

deposits located outside the United States (as defined in section 638 and the regulations thereunder), does not exceed—

(i) \$400,000 minus
(ii) All amounts deducted or deferred during the taxable year and all preceding taxable years under section 617 or section 615 of the Internal Revenue Code of 1954 and section 23(f) of the Internal Revenue Code of 1939 by corporations which are members of the group during the taxable year (and individuals or corporations which have transferred any mineral property to any such member within the meaning of section 617(g) (2)(B)) for taxable years ending after December 31, 1950 and prior to the taxable year, then the deduction under section 617 with respect to such foreign expenditures and paragraph (c) of § 1.1502-12 for each member shall be no greater than an allocable portion of such amount hereinafter referred to as the "consolidated foreign exploration limitation." Such allocable portion shall be determined under subparagraph (2) of this paragraph. If the amount of such expenditures exceeds the consolidated foreign exploration limitation, no deduction shall be allowed with respect to such excess.

(2) *Allocable portion of limitation.* A member's allocable portion of the consolidated foreign exploration limitation for a consolidated return year shall be—

(i) The amount allocated by the common parent pursuant to an allocation plan adopted by the consolidated group, but in no event shall a member be allocated more than the amount it could have deducted had it filed a separate return. Such allocation plan must include a statement which also contains the total foreign exploration expenditures of each member which could have been deducted under section 617 if the member had filed a separate return. Such plan must be attached to a consolidated return filed on or before the due date of such return (including extensions of time), and may not be changed after such date, or

(ii) If no plan is filed in accordance with subdivision (i) of this subparagraph, then the portion of the consolidated foreign exploration limitation allocable to each member incurring such expenditures is an amount equal to such limitation multiplied by a fraction, the numerator of which is the amount of foreign exploration expenditures which could have been deducted under section 617 by such member had it filed a separate return and the denominator of which is the aggregate of such amounts for all members of the group.

(b) *Section 615—(1) In general.* If the aggregate amount of the expenditures, to which section 615(a) applies, which are paid or incurred by the members of the group during any consolidated return year exceeds the lesser of—

(i) \$100,000, or
(ii) \$400,000 minus all such expenditures deducted (or deferred) by corporations which are members of the group during the taxable year (and individuals

or corporations which have transferred any mineral property to any such member within the meaning of section 615 (c) (2) (B)) for taxable years ending after December 31, 1950, and prior to the taxable year, then the deduction (or amount deferrable) under section 615 and paragraph (c) of § 1.1502-12 for each member shall be no greater than an allocable portion of such lesser amount, hereinafter referred to as the "consolidated exploration limitation". Such allocable portion shall be determined under subparagraph (2) of this paragraph.

(2) *Allocable portion of limitation.* A member's allocable portion of the consolidated exploration limitation for a consolidated return year shall be—

(i) The amount allocated by the common parent pursuant to an allocation plan adopted by the consolidated group, but in no event shall a member be allocated more than the amount it could have deducted (or deferred) had it filed a separate return. Such allocation plan must include a statement which also contains the total exploration expenditures of each member for the taxable year, and the expenditures of each member which could have been deducted (or deferred) under section 615 if the member had filed a separate return. Such plan must be attached to a consolidated return filed on or before the due date of such return (including extensions of time), and may not be changed after such date, or

(ii) If no plan is filed in accordance with subdivision (i) of this subparagraph, then the portion of the consolidated exploration limitation allocable to each member incurring such expenditures is an amount equal to such limitation multiplied by a fraction, the numerator of which is the amount which could have been deducted (or deferred) under section 615 by such member had it filed a separate return and the denominator of which is the aggregate of such amounts for all members of the group.

(c) *Examples.* The provisions of this section may be illustrated by the following examples:

Example (1). Corporation X and its wholly owned subsidiaries, corporations Y and Z, file a consolidated return for the calendar year 1971. None of the corporations have incurred exploration expenditures described in section 617 in previous years. During 1971, X incurred foreign exploration expenditures of \$30,000, Y of \$20,000, and Z of \$40,000. The amount of foreign exploration expenditures deductible under section 617 for purposes of computing separate taxable income under § 1.1502-12 will be the amount actually expended by each corporation.

Example (2). Assume the same facts as in example (1) except that prior to 1971, X, Y, and Z had deducted (or deferred) under section 615 and 617 a total of \$300,000 of exploration expenditures. During 1971, with respect to deposits located outside the United States X incurred exploration expenditures of \$25,000, Y of \$75,000, and Z of \$125,000. The consolidated exploration limitation under paragraph (a) of this section with respect to the foreign deposits (there is no limitation with respect to the domestic expenditures) is \$100,000. X may allocate the \$100,000 in any manner among the three members, except that X may not be allocated more than

\$25,000 nor Y more than \$75,000, the amount actually expended by X and Y and which they could have deducted had they each filed a separate return. If the allocation is not made in accordance with paragraph (a) (2) (i) of this section, the \$100,000 limitation will be allocated under paragraph (a) (2) (ii) of this section as follows:

Corporation	Expenditure	Fraction	Limitation	Allocable portion
X	\$25,000	$\frac{25,000}{200,000}$	× \$100,000 =	\$12,500
Y	\$75,000	$\frac{75,000}{200,000}$	× \$100,000 =	\$37,500
Z	\$125,000	$\frac{125,000}{200,000}$	× \$100,000 =	\$62,500

The denominator of \$200,000 was calculated as follows:

X = \$25,000
Y = \$75,000
Z = \$100,000 (maximum amount allowed if filed separately)
Total \$200,000.

Example (3). Assume the same facts as in example (2) and that on January 1, 1971, X acquired all of the stock of corporation T which prior to its taxable year beginning January 1, 1971, had previously deducted (or deferred) \$310,000 of exploration expenditures. Assume further that in 1971 X incurred \$25,000 of foreign exploration expenditures, Y \$50,000, T \$50,000, and Z none. A consolidated return is filed for 1971. None of the expenditures may be deducted under section 617 since the consolidated exploration limitation is zero. The limitation is zero since the aggregate amount of previously deducted (or deferred) exploration expenditures by the members of the group exceeds \$400,000. (The total of such expenditures is \$410,000, of which \$310,000 is attributable to T and, assuming the allocation of the limitation in example (2) is made under paragraph (a) (2) (ii) of this section, \$12,500 is attributable to X, \$37,500 to Y, and \$50,000 to Z.

Example (4). Assume the same facts as in example (3) except that on December 31, 1971, X sold all of the stock in Z to an unrelated party. The consolidated exploration limitation for 1972 will be \$40,000, computed by subtracting from \$400,000, the aggregate amount of previously deducted (or deferred) exploration expenditures incurred by the members of the group prior to 1972. (The total of such expenditures is \$360,000, of which \$12,500 is attributable to X, \$37,500 to Y and \$310,000 to T.) Amounts previously deducted (or deferred) by Z are not taken into account since it was not a member of the group at any time during 1972. Amounts previously deducted (or deferred) by Z shall be taken into account by it for subsequent separate return years.

[FR Doc.72-10020 Filed 6-29-72; 8:54 am]

[T.D. 7191]

PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Certain Sales of Low-Income Housing Projects

On November 24, 1971, notice of proposed rule making with respect to the amendment of the Income Tax Regulations (26 CFR Part 1) to conform the regulations to the provisions of section 910(a) of the Tax Reform Act of 1969

(83 Stat. 718), relating to certain sales of low-income housing projects, was published in the *FEDERAL REGISTER* (36 F.R. 22304). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the amendment as proposed is hereby adopted, subject to the following changes:

Section 1.1039-1 is changed by revising the last sentence of paragraph (b)(1), by revising the first sentence of paragraph (b)(3), by redesignating paragraph (c)(4) as paragraph (c)(4)(i) and adding a new paragraph (c)(4)(ii), by revising the first sentence of paragraph (d)(1), and by revising the first sentence of paragraph (d)(2). These revised and added provisions read as set forth below.

(Sec. 1039 of the Internal Revenue Code of 1954 (83 Stat. 718; 26 U.S.C. 1039) and sec. 7805 of the Internal Revenue Code of 1954 (68 Stat. 917; 26 U.S.C. 7805))

[SEAL] JOHNNIE M. WALTERS,
Commissioner of Internal Revenue.

Approved: June 26, 1972.

FREDERIC W. HICKMAN,
Acting Assistant Secretary
of the Treasury.

In order to conform the Income Tax Regulations (26 CFR Part 1) to the provisions of section 910(a) of the Tax Reform Act of 1969 (83 Stat. 718), the following new sections are added immediately after § 1.1038-2:

§ 1.1039 Statutory provisions; certain sales of low-income housing projects.

