qualified Adoption Expenses.

Employer-Provided Child Care

If you're an employer, you can claim the employer-provided child care credit on amounts you paid or incurred to acquire, construct, rehabilitate, or expand property used as part of your qualified child care facility. You must reduce your basis in that property by the credit claimed. For more information, see Form 8882, Credit for Employer-Provided Child Care Facilities and Services.

Disposition of a Portion of MACRS Property

If you sell a portion of MACRS property (a MACRS asset), you must reduce the adjusted basis of the asset by the adjusted basis of the portion sold. Use your records to determine which portion of the asset was sold, the date the asset was placed in service, the unadjusted basis of the portion sold, and its adjusted basis. See the partial disposition rules in Regulations section 1.168(i)-8 for more detail. The adjusted basis of the portion sold is used to determine the gain or loss realized on the sale. Also see Pub. 544.

If you physically abandon a portion of MACRS property (a MACRS asset) and you elect to recognize the loss on the abandonment by reporting the loss on your tax return, you must reduce the adjusted basis of the MACRS asset by the adjusted basis of the portion abandoned. Use your records to determine which portion of the asset was abandoned, the date the asset was placed in service, the unadjusted basis of the portion abandoned, and its adjusted basis. See the partial disposition rules in Regulations section 1.168(i)-8 for more detail. Also see *Example 2* and *Example 3* below.

Adjustments to Basis Examples

Example 1. In January 2017, you paid $80,000 for real property to be used as a factory. You also paid commissions of $2,000 and title search and legal fees of $600. You allocated the total cost of $82,600 between the land and the building—$10,325 for the land and $72,275 for the building. Immediately, you spent $20,000 in remodeling the building before you placed it in service. You were allowed depreciation of $14,526 for the years 2017 through 2021. In 2020, you had a $5,000 casualty loss from a storm that wasn't covered by insurance on the building. You claimed a deduction for this loss. You spent $5,500 to repair the damages and to otherwise improve the building. The adjusted basis of the building on January 1, 2022, is figured as follows:

Original cost of building including fees and commissions...............		$72,275
Adjustments to basis:		
Add:		
Improvements.................		20,000
Repair of damages.............		5,500
		$97,775
Subtract:		
Depreciation..........	$14,526	
Deducted casualty loss...	5,000	19,526
Adjusted basis on January 1, 2022....		**$78,249**

The basis of the land, $10,325, remains unchanged. It's not affected by any of the above adjustments.

Example 2. You own a building that you purchased in 1990 for $75,000. You use the building in your business. The building is a MACRS asset. You removed and abandoned the roof on the building and replaced it with a new roof. You make the partial disposition election to recognize loss on the abandonment of the old roof by reporting the loss on your timely filed tax return. The loss is the adjusted basis of the roof as of the first day of the tax year of the abandonment. Using your records, you determine that the abandoned roof was placed in service in 1990 with the building, the unadjusted basis of the building attributable to the roof is $5,000, and after you deducted depreciation of $3,500 on the roof, its adjusted basis as of the first day of the tax year of the abandonment is $1,500. Report the $1,500 ordinary loss in Part II of Form 4797. In your depreciation records, you must reduce the unadjusted basis of the building, $75,000, by the unadjusted basis of the roof, $5,000, as well as reduce the accumulated depreciation of the building by the accumulated depreciation on the roof, $3,500. You must also capitalize the cost of the replacement roof and depreciate it as a separate asset from the building.

Example 3. You own a bulldozer that you purchased 2 years ago for $25,000. You use the bulldozer in your business. The bulldozer is a MACRS asset. You removed and replaced the bucket on the bulldozer with a new bucket. You make the partial disposition election to recognize loss on the abandonment of the old bucket by reporting the loss on your timely filed tax return. The loss is the adjusted basis of the bucket as of the first day of the tax year of the abandonment. Using your records, you determine that the abandoned bucket was placed in service with the bulldozer, the unadjusted basis of the bucket is $5,000, and after you deducted depreciation of $3,800 on the bucket, the adjusted basis of the bucket as of the first day of the tax year of the abandonment is $1,200. Report the $1,200 ordinary loss in Part II of Form 4797. In your depreciation records, you must reduce the unadjusted basis of the bulldozer, $25,000, by the unadjusted basis of the bucket, $5,000, as well as reduce the accumulated depreciation of the bulldozer by the accumulated depreciation on the bucket, $3,800. You must also capitalize the cost of the replacement bucket and begin depreciating it as a separate asset from the bulldozer.

Basis Other Than Cost

There are many times when you can't use cost as basis. In these cases, the FMV or the adjusted basis of property may be used. Adjusted basis is discussed earlier.

FMV is the price at which property would change hands between a buyer and a seller, neither having to buy or sell, and both having reasonable knowledge of all necessary facts. Sales of similar property on or about the same date may be helpful in figuring the property's FMV.

Property Received for Services

If you receive property for services, include the property's FMV in income. The amount you include in income becomes your basis. If the services were performed for a price agreed on beforehand, it will be accepted as the FMV of the property if there is no evidence to the contrary.

