810-3-6-.01. Basis in Property.

(1) For the purposes of Chapter 6 of these regulations, the following definitions apply:

(a) Unadjusted basis in property - The original cost of the property if acquired after January 1, 1933. If the property was acquired prior to January 1, 1933 the unadjusted basis is the fair market value on January 1, 1933.

(b) Adjusted basis in property (for transactions before January 1, 1985) - The unadjusted basis in the property, plus the cost of improvements of a permanent character made to the property that have been properly classified as a capital expenditure, minus prior return of investment, depreciation, amortization, depletion, and other reductions in the original cost.

(c) Fair market value - The price at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and each having knowledge of all relevant facts.

1. The determination of the fair market value of property is generally a question of fact and shall be established by competent evidence. The general way of determining the fair market value of stock, in the absence of knowledge of sales on any given date, is to value the stock on the basis of the corporate assets underlying the stock as disclosed by a balance sheet as of this date.

(2) The general rule is that the unadjusted basis of property is its cost. The term "adjusted basis" means, in substance, the original capital investment ("unadjusted basis") adjusted to the date the taxpayer disposes of the property. "Basis" for determining gain or loss on sale or other disposition is also the "basis" for computing depreciation, and in some cases, depletion.

(a) The adjusted basis for determining the gain or loss from the sale or other disposition of property is the basis of the property defined in §40-18-6(a), Code of Alabama 1975, adjusted to the extent provided in §40-18-6(b)(1) as in effect prior to January 1, 1985, or adjusted to the extent provided in §40-18-6(b) as in effect after December 31, 1984; and interpreted below:

1. Expenditures made by the taxpayer after acquisition of a property for improvements, additions or betterments of a relatively permanent character, such as to prolong the life or increase the utility of the property in substantial degree beyond the life or utility reasonably to be expected from properties of like age and character, shall be added to and increase the original basis of such property for the purpose of determining gain or loss upon the disposition thereof. No adjustment shall be made in respect of any item which, under any applicable provision of law or regulation, is treated as an item not properly chargeable to a

capital account but is allowable as an expense deduction in computing net income for the taxable year.

2. Adjustments to basis may be made for carrying charges such as taxes and interest, with respect to unimproved and unproductive real property, if the taxpayer elects to treat these items as chargeable to asset accounts rather than as an allowable expense deduction. The term "taxes" for this purpose includes duties and excise taxes but does not include income taxes.

3. In any case in which a portion of the taxpayer's cost or investment has been returned to him in any form or manner since acquisition, or any losses have been incurred, or other items or events have transpired, resulting in a return of capital, the amount thereof shall apply against and reduce the original basis to the taxpayer. Thus, any receipts or credits arising from or related to the ownership of an item of property, which receipts or credits do not constitute income taxable under the law, are to be treated as a refund of a portion of the original cost.

(3) If a casualty loss has been sustained, the cost basis in the property must be reduced by the amount of the casualty loss claimed as a deduction in the computation of net income. If the loss is reimbursed, in part or total, by insurance proceeds; the insurance proceeds must be used to repair the property to its original state. For losses occurring in tax years ending before January 1, 1985, if the insurance proceeds are not used to repair the property to its original state, the casualty must be treated as an involuntary conversion and any gain recognized and reported as income. See Reg. 810-3-8-.06 for involuntary conversions. For losses in tax years beginning after December 31, 1984, see Reg. 810-3-8-.06(2) for determination of recognizable gain, if any.

(a) EXAMPLE: A rental dwelling was partially destroyed by fire. The fair market value of the property immediately before the fire was $20,000.00 ($2,000.00 for the land and $18,000.00 for the dwelling). The fair market value just after the fire was $12,000.00 ($2,000.00 for the land and $10,000.00 for the dwelling). The insurance reimbursement was $5,000.00. The entire amount of the insurance proceeds were used to repair the property to its original state. Taxpayers adjusted cost basis in the property before the casualty was $6,000.00 ($1,000.00 for the land and $5,000.00 for the dwelling). The adjusted basis in the property following the casualty is as follows:

	Land	Building
a. Cost/basis	$ 1,000	$ 5,000
b. Fair market value before	2,000	18,000
c. Fair market value after	2,000	10,000
d. Change in fair market value	0	8,000
e. Smaller of cost or change in market value	0	5,000

f. Less insurance proceeds	0	5,000
g. Casualty loss (e - f)	0	0
h. New adjusted basis before repairs	$ 1,000	0

(b) EXAMPLE: Same facts as in example (3)(a) above, except the dwelling is a personal residence. The casualty loss and adjusted basis would be computed as follows:

	Homesite
a. Cost/basis	$ 6,000
b. Fair market value before	20,000
c. Fair market value after	12,000
d. Change in market value	8,000
e. Smaller of cost or change in market value	6,000
f. Less insurance proceeds	5,000
g. Casualty loss (e - f)	$ 1,000
h. New adjusted basis before repairs	0

(4) The original basis must also be decreased by the amount of maximum allowable deductions for exhaustion, wear and tear, obsolescence (these three items hereinafter referred to as "depreciation"), amortization, and depletion under the law applicable to the periods of time prior to January 1, 1935 and subsequent to January 1, 1935. Deductions allowable shall reduce the original basis of the property to the adjusted basis for determining gain or loss. These deductions shall be the greater of the following two amounts:

(a) the amount allowed as deductions in computing taxable income to the extent resulting in a taxpayer's income taxes, or

(b) the amount allowable for the years involved.

(c) The general rule is "Always in the amount allowed, but never less than the amount allowable."

(d) It is not necessary for this depreciation, amortization, or depletion to have been claimed on tax returns or entered in taxpayer's records. It shall be assumed that the taxpayer has claimed maximum allowable deductions regardless of the expiration of the statutory period for claiming deductions. A taxpayer is not permitted to take advantage in a later year of his prior failure to take any such allowance or his taking an allowance plainly inadequate under the known facts in prior years. In the case of depreciation, if in prior years the taxpayer has consistently taken proper deductions under one method, the amount allowable for such prior years shall not be increased even though a greater amount would have been allowable under another proper method.

(5) In the case of stock, the original basis must be decreased by the amount of distributions previously made which at the date of distribution were either tax free or applicable in the reduction of basis. This does not apply to exempt dividends paid from income earned since January 1, 1933, by the corporations paying the dividend.

(6) For transactions occurring in a tax year beginning before January 1, 1985, whenever it appears that the basis of property of the taxpayer is a substituted basis, then the adjustments provided in §40-18-6(b) and this regulation shall be made after first making, in respect to such substituted basis, proper adjustments of a similar nature in respect of the period during which the property was held by the transferor, donor, or grantor, or during which the other property was held by the person from whom the basis is to be determined. A similar rule shall be applied in case of a series of substituted bases.

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Authority: §40-18-6, Code of Alabama 1975
History: Effective September 30, 1982.
Effective August 30, 1988.
Amended September 18, 1996, effective October 23, 1996.