(a) *Nonrecognition of gain.*—If—

(1) A qualified housing project is sold or disposed of by the taxpayer in an approved disposition, and

(2) Within the reinvestment period the taxpayer constructs, reconstructs, or acquires another qualified housing project.

Then, at the election of the taxpayer, gain from such approved disposition shall be recognized only to the extent that the net amount realized on such approved disposition exceeds the cost of such other qualified housing project. An election under this subsection shall be made at such time and in such manner as the Secretary or his delegate prescribes by regulations.

(b) *Definitions.*—For purposes of this section—

(1) *Qualified housing project.*—The term "qualified housing project" means a project to provide rental or cooperative housing for lower income families—

(A) With respect to which a mortgage is insured under section 221(d)(3) or 236 of the National Housing Act, and

(B) With respect to which the owner is, under such sections or regulations issued thereunder—

(i) Limited as to the rate of return on his investment in the project, and

(ii) Limited as to rentals or occupancy charges for units in the project.

(2) *Approved disposition.*—The term "approved disposition" means a sale or other disposition of a qualified housing project to the tenants or occupants of units in such project, or to a cooperative or other nonprofit organization formed solely for the benefit of such tenants or occupants, which sale or disposition is approved by the Secretary of Housing and Urban Development under section 221(d)(3) or 236 of the National Housing Act or regulations issued under such sections.

(3) *Reinvestment period.*—The reinvestment period, with respect to an approved disposition of a qualified housing project, is the period beginning 1 year before the date of such approved disposition and ending—

(A) One year after the close of the first taxable year in which any part of the gain from such approved disposition is realized, or

(B) Subject to such terms and conditions as may be specified by the Secretary or his delegate, at the close of such later date as the Secretary or his delegate may designate on application by the taxpayer. Such application shall be made at such time and in such manner as the Secretary or his delegate prescribes by regulations.

(4) *Net amount realized.*—The net amount realized on an approved disposition of a qualified housing project is the amount realized reduced by—

(A) The expenses paid or incurred which are directly connected with such approved disposition, and

(B) The amount of taxes (other than income taxes) paid or incurred which are attributable to such approved disposition.

(c) *Special rules.*—For purposes of applying subsection (a)(2) with respect to an approved disposition—

(1) No property acquired by the taxpayer before the date of the approved disposition shall be taken into account unless such property is held by the taxpayer on such date, and

(2) No property acquired by the taxpayer shall be taken into account unless, except as provided in subsection (d), the unadjusted basis of such property is its cost within the meaning of section 1012.

(d) *Basis of other qualified housing project.*—If the taxpayer makes an election under subsection (a) with respect to an approved disposition, the basis of the qualified housing project described in subsection (a)(2) shall be its cost reduced by an amount equal to the amount of gain not recognized by reason of the application of subsection (a).

(e) *Assessment of deficiencies.*—(1) *Deficiency attributable to gain.*—If the taxpayer has made an election under subsection (a) with respect to an approved disposition—

(A) The statutory period for the assessment of any deficiency, for any taxable year in which any part of the gain on such approved disposition is realized, attributable to the gain on such approved disposition shall not expire prior to the expiration of 3 years from the date the Secretary or his delegate is notified by the taxpayer (in such manner as the Secretary or his delegate may by regulations prescribe) of the construction, reconstruction, or acquisition of another qualified housing project or of the failure to construct, reconstruct, or acquire another qualified housing project, and

(B) Such deficiency may be assessed before the expiration of such 3-year period notwithstanding the provisions of section 6212 (c) or the provision of any other law or rule of law which would otherwise prevent such assessment.

(2) *Time for assessment of other deficiencies attributable to election.*—If a taxpayer has made an election under subsection (a) with respect to an approved disposition and another qualified housing project is constructed, reconstructed, or acquired before the beginning of the last taxable year in which any part of the gain upon such approved disposition is realized, any deficiency, to the extent resulting from such election, for any taxable year ending before such last taxable year may be assessed (notwithstanding the provisions of section 6212(c) or 6501 or the provisions of any other law or rule of law which would otherwise prevent such assessment) at any time before the expiration of the period within which a deficiency for such last taxable year may be assessed.

[Sec. 1039, as added by sec. 910(a), Tax Reform Act of 1969 (83 Stat. 718)]

§ 1.1039-1 Certain sales of low-income housing projects.

(a) *Nonrecognition of gain.* Section 1039 provides rules under which the taxpayer may elect not to recognize gain in certain cases where a qualified housing project is sold or disposed of after October 9, 1969, in an approved disposition and another such qualified housing project or projects (referred to as the "replacement project") is acquired, constructed, or reconstructed within a specified reinvestment period. If the requirements of section 1039 are met, and if the taxpayer makes an election in accordance with the provisions of paragraph (b)(4) of this section, then the gain realized upon the sale or disposition is recognized only to the extent that the net amount realized on such sale or disposition exceeds the cost of the replacement project. The terms "qualified housing project," "approved disposition," "reinvestment period," and "net amount realized" are defined in paragraph (c) of this section.

(b) *Rules of application.*—(1) *In general.* The election under section 1039(a) may be made only by the taxpayer owning the qualified housing project disposed of. Thus, if the qualified housing project disposed of is owned by a partnership, the partnership must make the election. (See section 703(b).) Similarly, if the qualified housing project disposed of is owned by a corporation or trust, the corporation or trust must make the election. In addition, the reinvestment of the taxpayer must be in such a manner that the taxpayer would be entitled to a deduction for depreciation on the replacement project. Thus, if the qualified housing project disposed of is owned by individual A, the purchase by A of stock in a corporation owning or constructing such a project or of an interest in a partnership owning such a project will not be considered as the purchase or construction by A of such a project.

(2) *Special rules.* (i) The cost of a replacement project acquired before the approved disposition of a qualified housing project shall be taken into account under section 1039 only if such property is held by the taxpayer on the date of the approved disposition.

(ii) Except as provided in section 1039 (d), no property acquired by the taxpayer shall be taken into account for purposes of section 1039(a)(2) unless the unadjusted basis of such property is its cost within the meaning of section 1012. For example, if a qualified housing project is acquired in an exchange under section 1031, relating to exchange of property held for productive use or investment, such property will not be taken into account under section 1039(a)(2) because its basis is determined by reference to the basis of the property exchanged. (See section 1031(d).)

(3) *Cost of replacement project.* The taxpayer's cost for the replacement project includes only amounts properly treated as capital expenditures by the

taxpayer that are attributable to acquisition, construction, or reconstruction made within the reinvestment period (as defined in paragraph (c) (4) of this section). See section 263 for rules as to what constitutes capital expenditures. Thus, assume that a calendar year taxpayer realizes gain in 1970 upon the approved disposition of a qualified housing project occurring on January 1, 1970. If the taxpayer had begun construction of another qualified housing project on January 1, 1969, and completes such construction on June 1, 1972, only that portion of the cost attributable to the period before January 1, 1972, constitutes the cost of the replacement project for purposes of section 1039. For purposes of determining the cost of a replacement project attributable to a particular period, the total cost of the project may be allocated to such period on the basis of the portion of the total project actually constructed during such period.

(4) *Election.* (i) An election not to recognize the gain realized upon an approved disposition of a qualified housing project to the extent provided in section 1039(a) may be made by attaching a statement to the income tax return filed for the first taxable year in which any portion of the gain on such disposition is realized. Such a statement shall contain the information required by subdivision (iii) of this subparagraph. If the taxpayer does not file such a statement for the first taxable year in which any portion of the gain is realized, but fails to report a portion of the gain realized upon the approved disposition as income for such year or for any subsequent taxable year, then an election shall be deemed to be made under section 1039 (a) with respect to that portion of the gain not reported as income.

(ii) An election may be made under section 1039(a) even though the replacement project has not been acquired or constructed at the time of election. However, if an election has been made and (a) a replacement project is not constructed, reconstructed, or acquired, (b) the cost of the replacement project is lower than the net amount realized from the approved disposition, or (c) a decision is made not to construct, reconstruct, or acquire a replacement project, then the tax liability for the year or years for which the election was made shall be recomputed and an amended return filed. An election may be made even though the taxpayer has filed his return and recognized gain upon the disposition provided that the period of limitation on filing claims for credit or refund prescribed by section 6511 has not expired. In such case, a statement containing the information required by subdivision (iii) of this subparagraph should be filed together with a claim for credit or refund for the taxable year or years in which gain was recognized.