Bargain Purchases

A bargain purchase is a purchase of an item for less than its FMV. If, as compensation for services, you purchase goods or other property at less than FMV, include the difference between the purchase price and the property's FMV in your income. Your basis in the property is its FMV (your purchase price plus the amount you include in income).

If the difference between your purchase price and the FMV represents a qualified employee discount, don't include the difference in income. However, your basis in the property is still its FMV. See *Employee Discounts* in Pub. 15-B.

Restricted Property

If you receive property for your services and the property is subject to certain restrictions, your basis in the property is its FMV when it becomes substantially vested unless you make the election discussed later. Property becomes substantially vested when your rights in the property or the rights of any person to whom you transfer the property are not subject to a substantial risk of forfeiture.

There is substantial risk of forfeiture when the rights to full enjoyment of the property depend on the future performance of substantial services by any person.

When the property becomes substantially vested, include the FMV, less any amount you paid for the property, in income.

Example. Your employer gives you stock for services performed under the condition that you'll have to return the stock unless you complete 5 years of service. The stock is under a substantial risk of forfeiture and isn't substantially vested when you receive it. You don't report any income until you have completed the 5 years of service that satisfy the condition.

FMV Figure the FMV of property you received without considering any restriction except one that by its terms will never end.

Example. You received stock from your employer for services you performed. If you want to sell the stock while you're still employed, you must sell the stock to your employer at book value. At your retirement or death, you or your estate must offer to sell the stock to your employer at its book value. This is a restriction that by its terms will never end and you must consider it when you figure the FMV.

Election. You can choose to include in your gross income the FMV of the property at the time of transfer, less any amount you paid for it. If you make this choice, the substantially vested rules don't apply. Your basis is the amount you paid plus the amount you included in income.

See the discussion of *Restricted Property* in Pub. 525 for more information.

Taxable Exchanges

A taxable exchange is one in which the gain is taxable or the loss is deductible. A taxable gain or deductible loss is also known as a recognized gain or loss. If you receive property in exchange for other property in a taxable exchange, the basis of property you receive is usually its FMV at the time of the exchange. A taxable exchange occurs when you receive cash or property not similar or related in use to the property exchanged.

Example. You trade a tract of farm land with an adjusted basis of $3,000 for a tractor that has an FMV of $6,000. You must report a taxable gain of $3,000 for the land. The tractor has a basis of $6,000.

Involuntary Conversions

If you receive property as a result of an involuntary conversion, such as a casualty, theft, or condemnation, you can figure the basis of the replacement property you receive using the basis of the converted property.

Similar or related property. If you receive replacement property similar or related in service or use to the converted property, the replacement property's basis is the old property's basis on the date of the conversion. However, make the following adjustments.

1. Decrease the basis by the following.
    a. Any loss you recognize on the conversion.
    b. Any money you receive that you don't spend on similar property.
2. Increase the basis by the following.

a. Any gain you recognize on the conversion.

b. Any cost of acquiring the replacement property.

Money or property not similar or related. If you receive money or property not similar or related in service or use to the converted property, and you buy replacement property similar or related in service or use to the converted property, the basis of the new property is its cost decreased by the gain not recognized on the conversion.

Example. The state condemned your property. The property had an adjusted basis of $26,000 and the state paid you $31,000 for it. You realized a gain of $5,000 ($31,000 − $26,000). You bought replacement property similar in use to the converted property for $29,000. You recognize a gain of $2,000 ($31,000 − $29,000), the unspent part of the payment from the state. Your gain not recognized is $3,000, the difference between the $5,000 realized gain and the $2,000 recognized gain. The basis of the new property is figured as follows:

Cost of replacement property......	$29,000
Minus: Gain not recognized.........	3,000
Basis of the replacement property	**$26,000**

Allocating the basis. If you buy more than one piece of replacement property, allocate your basis among the properties based on their respective costs.

Example. The state in the previous example condemned your unimproved real property and the replacement property you bought was improved real property with both land and buildings. Allocate the replacement property's $26,000 basis between land and buildings based on their respective costs.

More information. For more information about condemnations, see *Involuntary Conversions* in Pub. 544. For more information about casualty and theft losses, see Pub. 547.

Nontaxable Exchanges

Terms you may need to know (see Glossary):

Intangible property

Like-kind property

Personal property

Real property

A nontaxable exchange is an exchange in which you're not taxed on any gain and you can't deduct any loss. If you receive property in a nontaxable exchange, its basis is usually the same as the basis of the property you transferred. A nontaxable gain or loss is also known as an unrecognized gain or loss.

Like-Kind Exchanges

The exchange of property for the same kind of property may qualify as a nontaxable exchange under section 1031 of the Internal Revenue Code. Beginning after 2017, nontaxable like-kind exchange treatment under section 1031 applies only to exchanges of real property held for use in a trade or business or for investment, other than real property held primarily for sale. Before 2017, section 1031 also applied to certain exchanges of personal or intangible property. Nontaxable like-kind exchange treatment under section 1031 will still apply to a qualifying exchange of personal or intangible property if the taxpayer disposed of the exchanged property on or before December 31, 2017, or received replacement property on or before that date.