

always been properly accounted for in accordance with the straight-line method of computing the depreciation allowances or which, under the terms-letter, was permitted or required to be accounted for under the retirement method.

(4) *Depreciation*. The term *depreciation* means exhaustion, wear and tear, and obsolescence.

(5) *Predecessor*. The term *predecessor* means any person from whom property of a kind or class to which the Act refers was acquired, if the basis of such property is determined by reference to its basis in the hands of such person. Where a series of transfers of property has occurred and where in each instance the basis of the property was determined by reference to its basis in the hands of the prior holder, the term includes each such prior holder.

(6) *Changeover*. The term *changeover* means a change from the retirement to the straight-line method of computing the allowance of deductions for depreciation.

(7) *Changeover date*. The term *changeover date* means the first day of the first taxable year for which the changeover was effective.

(8) *1956 adjustment date*. The term *1956 adjustment date* means, in the case of any taxpayer, the first day of its first taxable year beginning after December 31, 1955.

(9) *Terms-letter*. The term *terms-letter* means the terms and conditions prescribed by the Commissioner in connection with the changeover.

(10) *Terms-letter reserve*. The term *terms-letter reserve* means the reserve for depreciation prescribed by the Commissioner in connection with the changeover.

(11) *Depreciation sustained before March 1, 1913*. The term *depreciation sustained before March 1, 1913* may be construed to mean, to the extent that it is impossible to determine the actual amount of such depreciation from the books and records, that amount which is obtained by (i) deducting the "cost of reproduction new less depreciation" from the "cost of reproduction new", as ascertained as of the valuation date by the Interstate Commerce Commission under the provisions of section 19a of part I of the Interstate Commerce

Act (49 U.S.C. 19a), and then (ii) making such retroactive adjustments to the remainder as are required, in the opinion of the Commissioner of Internal Revenue, to properly reflect the depreciation sustained before March 1, 1913. For this purpose, any retirement-straight line property held on March 1, 1913, and retired on or before the valuation date shall be taken into account.

§ 1.9001-2 Basis adjustments for taxable years beginning on or after 1956 adjustment date.

(a) *In general*. Subsection (d) of the Act provides the basis adjustments required to be made by the taxpayer as of the 1956 adjustment date in respect of all periods before that date in order to determine the adjusted basis of all retirement-straight line property held by the taxpayer on that date. This adjusted basis on the 1956 adjustment date shall be used by the taxpayer for all purposes of the Code for any taxable year beginning after December 31, 1955. In order to arrive at the adjusted basis on the 1956 adjustment date, the taxpayer shall start with the unadjusted basis of all retirement-straight line property held on the changeover date by the taxpayer or a predecessor and shall, with respect to both the asset and reserve accounts, (1) make the adjustments prescribed by this section and subsection (d) of the Act and (2) also make those adjustments required, in accordance with the method of accounting regularly used, for those additions, retirements, and other dispositions of property which occurred on or after the changeover date and before the taxpayer's 1956 adjustment date. For an illustration of adjustments required in accordance with the method of accounting regularly used, see paragraph (e)(3) of this section. The adjustments required by subsection (d) of the Act shall be made in lieu of the adjustments for depreciation otherwise required by section 1016(a) (2) and (3) of the Code. The adjustments required by subsection (d) of the Act are set forth in paragraphs (b), (c), and (d) of this section.

(b) *Adjustment for depreciation sustained before March 1, 1913*—(1) *In general*. Subsection (d)(1) of the Act requires an adjustment to be made as of

the 1956 adjustment date for depreciation sustained before March 1, 1913, on all retirement-straight line property held on March 1, 1913, by the taxpayer or a predecessor for which cost was or is claimed as basis and which was either (i) retired before the changeover date by the taxpayer or a predecessor or (ii) held on the changeover date by the taxpayer or a predecessor. This adjustment for depreciation sustained before March 1, 1913, shall be made in accordance with the conditions and limitations described in subparagraphs (2) and (3) of this paragraph and shall be allocated, in the manner prescribed in subparagraph (4) of this paragraph, among all retirement-straight line property held by the taxpayer on its 1956 adjustment date. The term "cost", when used in this paragraph with reference to the basis of property, shall be construed to mean the amount paid for the property or, if that amount could not be determined, then such other amount as was accepted by the Commissioner as "cost" for basis purposes.

(2) *Depreciation sustained on property retired before the changeover date.* Pursuant to subsection (d)(1)(A) of the Act, an adjustment to the basis of retirement-straight line property held by the taxpayer on its 1956 adjustment date shall be made as of that date for depreciation sustained before March 1, 1913, on all retirement-straight line property held on March 1, 1913, by the taxpayer or a predecessor for which cost was claimed as the basis and which was retired before the changeover date by the taxpayer or a predecessor, except that:

(i) The adjustment shall be made only if a deduction was allowed in computing net income by reason of the retirement and the deduction so allowed was computed on the basis of the cost of the property unadjusted for depreciation sustained before March 1, 1913, and

(ii) In the case of any such property retired during any taxable year beginning after December 31, 1929, the adjustment shall not exceed that portion of the amount attributable to depreciation sustained before March 1, 1913, which resulted, by reason of the deduction so allowed, in a reduction of taxes

under the Code or under prior income, war-profits or excess-profits tax laws.