(iii) The statement referred to in subdivisions (i) and (ii) of this subparagraph shall contain the following information:

(a) The date of the approved disposition;

(b) If a replacement project has been acquired, the date of acquisition and cost of the project;

(c) If a replacement project has been constructed or reconstructed by or for the taxpayer, the date construction was begun, the date construction was completed, and the percentage of construction completed within the reinvestment period;

(d) If no replacement project has been constructed, reconstructed, or acquired prior to the time of filing of the statement, the estimated cost of such construction, reconstruction, or acquisition;

(e) The adjusted basis of the project disposed of; and

(f) The amount realized upon the approved disposition and a description of the expenses directly connected with the disposition and the taxes (other than income taxes) attributable to the disposition.

(c) *Definitions.*—(1) *General.* The definitions contained in subparagraphs (2) through (5) of this paragraph shall apply for purposes of this section.

(2) *Qualified housing project.* The term "qualified housing project" means a rental or cooperative housing project for lower income families that has been constructed, reconstructed, or rehabilitated pursuant to a mortgage which is insured under section 221(d)(3) or 236 of the National Housing Act, provided that with respect to the housing project disposed of and the replacement project constructed, reconstructed, or acquired, the owner of the project at the time of the approved disposition and prior to the close of the reinvestment period is, under such sections or regulations issued thereunder,

(i) Limited as to rate of return on his investment in the project, and

(ii) Limited as to rentals or occupancy charges for units in the project.

If the owner of the project is organized and operated as a nonprofit cooperative or other nonprofit organization, then such owner shall be considered to meet the requirement of subdivision (i) of this subparagraph.

(3) *Approved disposition.* The term "approved disposition" means a sale or other disposition of a qualified housing project to the tenants or occupants of units in such project, or to a nonprofit cooperative or other nonprofit organization formed and operated solely for the benefit of such tenants or occupants, provided that it is approved by the Secretary of Housing and Urban Development or his delegate under section 221 (d)(3) or 236 of the National Housing Act or regulations issued under such sections. Evidence of such approval should be attached to the tax return or statement in which the election under section 1039 is made.

(4) *Reinvestment period.* (i) The term "reinvestment period" means the period beginning 1 year before the date of the disposition and ending 1 year after the close of the first taxable year in which any part of the gain from such disposition is realized, or at such later date as

may be designated pursuant to an application made by the taxpayer. Such application shall be made before the expiration of 1 year after the close of the first taxable year in which any part of the gain from such disposition is realized, unless the taxpayer can show to the satisfaction of the district director that—

(a) Reasonable cause exists for not having filed the application within the required period, and

(b) The filing of such application was made within a reasonable time after the expiration of the required period.

The application shall contain all the information required by paragraph (b) (4) of this section and shall be made to the district director for the internal revenue district in which the return is filed for the first taxable year in which any of the gain from the approved disposition is realized.

(ii) Ordinarily, requests for extension of the reinvestment period will not be granted until near the end of such period and any extension will usually be limited to a period not exceeding 1 year. Although granting of an extension depends upon the facts and circumstances of a particular case, if a predominant portion of the construction of the replacement project has been completed or is reasonably expected to be completed within the reinvestment period (determined without regard to any extension thereof), an extension of the reinvestment period will ordinarily be granted. The fact that there is a scarcity of replacement property for acquisition will not be considered sufficient grounds for granting an extension.

(5) *Net amount realized.* (i) The "net amount realized" from the approved disposition of a qualified housing project is the amount realized from such disposition, reduced by—

(a) The expenses paid or incurred by the taxpayer which are directly connected with the approved disposition, and

(b) The amount of taxes (other than income taxes) paid or incurred by the taxpayer which are attributable to the approved disposition.

(ii) Examples of expenses directly connected with an approved disposition of a qualified housing project include amounts paid for sales or other commissions, advertising, and for the preparation of a deed or other legal services in connection with the disposition. An amount paid for a repair to the building will be considered as an expense directly connected with the approved disposition under subdivision (i) (a) of this subparagraph only if such repair is required as a condition of sale, or is required by the Secretary of Housing and Urban Development or his delegate as a condition of approval of the disposition.

(iii) Examples of taxes that are attributable to the approved disposition include local property transfer taxes and stamp taxes. A local real property tax is not so attributable.

(d) *Basis and holding period of replacement project.*—(1) *Basis.* If the taxpayer makes an election under section

1039, the basis of the replacement housing project shall be its cost (including costs incurred subsequent to the reinvestment period) reduced by the amount of gain not recognized under section 1039 (a). If the replacement consists of more than one housing project, the basis determined under this subparagraph shall be allocated to the properties in proportion to their respective costs.

(2) *Holding period.* The holding period of the replacement housing project shall begin on the date the taxpayer acquires such project, that is, on the date the taxpayer first acquires possession or control of such project and bears the burdens and enjoys the benefits of ownership of the replacement project. (For special rule regarding the holding period of property for purposes of section 1250, see section 1250(e)(4).)

(e) *Assessment of deficiencies.*—(1) *Deficiency attributable to gain.* If a taxpayer makes an election under section 1039(a) with respect to an approved disposition, any deficiency attributable to the gain on such disposition, for any taxable year in which any part of such gain is realized, may be assessed at any time before the expiration of 3 years after the date the district director or director of the regional service center with whom the return for such year has been filed is notified by the taxpayer of the acquisition or the completion of construction or reconstruction of the replacement qualified housing project or of the failure to acquire, construct, or reconstruct a replacement qualified housing project, as the case may be. Such a deficiency may be assessed before the expiration of such 3-year period notwithstanding the provisions of any other law or rule of law which would otherwise prevent such assessment. If replacement has been made, such notification shall contain the information required by paragraph (b)(4) (iii) of this section. Such notification shall be attached to the return filed for the taxable year or years in which the replacement occurs, or in which the period for the replacement expires, and a copy of such notification shall be filed with the district director or director of regional service center with whom the election under section 1039(a) was required to be filed, if the return is not filed with such director.

(2) *Deficiency attributable to election.* If gain upon an approved disposition is realized in two (or more) taxable years, and the replacement qualified housing project was acquired, constructed, or reconstructed before the beginning of the last such year, any deficiency, for any taxable year before such last year, which is attributable to an election by the taxpayer under section 1039(a) may be assessed at any time before the expiration of the period within which a deficiency for such last taxable year may be assessed, notwithstanding the provisions of section 6212(c) or 6501 or the provisions of any law or rule of law which would otherwise prevent such assessment. Thus, if gain upon an approved disposition is realized in 1971 and 1975,

and if a replacement project is purchased in 1971, any deficiency for 1971 may be assessed within the period for assessing a deficiency for 1975.

[FR Doc. 72-10019 Filed 6-29-72; 8:54 am]

[T.D. 7193]

PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Gain From Dispositions of Certain Depreciable Realty

On March 5, 1971, notice of proposed rule making with respect to the amendment of the Income Tax Regulations (26 CFR Part 1) under section 1250 of the Internal Revenue Code of 1954 (relating to gain from dispositions of certain depreciable realty), as amended by section 521 (b), (c), and (e) of the Tax Reform Act of 1969 (83 Stat. 652, 653), was published in the FEDERAL REGISTER (36 F.R. 4388). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the amendment as proposed is hereby adopted, subject to the following changes:

PARAGRAPH 1. Section 1.1250-1 is changed by inserting a new sentence between the second and third sentences of paragraph (a)(2)(ii), by revising the second and fourth sentences of example (2) of paragraph (a)(3)(iii), by revising the ninth and 12th (i.e., the last) sentences of example (2) of paragraph (g), and by adding a new example (3) to paragraph (g). The revised and added provisions read as set forth below.

PAR. 2. Section 1.1250-2 is revised by redesignating paragraph (b)(6) as paragraph (b)(7), by adding a new paragraph (b)(6), and by adding new examples (4) and (5) to paragraph (b)(7) as redesignated. These added provisions read as set forth below.

(Sec. 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805))

[SEAL] JOHNNIE M. WALTERS,
Commissioner of Internal Revenue.

Approved: June 26, 1972.

FREDERIC W. HICKMAN,
Acting Assistant Secretary
of the Treasury.

In order to reflect section 521 (b), (c), and (e) of the Tax Reform Act of 1969 (83 Stat. 652, 653), the Income Tax Regulations (26 CFR Part 1) under section 1250 of the Internal Revenue Code of 1954 (relating to gain from dispositions of certain depreciable realty) are amended as follows:

PARAGRAPH 1. Section 1.1250-1 is amended by adding new paragraphs (a), (d)(1), and (g) to read as follows:

§ 1.1250-1 Gain from dispositions of certain depreciable realty.

