**8549. How is tax basis adjusted and what affect does it have in the computation of capital gain or loss?**

As discussed in Q 8548, gain or loss is measured by determining whether the amount received in exchange for property was more or less than the taxpayer’s “basis.” If the amount received is more than basis, there is a taxable gain. Conversely, if basis is greater than the amount received there is a taxable loss. However, during the taxpayer’s ownership of property, certain adjustments to the original tax basis are required. Thus, tax basis as adjusted is referred to as “adjusted basis.”

In the course of a taxpayer’s ownership of property, basis can be increased or it can be decreased.

**CAPTIAL IMPROVEMENT**

*Example.*  Asher purchases a 10 story office building for $500,000. Subsequently, Asher decides to add an 11th story to the building at a cost of $100,000. As a capital improvement, Asher’s original $500,000 basis is adjusted upward to $600,000[[1]](#endnote-1) and becomes the adjusted basis in the building.

**DEPRECIATION**

Broadly described, depreciation is a means of deducting the cost of an asset over its useful life. For example, the cost of a commercial building (excluding the land which is nondepreciable) is depreciated over 39 years.[[2]](#endnote-2) Based on a tax fiction, at the end of the 39 year depreciation period, the building will be completely “used up” and worth nothing. So every year, the basis of the building is adjusted downward by the amount of that year’s depreciation deduction.[[3]](#endnote-3)

*Example.*  Asher purchases a 10 story office building for $390,000.[[4]](#endnote-4) Because the building is depreciable over 39 years, each year Asher claims a $10,000 depreciation deduction. So after 9 years, Asher’s original basis is adjusted downward to $300,000 ($390,000 minus $90,000). So, if at time Asher were to sell the building for $400,000, he would have a taxable gain of $100,000 ($400,000 minus $300,000).

1. IRC Sec. 1016(a)(1). [↑](#endnote-ref-1)
2. IRC Sec. 168(c). [↑](#endnote-ref-2)
3. IRC Sec. 1016(a)(2). [↑](#endnote-ref-3)
4. For purposes of this example, the amount of the purchase price attributable to the land is ignored. [↑](#endnote-ref-4)