(3) *Depreciation sustained on property held on the changeover date.* Pursuant to subsection (d)(1)(B) of the Act, an adjustment to the basis of retirement-straight line property held by the taxpayer on its 1956 adjustment date shall be made as of that date for depreciation sustained before March 1, 1913, on all retirement-straight line property held on March 1, 1913, by the taxpayer or a predecessor for which cost was or is claimed as basis and which was held on the changeover date by the taxpayer or a predecessor. This subparagraph shall not apply, however, to any such property which (i) was disposed of on or after the changeover date by reason of sale, casualty, or abnormal retirement in the nature of special obsolescence, and (ii) is property to which paragraph (c) of this section and subsection (d)(2) of the Act apply.

(4) *Manner of allocating adjustment.* Pursuant to subsection (d)(1) of the Act, the amount of the adjustment required under this paragraph for depreciation sustained before March 1, 1913, which is attributable to a particular kind or class of retirement-straight line property held by the taxpayer on its 1956 adjustment date shall be made with respect to that kind or class of such property. If the adjustment required under this paragraph for depreciation sustained before March 1, 1913, is attributable to retirement-straight property of a particular kind or class no longer held by the taxpayer on its 1956 adjustment date, then the part of the adjustment to be allocated to any retirement-straight line property held by the taxpayer on its 1956 adjustment date shall be that amount which bears the same ratio to the adjustment as the unadjusted basis of the property so held bears to the entire unadjusted basis of all retirement-straight line property held by the taxpayer on its 1956 adjustment date.

(c) *Adjustment for part of terms-letter reserve applicable to property disposed of on or after changeover date and before 1956 adjustment date.* Pursuant to subsection (d)(2) of the Act, an adjustment to the basis of retirement-straight line property held by the taxpayer on its 1956 adjustment date shall be made as

of that date for that part of the terms-letter reserve which was applicable to any retirement-straight line property disposed of by sale, casualty, or abnormal retirement in the nature of special obsolescence, but only if the sale occurred in, or a deduction by reason of such casualty or abnormal retirement was allowed for Federal income-tax purposes for a period on or after the changeover date and before the taxpayer's 1956 adjustment date. This paragraph shall apply even though, in computing the adjusted basis of the property for purposes of determining gain or loss on the sale, casualty, or abnormal retirement, the basis of the retirement-straight line property was not reduced by the part of the terms-letter reserve applicable to the property. If necessary, the adjustment required by this paragraph shall be allocated, in the manner prescribed in paragraph (b)(4) of this section, among all retirement-straight line property held by the taxpayer on its 1956 adjustment date.

(d) *Adjustment for depreciation allowable under the terms-letter for periods on and after the changeover date and before the 1956 adjustment date.* Pursuant to subsection (d)(3) of the Act, an adjustment to the basis of retirement-straight line property held by the taxpayer on its 1956 adjustment date shall be made as of that date for the entire amount of depreciation allowable under the terms-letter for all periods on and after the changeover date and before the taxpayer's 1956 adjustment date. This adjustment shall include all such depreciation allowable with respect to any retirement-straight line property which was disposed of on or after the changeover date and before the 1956 adjustment date.

(e) *Illustration of basis adjustments required for taxable years beginning on or after the 1956 adjustment date.* The application of this section may be illustrated by the following example, which is based upon the assumption that multiple asset accounts are used:

Example. (1) Assume that on its changeover date, January 1, 1943, the taxpayer or its predecessor held retirement-straight line property with an unadjusted cost basis of \$10,000. The terms-letter reserve established as of January 1, 1943, with respect to such

property was \$3,000. Depreciation sustained before March 1, 1913, on retirement-straight line property held on that date by the taxpayer or its predecessor, for which cost was or is claimed as basis, amounts to \$800. Of this total depreciation sustained before March 1, 1913, \$200 is attributable to retirement-straight line property retired before January 1, 1943, under circumstances requiring the adjustment under paragraph (b)(2) of this section, and \$600 is attributable to retirement-straight line property held on January 1, 1943, by the taxpayer or its predecessor. On December 31, 1954, retirement-straight line property costing \$1,500 was permanently retired under circumstances giving rise to an abnormal retirement in the nature of special obsolescence. The terms-letter reserve applicable to this retired property was \$450, of which \$120 represents depreciation sustained before March 1, 1913. On December 31, 1954, retirement-straight line property costing \$1,000 was also permanently retired under circumstances giving rise to a normal retirement. None of the property retired on December 31, 1954, had any market or salvage value on that date. Depreciation allowable under the terms-letter on retirement-straight line property for all periods on and after January 1, 1943, and before January 1, 1956 (the taxpayer's 1956 adjustment date), amounts to \$2,155, of which \$345 is applicable to the property retired as an abnormal retirement.