(a) *Dispositions after December 31, 1969.*—(1) *Ordinary income.* (i) In general, section 1250(a)(1) provides that, upon a disposition of an item of section 1250 property after December 31, 1969,

the applicable percentage of the lower of—

(a) The additional depreciation (as defined in § 1.1250-2) attributable to periods after December 31, 1969 in respect of the property, or

(b) The excess of the amount realized on a sale, exchange, or involuntary conversion (or the fair market value of the property on any other disposition) over the adjusted basis of the property,

shall be treated as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231 (that is, shall be recognized as ordinary income). The amount of such gain shall be determined separately for each item (see subparagraph (2)(ii) of this paragraph) of section 1250 property. If the amount determined under (b) of this subdivision exceeds the amount determined under (a) of this subdivision, then such excess shall be treated as provided in subdivision (ii) of this subparagraph. For relation of section 1250 to other provisions, see paragraph (c) of this section.

(ii) If the amount determined under subdivision (i)(b) of this subparagraph exceeds the amount determined under subdivision (i)(a) of this subparagraph, then the applicable percentage of the lower of—

(a) The additional depreciation attributable to periods before January 1, 1970, or

(b) Such excess,

shall also be recognized as ordinary income.

(iii) If gain would be recognized upon a disposition of an item of section 1250 property under subdivisions (i) and (ii) of this subparagraph, and if section 1250 (d) applies, then the gain recognized shall be considered as recognized first under subdivision (i) of this subparagraph. (See example (3)(i) of paragraph (c)(4) of § 1.1250-3.)

(2) *Meaning of terms.* (i) For purposes of section 1250, the term "disposition" shall have the same meaning as in paragraph (a)(3) of § 1.1245-1. "Section 1250 property" is, in general, depreciable real property other than section 1245 property. See paragraph (e) of this section. See paragraph (d)(1) of this section for meaning of the term "applicable percentage." If, however, the property is considered to have two or more elements with separate periods (for example, because units thereof are placed in service on different dates, improvements are made to the property, or because of the application of paragraph (h) of § 1.1250-3), see the special rules of § 1.1250-5.

(ii) For purposes of applying section 1250, the facts and circumstances of each disposition shall be considered in determining what is the appropriate item of section 1250 property. In general, a building is an item of section 1250 property, but in an appropriate case more than one building may be treated as a single item. For example, if two or more buildings or structures on a single tract or parcel (or contiguous tracts or par-

cels) of land are operated as an integrated unit (as evidenced by their actual operation, management, financing, and accounting), they may be treated as a single item of section 1250 property. For the manner of determining whether an expenditure shall be treated as an addition to capital account of an item of section 1250 property or as a separate item of section 1250 property, see paragraph (d) (2) (iii) of § 1.1250-5.

(3) *Sale, exchange, or involuntary conversion after December 31, 1969.* (i) In the case of a disposition of section 1250 property by a sale, exchange, or involuntary conversion after December 31, 1969, the gain to which section 1250(a)(1) applies is the applicable percentage for the property (determined under paragraph (d) (1) of this section) multiplied by the lower of (a) the additional depreciation in respect of the property attributable to periods after December 31, 1969, or (b) the excess (referred to as "gain realized") of the amount realized over the adjusted basis of the property.

(ii) In addition to gain recognized under section 1250(a)(1) and subdivision (i) of this subparagraph, gain may also be recognized under section 1250(a)(2) and this subdivision if the gain realized exceeds the additional depreciation attributable to periods after December 31, 1969. In such a case, the amount of gain recognized under section 1250(a)(2) and this subdivision is the applicable percentage for the property (determined under paragraph (d) (2) of this section) multiplied by the lower of (a) the additional depreciation attributable to periods before January 1, 1970, or (b) the excess (referred to as "remaining gain") of the gain realized over the additional depreciation attributable to periods after December 31, 1969.

(iii) The provisions of this subparagraph may be illustrated by the following examples:

Example (1). Section 1250 property which has an adjusted basis of \$500,000 is sold for \$650,000 after December 31, 1969, and thus the gain realized is \$150,000. At the time of the sale the additional depreciation in respect of the property attributable to periods after December 31, 1969, is \$190,000 and the applicable percentage is 100 percent (paragraph (d) (1) (i) (e) of this section). Since the gain realized (\$150,000), is lower than the additional depreciation (\$190,000), the amount of gain recognized as ordinary income under section 1250(a)(1) is \$150,000 (that is, 100 percent of \$150,000). No gain is recognized under section 1250(a)(2).

Example (2). Section 1250 property which has an adjusted basis of \$440,000 is sold for \$500,000 on December 31, 1974, and thus the gain realized is \$60,000. The property was acquired on March 31, 1966. At the time of the sale, the additional depreciation attributable to periods after December 31, 1969, is \$20,000, and the additional depreciation attributable to periods before January 1, 1970, is \$60,000. The property qualified as residential rental property for each taxable year ending after December 31, 1969, and the applicable percentage is 95 percent (paragraph (d) (1) (i) (e) of this section). The applicable percentage under paragraph (d) (2) of this section is 15 percent. Since the additional depreciation attributable to periods after December 31, 1969 (\$20,000), is

lower than the gain realized (\$60,000), the amount of gain recognized as ordinary income under section 1250(a)(1) is \$19,000 (that is, 95 percent of \$20,000). In addition, gain is recognized under section 1250(a)(2) since there is remaining gain of \$40,000 (that is, the gain realized (\$60,000) minus the additional depreciation attributable to periods after December 31, 1969 (\$20,000)). Since the remaining gain of \$40,000 is lower than the additional depreciation attributable to periods before January 1, 1970 (\$60,000), the amount of gain recognized as ordinary income under section 1250(a)(2) is \$6,000 (that is, 15 percent of \$40,000). The remaining \$34,000 (that is, gain realized \$60,000, minus gain recognized under section 1250(a), \$25,000) of the gain may be treated as gain from the sale or exchange of property described in section 1231.

(4) *Other dispositions after December 31, 1969.* (i) In the case of a disposition of section 1250 property after December 31, 1969, other than by way of a sale, exchange, or involuntary conversion, the gain to which section 1250(a)(1) applies is the applicable percentage for the property (determined under paragraph (d) (1) of this section) multiplied by the lower of (a) the additional depreciation in respect of the property attributable to periods after December 31, 1969, or (b) the excess (referred to as "potential gain") of the fair market value of the property over its adjusted basis. In addition, if the potential gain exceeds the additional depreciation attributable to periods after December 31, 1969, then the gain to which section 1250(a)(2) applies is the applicable percentage for the property (determined under paragraph (d) (2) of this section) multiplied by the lower of (c) the additional depreciation attributable to periods before January 1, 1970, or (d) the excess (referred to as "remaining potential gain") of the potential gain over the additional depreciation attributable to periods after December 31, 1969. If property is transferred by a corporation to a shareholder for an amount less than its fair market value in a sale or exchange, for purposes of applying section 1250 such transfer shall be treated as a disposition other than by way of a sale, exchange, or involuntary conversion.

(ii) The provisions of this subparagraph may be illustrated by the following examples:

Example (1). Section 1250 property having an adjusted basis of \$500,000 and a fair market value of \$550,000 is distributed by a corporation to a stockholder in complete liquidation of the corporation after December 31, 1969, and thus the potential gain is \$50,000. At the time of the liquidation, the additional depreciation for the property attributable to periods after December 31, 1969, is \$80,000 and the applicable percentage is 100 percent (paragraph (d) (1) (i) (e) of this section). Since the potential gain of \$50,000 is lower than the additional depreciation attributable to periods after December 31, 1969 (\$80,000), the amount of gain recognized as ordinary income under section 1250(a)(1) is \$50,000 (that is, 100 percent of \$50,000) even though in the absence of section 1250, section 336 would preclude recognition of gain to the corporation.

Example (2). The facts are the same as in example (1) except that the fair market value of the property is \$650,000, and thus

the potential gain is \$150,000. Since the additional depreciation attributable to periods after December 31, 1969 (\$80,000), is lower than the potential gain of \$150,000, the amount of gain recognized as ordinary income under section 1250(a)(1) is \$80,000 (that is, 100 percent of \$80,000). In addition, section 1250(a)(2) applies since there is remaining potential gain of \$70,000, that is, potential gain (\$150,000) minus additional depreciation attributable to periods after December 31, 1969 (\$80,000). The additional depreciation attributable to periods before January 1, 1970, is \$90,000 and the applicable percentage under paragraph (d) (2) of this section is 50 percent. Since the remaining potential gain of \$70,000 is lower than the additional depreciation attributable to periods before January 1, 1970 (\$90,000), the amount of gain recognized as ordinary income under section 1250(a)(2) is \$35,000 (that is, 50 percent of \$70,000). Thus under section 1250(a), \$115,000 (that is, \$80,000 under section 1250(a)(1), plus \$35,000 under section 1250(a)(2)) is recognized as ordinary income, even though in the absence of section 1250, section 336 would preclude recognition of gain to the corporation.

(5) *Instances of nonapplication.* (i) Section 1250(a)(1) does not apply to losses. Thus, section 1250(a)(1) does not apply if a loss is realized upon a sale, exchange, or involuntary conversion of property, all of which is considered section 1250 property, nor does the section apply to a disposition of such property other than by way of sale, exchange, or involuntary conversion if at the time of the disposition the fair market value of such property is not greater than its adjusted basis.

(ii) In general, in the case of section 1250 property with a holding period under section 1223 of more than 1 year, section 1250(a)(1) does not apply if for periods after December 31, 1969, there are no "depreciation adjustments in excess of straight line" (as computed under section 1250(b) and paragraph (b) of § 1.1250-2).

(6) *Allocation rules.* (i) In the case of a sale, exchange, or involuntary conversion of section 1250 property and non-section 1250 property in one transaction after December 31, 1969, the total amount realized upon the disposition shall be allocated between the section 1250 property and the other property in proportion to their respective fair market values. Such allocation shall be made in accordance with the principles set forth in paragraph (a) (5) of § 1.1245-1 (relating to allocation between section 1245 property and nonsection 1245 property).

(ii) If an item of section 1250 property has two (or more) applicable percentages because one subdivision of paragraph (d) (1) (i) of this section applies to one portion of the taxpayer's holding period (determined under § 1.1250-4) and another subdivision of such paragraph applies with respect to another such portion, then the gain realized on a sale, exchange, or involuntary conversion, or the potential gain in the case of any other disposition, shall be allocated to each such portion of the taxpayer's holding period after December 31, 1969, in the same proportion as the additional depreciation with respect to such item for such portion bears to the additional

depreciation with respect to such item for the entire holding period after December 31, 1969.

(d) *Applicable percentage*—(1) *Definition for purposes of section 1250(a)* (1). (i) For purposes of section 1250(a) (1), the term "applicable percentage" means—

(a) In the case of property disposed of pursuant to a written contract which was, on July 24, 1969, and at all times thereafter binding on the owner of the property, 100 percent minus 1 percentage point for each full month the property was held after the date on which the property was held 20 full months;

(b) In the case of property constructed, reconstructed, or acquired by the taxpayer before January 1, 1975, with respect to which a mortgage is insured under section 221(d)(3) or 236 of the National Housing Act, or housing is financed or assisted by direct loan or tax abatement under similar provisions of State or local laws, and with respect to which the owner is subject to the restrictions described in section 1039(b) (1) (B) (relating to approved dispositions of certain Government-assisted housing projects), 100 percent minus 1 percentage point for each full month of the taxpayer's holding period for the property (determined under § 1.1250-4) during which the property qualified under this sentence, beginning after the date on which the property so qualified for 20 full months.

(c) In the case of residential rental property (as defined in section 167(j)(2) (B)) other than that covered by (a) and (b) of this subdivision, 100 percent minus 1 percentage point for each full month of the taxpayer's holding period for the property (determined under § 1.1250-4) included within a taxable year for which the property qualified as residential rental property, beginning after the date on which the property so qualified for 100 full months.

(d) In the case of property with respect to which a deduction was allowed under section 167(k) (relating to depreciation of expenditures to rehabilitate low-income rental housing), 100 percent minus 1 percentage point for each full month of the taxpayer's holding period (determined under § 1.1250-4) beginning 100 full months after the date on which the property was placed in service.

(e) In the case of all other property, 100 percent.

The provisions of (a), (b), and (c) of this subdivision shall not apply with respect to additional depreciation described in section 1250(b)(4). If the taxpayer's holding period under § 1.1250-4 includes a period before January 1, 1970, such period shall be taken into account in applying each provision of this subdivision.

(ii) A single item of property may have two (or more) applicable percentages under the provisions of subdivision (i) of this subparagraph. For example, if the provision of subdivision (i) of this subparagraph which applies to an item of section 1250 property (or to an element

of such property if the property is treated as consisting of more than one element under § 1.1250-5) in the taxable year in which the item (or element) is disposed of did not apply to the item (or element) in a prior taxable year which is included within the taxpayer's holding period under § 1.1250-4 and which ends after December 31, 1969, then each provision of subdivision (i) of this subparagraph shall apply only for the period during which the property qualified under such provision.

(iii) If the taxpayer makes rehabilitation expenditures and elects to compute depreciation under section 167(k) with respect to the property attributable to the rehabilitation expenditures, such property will generally constitute a separate improvement under paragraph (c) of § 1.1250-5 and therefore will constitute an element of section 1250 property. For computation of applicable percentage and gain recognized under section 1250 (a) in such a case, see paragraph (a) of § 1.1250-5.

(iv) The principles of this subparagraph may be illustrated by the following examples:

Example (1). Section 1250 property is sold on December 31, 1970, pursuant to a written contract which was binding on the owner of the property on July 24, 1969, and at all times thereafter. The property was acquired on July 31, 1968. The applicable percentage for the property under subdivision (i) (a) of this subparagraph is 91 percent, since the property was held 29 full months.

Example (2). Section 1250 property is sold on June 30, 1978. The property was acquired by a calendar year taxpayer on June 30, 1966. Subdivision (i) (e) of this subparagraph applies to the property in 1977 and 1978. However, subdivision (i) (c) of this subparagraph applied to the property for the taxable years of 1970 through 1976. Thus, the property has two applicable percentages under this subparagraph. The period before January 1, 1970 (42 full months), and the period from 1970 through 1976 (84 full months) are both taken into account in determining the applicable percentage under subdivision (i) (c) of this subparagraph. Thus, the applicable percentage is 74 percent (that is, 100 percent minus the excess of the holding period taken into account (126 full months) over 100 full months). The applicable percentage for the years 1977 and 1978 is 100 percent under subdivision (i) (e) of this subparagraph.

Example (3). Section 1250 property is sold on December 31, 1978. The property was acquired by a calendar year taxpayer on December 31, 1969. The taxpayer made rehabilitation expenditures in 1973 and properly elected to compute depreciation under section 167(k) on the property attributable to the expenditures for the 60-month period beginning on January 1, 1974, the date such property was placed in service. Subdivision (i) (c) applies to the property (other than the property with respect to which a deduction was allowed under section 167(k)) for the taxable years of 1970 through 1978 (108 full months) and the applicable percentage for such property is 92 percent. The applicable percentage for the property with respect to which a deduction under section 167(k) was allowed is 100 percent under subdivision (i) (d) of this subparagraph, since the holding period for purposes of such subdivision begins on the date such property is placed in service.

Example (4). Section 1250 property is sold by a calendar year taxpayer on March 31,

1974. The property was transferred to the taxpayer by gift on December 31, 1970, and under section 1250(e)(2), the taxpayer's holding period for the property for purposes of computing the applicable percentage includes the transferor's holding period of 80 full months. Subdivision (i) (c) of this subparagraph applies to the property in the years 1970 through 1974. The applicable percentage under subdivision (i) (c) of this subparagraph is 81 percent, since the period before January 1, 1970 (68 full months), and that portion of the period after December 31, 1969, during which such subdivision applied (51 full months) are taken into account.

(g) *Examples.* The principles of this section may be illustrated by the following examples:

Example (1). Section 1250 property which has an adjusted basis of \$350,000 is sold for \$630,000 on December 31, 1984. The property was acquired by a calendar year taxpayer on December 31, 1969. For the taxable years from 1970 through 1980, the property qualified as residential rental property and the applicable percentage for those years is 68 percent (paragraph (d) (1) (i) (c) of this section). For taxable years from 1981 through 1984, the property did not qualify as residential rental property and the applicable percentage for those years is 100 percent (paragraph (d) (1) (i) (e) of this section). The additional depreciation for the years from 1970 through 1980 is \$120,000. The additional depreciation for the years from 1981 through 1984 is \$20,000. The gain realized is \$280,000 (that is, amount realized, \$630,000, minus adjusted basis \$350,000). The gain recognized as ordinary income under section 1250(a)(1) is computed in two steps. First, since the additional depreciation attributable to the years 1970 through 1980 (\$120,000) is lower than the gain realized attributable to such years determined under paragraph (a) (6) of this section (\$240,000, that is, gain realized, \$280,000, multiplied by $\frac{1}{2}$), the gain recognized as ordinary income under section 1250(a)(1) in the first step is \$81,600, that is, 68 percent of \$120,000. Second, since the additional depreciation attributable to the years 1981 through 1984 (\$20,000) is lower than the gain realized attributable to those years (\$40,000, that is, gain realized, \$280,000, multiplied by $\frac{1}{2}$), the gain recognized as ordinary income under section 1250(a)(1) for the years from 1981 through 1984 is \$20,000 (that is, 100 percent of \$20,000). The total gain recognized under section 1250(a)(1) is \$101,600 (that is, \$81,600 plus \$20,000).