(2) The reserve for depreciation as of January 1, 1956, contains a credit balance of \$3,360, determined as follows but without regard to the Act:

(i) Credits to reserve:	
Terms-letter reserve as of January 1, 1943	\$3,000
Depreciation allowable under terms-letter from January 1, 1943, to December 31, 1955	2,155
Balance	5,155
(ii) Charges to reserve:	
Part of terms-letter reserve applicable to property abnormally retired	\$450
Depreciation applicable to property abnormally retired and allowable from January 1, 1943, to December 31, 1954	345
Adjustment for normal retirement	1,000
	\$1,795
(iii) Balance as of January 1, 1956	3,360

(3) The adjusted basis on January 1, 1956, of the retirement-straight line property held by the taxpayer on that date is \$6,010, determined as follows and in accordance with this section:

(i) Asset account:	
Unadjusted cost on January 1, 1943	\$10,000

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Less:			
Adjustment for abnormal retirement	\$1,500		
Adjustment for normal retirement	1,000		
		2,500	
Balance as of January 1, 1956		7,500	
(ii) Credits to reserve for depreciation:			
Depreciation sustained before March 1, 1913, on—			
Property retired before January 1, 1943		200	
Property held on January 1, 1943	\$600		
Less part of such depreciation sustained on property abnormally retired on December 31, 1954		120	
			480
Part of terms-letter reserve applicable to property abnormally retired on December 31, 1954 (including \$120 depreciation sustained before March 1, 1913)			450
Depreciation allowable under terms-letter from January 1, 1943, to December 31, 1955			2,155
Total Credits			3,285
(iii) Charges to reserve for depreciation:			
Part of terms-letter reserve applicable to property abnormally retired			450
Depreciation applicable to property abnormally retired and allowable from January 1, 1943, to December 31, 1954			345
Adjustment for normal retirement			1,000
Total charges			1,795
(iv) Balance in reserve for depreciation:			
Total credits			3,285
Total charges			1,795
Balance as of January 1, 1956			1,490
(v) Adjusted basis of property:			
Balance in asset account			7,500
Balance in reserve for depreciation			1,490
Adjusted basis as of January 1, 1956			6,010

		1,130
Balance		4,490
(iii) Debit adjustment:		
Terms-letter reserve as of January 1, 1943		3,000
(iv) Credit Balance in reserve, as determined under subparagraph (3)(iv) of this paragraph ..		1,490

(5) The \$6,010 adjusted basis as of January 1, 1956, of the retirement-straight line property held by the taxpayer on that date is to be recovered over the estimated remaining useful life of that property. The remaining useful life of the property will be reviewed regularly, and appropriate adjustments in the rates will be made as necessary in order to spread the remaining cost less estimated salvage over the estimated remaining useful life of the property. See § 1.167(a)-1.

§ 1.9001-3 Basis adjustments for taxable years between changeover date and 1956 adjustment date.

(a) *In general.* (1) Subsection (e) of the Act provides the adjustments required to be made in determining the adjusted basis of any retirement-straight line property as of any time on or after the changeover date and before the taxpayer's 1956 adjustment date. This adjusted basis shall be used for all purposes of the Internal Revenue Code of 1939 and the Internal Revenue Code of 1954 for taxable years beginning on or after the changeover date and before the taxpayer's 1956 adjustment date, except as provided in subparagraph (4) of this paragraph. The adjustments so required, which are set forth in paragraphs (b) and (c) of this section, shall not be used in determining the adjusted basis of property for taxable years beginning before the changeover date or on or after the taxpayer's 1956 adjustment date.

(2) In order to arrive at the adjusted basis as of any specific date occurring on or after the changeover date and before the 1956 adjustment date, the taxpayer shall start with the unadjusted basis of all retirement-straight line property held on the changeover date by the taxpayer or its predecessor and shall, as of that specific date and with respect to both the asset and reserve accounts, (i) make the adjustments prescribed by this section and subsection (e) of the Act and (ii) also make those adjustments required, in accordance with the method of accounting

(4) The following adjustments to the reserve determined under subparagraph (2) of this paragraph may be made in order to arrive at the reserve determined under subparagraph (3)(iv) of this paragraph:

(i) Credit balance in reserve, as determined under subparagraph (2) of this paragraph	\$3,360
(ii) Credit adjustments:	
Depreciation sustained before March 1, 1913, on—	
Property retired before January 1, 1943	\$200
Property held on January 1, 1943	480
Part of terms-letter reserve applicable to property abnormally retired on December 31, 1954	450