Example (2). Section 1250 property which has an adjusted basis of \$400,000 is sold for \$472,000 on December 31, 1978. The property was acquired on December 31, 1966. The additional depreciation attributable to periods before January 1, 1970, is \$40,000 and the applicable percentage under paragraph (d) (2) of this section is zero percent. The property qualifies as residential rental property for the years 1970 through 1976, but fails to qualify for 1977 and 1978. Under paragraph (d) (1) of this section, the applicable percentage for the years 1970 through 1976 is 80 percent (paragraph (d) (1) (i) (c) of this section), and the applicable percentage for the years 1977 and 1978 is 100 percent (paragraph (d) (1) (i) (e) of this section). The additional depreciation attributable to the years 1970 through 1976 is \$50,000, and the additional depreciation attributable to the years 1977 and 1978 is \$10,000. The gain recognized as ordinary income under section 1250(a)(1) is computed in two steps. First, since the additional depreciation attributable to the years 1970 through 1976

(\$50,000) is lower than the gain realized attributable to such years (\$60,000, that is, \$72,000 multiplied by $\frac{5}{6}$), the gain recognized under section 1250(a)(1) in the first step is \$40,000 (that is, 80 percent of \$50,000). Second, since the additional depreciation attributable to 1977 and 1978 (\$10,000) is lower than the gain realized attributable to such years (\$12,000, that is, \$72,000 multiplied by $\frac{1}{6}$), the gain recognized under section 1250(a)(1) in the second step is \$10,000 (that is, 100 percent of \$10,000). In addition, section 1250(a)(2) applies. However, since the applicable percentage is zero percent, none of the gain is recognized as ordinary income under section 1250(a)(2). Thus, the remaining \$22,000 (that is, gain realized, \$72,000, minus gain recognized under section 1250(a), \$50,000) of the gain may be treated as gain from the sale or exchange of property described in section 1231.

Example (3). The facts are the same as in example (2) except that the property is disposed of on December 31, 1980. The property qualifies as residential rental property for the years 1979 and 1980. Thus, the applicable percentage for years 1970 through 1976, 1979, and 1980 is 56 percent (paragraph (d)(1)(i)(c) of this section). The applicable percentage for the years 1977 and 1978 is 100 percent (paragraph (d)(1)(i)(e) of this section). The additional depreciation for the years 1979 and 1980 is \$8,000. The gain recognized under section 1250(a)(1) is computed in two steps. First, since the additional depreciation attributable to the years 1970 through 1976, 1979, and 1980 (\$58,000) is lower than the gain realized attributable to such years (\$61,412, that is, \$72,000 multiplied by $\frac{58,000}{68,000}$), the gain recognized under section 1250(a)(1) in the first step is \$32,480 (that is, 56 percent of \$58,000). Second, since the additional depreciation attributable to 1977 and 1978 (\$10,000) is lower than the gain realized attributable to such years (\$10,588, that is, \$72,000 multiplied by $\frac{10,000}{68,000}$), the gain recognized under section 1250(a)(1) in the second step is \$10,000 (that is, 100 percent of \$10,000). In addition, section 1250(a)(2) applies. However, since the applicable percentage is zero percent, none of the gain is recognized as ordinary income under section 1250(a)(2). Thus, the remaining \$29,520 (that is, gain realized, \$72,000, minus gain recognized under section 1250(a), \$42,480) of the gain may be treated as gain from the sale or exchange of property described in section 1231.

PAR. 2. Section 1250-2 is amended by adding a new paragraph (a)(2), revising paragraph (a)(3), adding new subparagraphs (2) and (4) to paragraph (b), and by adding a new example (3) to paragraph (b)(6). These added and revised provisions read as follows:

§ 1.1250-2 Additional depreciation defined.

(a) In general. * * *

(2) *Definition for purposes of section 1250(b)(4).* Except as otherwise provided in paragraph (e) of this section, for purposes of section 1250(b)(4), the term "additional depreciation" means—

(i) In the case of property with respect to which a deduction under section 167(k) (relating to depreciation of expenditures to rehabilitate low-income rental housing) was allowed, which at the time of disposition has a holding period under section 1223 of not more than 1 year

from the time the rehabilitation expenditures were incurred, the "depreciation adjustments" (as defined in paragraph (d) of this section) in respect of the property, and

(ii) In the case of property with respect to which a deduction under section 167(k) (relating to depreciation of expenditures to rehabilitate low-income rental housing) was allowed, which at the time of disposition has a holding period under section 1223 of more than 1 year from the time the rehabilitation expenditures were incurred, the depreciation adjustments in excess of straight line for the property, computed under paragraph (b)(2) of this section.

For purposes of this subparagraph, all rehabilitation expenditures which are incurred in connection with the rehabilitation of an element of section 1250 property shall be considered incurred on the date the last such expenditure is considered incurred under the accrual method of accounting, regardless of the method of accounting used by the taxpayer with regard to other items of income and expense. If the property consists of two or more elements (for example, if the property is placed in service at different times), then each element shall be treated as if it were a separate property and the expenditures attributable to each such element shall be considered incurred on the date the last such expenditure is considered incurred.

(3) *Allocation to certain periods.* With respect to a taxable year beginning in 1963 and ending in 1964, or beginning in 1969 and ending in 1970, the amount of depreciation adjustments or of depreciation adjustments in excess of straight line (as the case may be) shall be ascertained by applying the principles of paragraph (c)(3) of § 1.167(a)-8 (relating to determination of adjusted basis of retired asset), and the amount determined in such manner shall be allocated on a daily basis in order to determine the portion thereof which is attributable to a period after December 31, 1963, or after December 31, 1969, as the case may be.

(b) Computation of depreciation adjustments in excess of straight line. * * *

(2) *Depreciation under section 167(k).* For purposes of paragraph (a)(2) of this section, depreciation adjustments in excess of straight line shall be, in the case of any property with respect to which a deduction was allowed under section 167(k) (relating to depreciation of expenditures to rehabilitate low-income rental housing), the excess of (i) the sum of the "depreciation adjustments" (as defined in paragraph (d) of this section) allowed in respect of the property, over (ii) the sum such adjustments would have been if such adjustments had been determined for the entire period the property was held under the straight line method of depreciation permitted by section 167(b)(1).

(4) *Special rule for computing useful life and salvage value (section 167(k)).*

For purposes of computing under subparagraph (2)(ii) of this paragraph the sum the depreciation adjustments would have been under the straight line method, the useful life and salvage value permitted under section 167(k) shall not apply, the useful life of the property shall be determined under paragraph (b) of § 1.167(a)-1 (or, if applicable, under the lease-renewal-period provision of paragraph (c) of this section), and the salvage value of the property shall be determined under paragraph (c) of § 1.167(a)-1. Such useful life or salvage value shall be determined by taking into account for each taxable year the same facts and circumstances as would have been taken into account if the taxpayer had used the straight line method permitted under section 167(b)(1) throughout the period the property was held.

(6) *Determination of additional depreciation in certain cases.* If an item of section 1250 property is subject to two (or more) applicable percentages, a separate computation of additional depreciation shall be made for the portion of the taxpayer's holding period subject to each such percentage. That is, a separate computation shall be made to determine the excess of (i) the depreciation adjustments (as defined in paragraph (d) of this section) for each such portion of the taxpayer's holding period after December 31, 1963, over (ii) the amount such adjustments would have been for each such portion if such adjustments were determined under the straight line method of depreciation (or, if applicable, under the lease-renewal-period provision in paragraph (c) of this section). Thus, for example, in the case of an item of section 1250 property acquired on January 1, 1968, and disposed of on January 1, 1973, if the applicable percentage for the period before January 1, 1970, were determined under paragraph (d)(2) of § 1.1250-1 and the applicable percentage for the period after December 31, 1969, were determined under paragraph (d)(1)(i)(e) of § 1.1250-1, the additional depreciation would be computed separately for the period before January 1, 1970, and for the period after December 31, 1969. If the additional depreciation attributable to any such portion of the taxpayer's holding period is a deficit (that is, if the depreciation adjustments for that portion are less than the amount such adjustments would have been for that portion if depreciation adjustments were determined for the entire period the property was held under the straight line method of depreciation, or, if applicable, under the lease-renewal-period provision in paragraph (c) of this section), then such deficit will be applied to reduce the additional depreciation for other portion (or portions) of the taxpayer's holding period. (See examples (4) and (5) of subparagraph (7) of this paragraph.)

(7) Examples. * * *

Example (3). On January 1, 1978, a calendar year taxpayer sells section 1250 property. The property, which is attributable to rehabilitation expenditures of \$50,000 incurred

in 1970, was placed in service on January 1, 1971. The taxpayer elected to compute depreciation for the period of 1971 through 1975 under section 167(k). Under such section salvage value is not taken into account in computing annual allowances, and the useful life of the property is deemed to be 5 years. For purposes of applying subparagraph (4) of this paragraph, if the taxpayer had used the straight line method permitted under section 167(b)(1) for such period, he would have used a salvage value of \$5,000 and a useful life of 15 years. Depreciation under the straight line method would thus have been \$3,000 each year, $\frac{1}{15}$ of \$45,000 (that is, \$50,000 minus \$5,000). As of January 1, 1978, the additional depreciation for the property is \$29,000, as computed in the table below:

Year	Actual depreciation	Straight line	Additional depreciation (deficit)
1971	10,000	3,000	7,000
1972	10,000	3,000	7,000
1973	10,000	3,000	7,000
1974	10,000	3,000	7,000
1975	10,000	3,000	7,000
1976		3,000	(3,000)
1977		3,000	(3,000)
Total	50,000	21,000	29,000

Example (4). Section 1250 property which has an adjusted basis of \$108,000 is sold for \$148,000 on December 31, 1972, and thus the gain realized is \$38,000. The property was acquired on December 31, 1963. The applicable percentage for the period before January 1, 1970, is 12 percent (paragraph (d)(2) of § 1.1250-1) and the applicable percentage for the period after December 31, 1969, is 100 percent (paragraph (d)(1)(i)(e) of § 1.1250-1). The additional depreciation must be computed separately for the period before January 1, 1970, and for the period after December 31, 1969. Assume that the additional depreciation for the period before January 1, 1970, is \$32,000 and that there is a deficit in additional depreciation of \$2,000 for the period after December 31, 1969. Accordingly, the additional depreciation for the period before January 1, 1970 (\$32,000) is reduced to \$30,000 by the \$2,000 deficit in additional depreciation for the period after December 31, 1969. Although section 1250 (a)(1) applies to the property, none of the gain is recognized as ordinary income under that section since there is a deficit in additional depreciation for the period after December 31, 1969. Gain is recognized under section 1250(a)(2) since there is remaining gain of \$38,000 (that is, gain realized, \$38,000, minus the additional depreciation attributable to periods after December 31, 1969, zero). Since the additional depreciation attributable to the period before January 1, 1970 (\$30,000), is lower than the gain realized (\$38,000), the amount of gain recognized under section 1250(a)(2) is \$3,600 (that is, 12 percent of \$30,000).

Example (5). Section 1250 property which has an adjusted basis of \$207,000 is sold for \$287,000 on February 24, 1983, and thus the gain realized is \$80,000. The property was acquired on April 30, 1970. The applicable percentage for the period from April 30, 1970, through December 31, 1981, is 60 percent (paragraph (d)(1)(i)(c) of § 1.1250-1) and the applicable percentage for the period from January 1, 1982, through February 24, 1983, is 100 percent (paragraph (d)(1)(i)(e) of § 1.1250-1). The additional depreciation must be computed separately for the period before January 1, 1982, and for the period after December 31, 1981. Assume that the additional depreciation for the period before January 1, 1982, is \$43,000 and that there is a deficit in additional depreciation of \$6,000

for the period after December 31, 1981. Accordingly, the additional depreciation for the period before January 1, 1982 (\$43,000), is reduced to \$37,000 by the \$6,000 deficit for the period after December 31, 1981. There is no gain recognized under section 1250(a)(1) for the period after December 31, 1981, since there is a deficit in additional depreciation for that period. The gain recognized under section 1250(a)(1) for the period before January 1, 1982, is \$22,200, that is, the lower of the gain realized attributable to that period (\$80,000) or the additional depreciation attributable to that period (\$37,000), or \$37,000, multiplied by 60 percent, the applicable percentage.

PAR. 3. Section 1.1250-3 is amended by adding a new example (3) to paragraph (c)(4) to read as follows:

§ 1.1250-3 Exceptions and limitations.

(c) *Limitation for certain tax-free transactions.* * * *

(4) *Examples.* * * *

Example (3). (1) Miller transfers section 1250 property after December 31, 1969, to a corporation, which is not exempt from taxation, in exchange for cash of \$9,000 and stock in the corporation worth \$31,000, in a transaction qualifying under section 351. Thus, the amount realized is \$40,000 (\$9,000 plus \$31,000). The property has an applicable percentage under paragraph (d)(1)(i)(e) of this section of 100 percent and an applicable percentage under paragraph (d)(2) of this section of 50 percent. The adjusted basis of the property on the date of the transfer is \$24,000, and the gain realized is \$16,000 (that is, amount realized, \$40,000, minus adjusted basis, \$24,000). The additional depreciation attributable to periods after December 31, 1969, is \$8,000 and the additional depreciation attributable to periods before January 1, 1970, is \$12,000. Since the additional depreciation attributable to periods after December 31, 1969 (\$8,000), is lower than the gain realized (\$16,000), the amount of gain which would be recognized as ordinary income under section 1250(a)(1) would be \$8,000 (100 percent of \$8,000) if the limitation provided in section 1250(d)(3) did not apply. In addition, gain is recognized under section 1250(a)(2) since there is a remaining potential gain of \$8,000 (that is, gain realized, \$16,000, minus additional depreciation attributable to periods after December 31, 1969 (\$8,000)). Since the remaining potential gain (\$8,000) is lower than the additional depreciation attributable to periods before January 1, 1970 (\$12,000), the amount of gain which would be recognized under section 1250(a)(2) would be \$4,000 (50 percent of \$8,000) if the limitation in section 1250(d)(3) did not apply. Since under section 351(b) gain in the amount of \$9,000 would be recognized to the transferor without regard to section 1250, the limitation in section 1250(d)(3) limits the gain taken into account by the transferor under section 1250(a) to \$9,000. Since the section 1250(a)(1) gain is considered as recognized first under paragraph (a)(1)(iii) of § 1.1250-1, of the \$9,000 of gain recognized, \$8,000 is recognized under section 1250(a)(1) and \$1,000 is recognized under section 1250(a)(2).

(ii) The amount of additional depreciation for the property in the hands of the transferee immediately after the transfer is \$10,000, the amount of additional depreciation immediately before the transfer (\$20,000), minus the sum of (a) the amount of additional depreciation necessary to produce an amount equal to the gain recognized under section 1250(a)(1) upon the transfer, \$8,000 (that is, gain recognized

under section 1250(a)(1), \$8,000, divided by 100 percent, the applicable percentage under section 1250(a)(1)), plus (b) the amount of additional depreciation necessary to produce an amount equal to the gain recognized under section 1250(a)(2) upon the transfer, \$2,000 (that is, gain recognized under section 1250(a)(2), \$1,000, divided by 50 percent, the applicable percentage under section 1250(a)(2)). Of this amount, zero (that is, \$8,000 minus \$8,000) is attributable to periods after December 31, 1969, and \$10,000 (\$12,000 minus \$2,000) is attributable to periods before January 1, 1970.

PAR. 4. Section 1.1250-5 is amended by adding a new paragraph (b), to read as follows:

§ 1.1250-5 Property with two or more elements.

(b) *Dispositions after December 31, 1969—(1) Amount treated as ordinary income.* If section 1250 property consisting of two or more elements (described in paragraph (c) of this section) is disposed of after December 31, 1969, the amount of gain taken into account under section 1250(a) shall be the sum, determined in 5 steps under subparagraphs (2), (3), (4), (5), and (6) of this paragraph, of the amount of gain for each element. Steps 3 and 4 are used only if the gain realized exceeds the additional depreciation attributable to periods after December 31, 1969, in respect of the property as a whole.

(2) *Step 1.* The first step is to make the following computations:

(i) In respect of the property as a whole, compute the additional depreciation (as defined in section 1250(b)) attributable to periods after December 31, 1969, and the gain realized. For purposes of this paragraph, in the case of a transaction other than a sale, exchange, or involuntary conversion, the gain realized shall be considered to be the excess of the fair market value of the property over its adjusted basis.

(ii) In respect of each element as if it were a separate property, compute the additional depreciation for the element attributable to periods after December 31, 1969, and the applicable percentage (as defined in section 1250(a)(1)) for the element. For additional depreciation in respect of an element of property acquired in certain transactions, see paragraph (e) of this section. For purposes of determining additional depreciation, the holding period of an element shall be determined under section 1223, applied by treating the element as a separate property. However, for the purpose of determining applicable percentage, the holding period for an element shall, except to the extent provided in paragraphs (c)(5), (e), and (f) of this section, be determined in accordance with the rules prescribed in § 1.1250-4.

(3) *Step 2.* The second step is to determine the amount of gain recognized for each element under section 1250(a)(1) in the following manner:

(i) If the amount of additional depreciation in respect of the property as a whole attributable to periods after December 31, 1969, is equal to the sum of

the additional depreciation in respect of each element having such additional depreciation, and if such amount is not more than the gain realized, then the amount of gain to be taken into account for an element under section 1250(a)(1) is the product of the additional depreciation attributable to periods after December 31, 1969, for the element, multiplied by the applicable percentage for the element determined under section 1250(a)(1).

(ii) If subdivision (i) of this subparagraph does not apply, the amount of gain to be taken into account under section 1250(a)(1) for an element is the product of—

(a) The additional depreciation attributable to periods after December 31, 1969, for the element multiplied by

(b) The applicable percentage for the element determined under section 1250(a)(1) for the element, and multiplied by

(c) A ratio, computed by dividing (1) the lower of the additional depreciation in respect of the property as a whole which is attributable to periods after December 31, 1969, or the gain realized, by (2) the sum of the additional depreciation attributable to periods after December 31, 1969, in respect of each element having such additional depreciation.

(4) Step (3). If the gain realized exceeds the additional depreciation in respect of the property as a whole attributable to periods after December 31, 1969,

(i) Compute the additional depreciation attributable to periods before January 1, 1970, and the remaining gain (or remaining potential gain in the case of a transaction other than a sale, exchange, or involuntary conversion), in respect of the property as a whole.

(ii) Compute the additional depreciation attributable to periods before January 1, 1970, and the applicable percentage determined under section 1250(a)(2) in respect of each element as if it were a separate property. For additional depreciation in respect of an element of property acquired in certain transactions, see paragraph (e) of this section. For purposes of determining additional depreciation, the holding period of an element shall be determined under section 1223, applied by treating the element as a separate property. However, for the purpose of determining applicable percentage, the holding period of an element shall, except to the extent provided in paragraphs (c)(5), (e), and (f) of this section, be determined in accordance with the rules prescribed in § 1.1250-4.

(5) Step (4). The fourth step is to compute the gain recognized under section 1250(a)(2) for each element (if computation was required under step (3)) in the following manner:

(i) If the amount of additional depreciation in respect of the property as a whole attributable to periods before January 1, 1970, is equal to the sum of the additional depreciation in respect of each element having such additional depreciation, and if such amount is not more than the remaining gain (or remaining potential gain), then the amount of gain to be taken into account

for an element under section 1250(a)(2) is the product of the additional depreciation attributable to periods before January 1, 1970, for the element, multiplied by the applicable percentage determined under section 1250(a)(2) for the element.

(ii) If subdivision (i) of this subparagraph does not apply, the amount of gain to be taken into account for an element under section 1250(a)(2) is the product of—

(a) The additional depreciation attributable to periods before January 1, 1970, for the element, multiplied by,

(b) The applicable percentage for the element determined under section 1250(a)(2), and multiplied by,

(c) A ratio, computed by dividing (1) the lower of the additional depreciation in respect of the property as a whole which is attributable to periods before January 1, 1970,

or the remaining gain (or remaining potential gain), by (2) the sum of the additional depreciation attributable to periods before January 1, 1970, in respect of each element having additional depreciation.

(6) Step (5). The fifth step is to compute the sum of the amount of gain for each element, as determined in steps (2) and (4).

(7) Examples. The provisions of this subparagraph may be illustrated by the following examples:

Example (1). Gain of \$60,000 is realized upon a sale, after the December 31, 1969, of section 1250 property which was constructed by the taxpayer after such date. The property consists of four elements (W, X, Y, and Z). Since on the date of sale the amount of additional depreciation attributable to periods after December 31, 1969, in respect of the property as a whole (\$32,000), is equal to the sum of the additional depreciation in respect of each element having such additional depreciation and is less than the gain realized, the gain recognized for each element is determined under subparagraph (3)(i) of this paragraph. The amount of gain taken into account under section 1250(a)(1) is \$28,500, as determined in the following table in accordance with the additional facts assumed:

Element	Additional depreciation after Dec. 31, 1969	×	Applicable percentage (1250(a)(1))	=	Gain for element
W.....	\$14,000	×	80	=	\$11,200
X.....	6,000	×	90	=	5,400
Y.....	2,000	×	95	=	1,900
Z.....	10,000	×	100	=	10,000
Total...	32,000				28,500

Example (2). Assume the same facts as in example (1), except that the property was acquired by the taxpayer before January 1, 1970. Since the gain realized (\$60,000) exceeds the additional depreciation attributable to periods after December 31, 1969 (\$32,000), section 1250(a)(2) applies to the remaining gain of \$28,000. Since the additional depreciation in respect of the property as a whole attributable to periods before January 1, 1970 (\$21,000), is equal to the sum of the additional depreciation in respect of each element having such additional depreciation and is less than the remaining gain (\$28,000), the amount of gain recognized for each element under section 1250(a)(2) is determined under subpara-

graph (5)(i) of this paragraph. The amount of gain taken into account under section 1250(a)(1) is \$28,500 the same as in example (1). The amount of gain taken into account under section 1250(a)(2) is \$3,900, as determined in the following table in accordance with the additional facts assumed:

Element	Additional depreciation before Jan. 1, 1970	×	Applicable percentage (1250(a)(2))	=	Gain for element (1250(a)(2))
W.....	\$8,000	×	0	=	\$0
X.....	6,000	×	10	=	600
Y.....	2,000	×	15	=	300
Z.....	5,000	×	60	=	3,000
Total...	21,000				3,900

Example (3). (i) The facts are the same as in example (2) except that element Y has a deficit in additional depreciation attributable to periods after December 31, 1969, of \$6,000 and thus the additional depreciation attributable to periods after December 31, 1969, in respect of the property as a whole is \$24,000. The sum of the additional depreciation for each element having additional depreciation is \$30,000, or \$6,000 more than the additional depreciation in respect of the property as a whole. Thus, the gain recognized for each element under section 1250(a)(1) is determined under subparagraph (3)(ii) of this paragraph. The ratio referred to in subparagraph (3)(ii)(c) of this paragraph is 24:30, that is, the lower of the additional depreciation in respect of the property as a whole attributable to periods after December 31, 1969 (\$24,000), or the gain realized (\$60,000), divided by the sum of the additional depreciation in respect of each element having such additional depreciation (\$30,000). The amount of gain taken into account under section 1250(a)(1) is \$21,280, as determined in the following table:

Element	Additional depreciation after Dec. 31, 1969	×	Applicable percentage (1250(a)(1))	×	Ratio	=	Gain for element
W.....	\$14,000	×	80	×	24:30	=	\$8,960
X.....	6,000	×	90	×	24:30	=	4,320
Y.....	(6,000)	×	95	×	24:30	=	0
Z.....	10,000	×	100	×	24:30	=	8,000
Total...	24,000						21,280

(ii) In addition, gain is recognized under section 1250(a)(2) since there is a remaining potential gain of \$36,000, that is, gain realized (\$60,000) minus the additional depreciation attributable to periods after December 31, 1969 (\$24,000). The gain recognized in respect of each element and the gain recognized under section 1250(a)(2) (\$3,900) are the same as in example (2), since the additional depreciation attributable to periods before January 1, 1970 (\$21,000) is less than the remaining gain (\$36,000).

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SUBCHAPTER D—MISCELLANEOUS EXCISE TAXES

[T.D. 7194]

PART 154—TEMPORARY REGULATIONS IN CONNECTION WITH THE AIRPORT AND AIRWAY REVENUE ACT OF 1970

Tax on Use of Civil Aircraft

In order to provide rules relating to the application of the tax on use of civil aircraft to secondhand aircraft, the