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Title 26—INTERNAL REVENUE

Chapter I—Internal Revenue Service, Department of the Treasury

SUBCHAPTER A—INCOME TAX

[T.D. 7203]

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

Investment Credit

On March 24, 1972, notice of proposed rule making with respect to the amendment of the Income Tax Regulations (26 CFR Part 1) under sections 46–50, 167, 169, and 1245 of the Internal Revenue Code of 1954 (relating to the investment credit) to reflect the changes made by section 101–108 of the Revenue Act of 1971 (85 Stat. 498) was published in the FEDERAL REGISTER (37 F.R. 6094). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the amendment of the regulations as proposed is hereby adopted, subject to the changes set forth below:

PARAGRAPH 1. Section 1.46–2(g), as set forth in paragraph 3 of the appendix to the notice of proposed rule making, is changed by deleting the last sentence of subdivision (c) of example (5).

PAR. 2. Section 1.48–4, as set forth in paragraph 12 of the appendix to the notice of proposed rule making, is changed by deleting "March 15, 1972" from the only sentence of paragraph (f)(2) and the first sentence of paragraph (g)(2) and inserting in lieu thereof "October 24, 1972".

PAR. 3. Paragraph 21 of the appendix to the notice of proposed rule making is renumbered as paragraph 13, the second word thereof is changed from "fifth" to "third", and the third sentence of § 1.48–4(j) is changed by deleting "March 15, 1972" and inserting in lieu thereof "October 24, 1972".

PAR. 4. Paragraphs 22 through 29 of the appendix to the notice of proposed rule making are renumbered as paragraphs 14 through 21 respectively.

(Secs. 38(b) (76 Stat. 963; 26 U.S.C. 38(b)), 47(a) (76 Stat. 966; 26 U.S.C. 47(a)), 48(d) (85 Stat. 507; 26 U.S.C. 48(d)), and 7805 (68A Stat. 917; 26 U.S.C. 7805), Internal Revenue Code of 1954)

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

Approved: August 17, 1972.

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

§ 1.46 Statutory provisions; amount of credit.

SEC. 46 *Amount of credit.* * * *

(b) *Carryback and carryover of unused credits*—(1) *Allowance of credit.* If the amount of the credit determined under subsection (a)(1) for any taxable year exceeds the limitation provided by subsection (a)(2) for such taxable year (hereinafter in this subsection referred to as "unused credit year"), such excess shall be—

(A) An investment credit carryback to each of the 3 taxable years preceding the unused credit year, and

(B) An investment credit carryover to each of the 7 taxable years following the unused credit year,

and shall be added to the amount allowable as a credit by section 38 for such years, except that such excess may be a carryback only to a taxable year ending after December 31, 1961. The entire amount of the unused credit for an unused credit year shall be carried to the earliest of the 10 taxable years to which (by reason of subparagraphs (A) and (B)) such credit may be carried, and then to each of the other 9 taxable years to the extent that, because of the limitation contained in paragraph (2), such unused credit may not be added for a prior taxable year to which such unused credit may be carried. In the case of an unused credit for an unused credit year ending before January 1, 1971, which is an investment carryover to a taxable year beginning after December 31, 1970 (determined without regard to this sentence), this paragraph shall be applied by substituting "10 taxable years" for "7 taxable years" in subparagraph (B) and by substituting "13 taxable years" for "10 taxable years" and "12 taxable years" for "9 taxable years" in the preceding sentence.

* * * * *

(3) *Special rules for carryovers from pre-1971 unused credit years.* The extent to which an investment credit carryover from an unused credit year ending before January 1, 1971, may be added under paragraph (1) for a taxable year beginning after December 31, 1970, shall be determined without regard to paragraph (2)(A). In determining the excess under paragraph (1) for any taxable year beginning after December 31, 1970, the limitation provided by subsection (a)(2) for such taxable year shall be reduced by the investment credit carryovers from such unused credit years (to the extent such unused credit may not be added for a prior taxable year).

* * * * *

(5) *Certain taxable years ending in 1969, 1970, or 1971.* The amount which may be added under this subsection for any taxable year beginning after December 31, 1968, and ending after April 18, 1969, and before January 1, 1972, shall not exceed 20 percent of the higher of—

(A) The aggregate of the investment credit carrybacks and investment credit carryovers to the taxable year, or

(B) The highest amount computed under subparagraph (A) for any preceding taxable year which began after December 31, 1968, and ended after April 18, 1969.

In the case of a taxable year ending after August 15, 1971, and before January 1, 1972, the percentage contained in the preceding sentence shall be increased by 6 percentage points for each month (or portion thereof) in the taxable year after August 15, 1971.

(6) *Additional 3-year carryover period in certain cases.* Any portion of an investment credit carryback or carryover to any taxable year beginning after December 31, 1968, and ending after April 18, 1969, and before January 1, 1971, which—

(A) May be added under this subsection under the limitation provided by paragraph (2), and

(B) May not be added under the limitation provided by paragraph (5),

shall be an investment credit carryover to each of the 3 taxable years following the seventh taxable year after the unused credit year, and shall (subject to the provisions of paragraphs (1), (2), and (5)) be added to the amount allowable as a credit by section 38 for such years.

(c) *Qualified investment.* * * *

(2) *Applicable percentage.* For purposes of paragraph (1), the applicable percentage for any property shall be determined under the following table:

If the useful life is—	*The applicable percentage is—*
3 years or more but less than 5 years	66⅔
5 years or more but less than 7 years	33⅓
7 years or more	100

For the purposes of this subpart, the useful life of any property shall be the useful life used in computing the allowance for depreciation under section 167 for the taxable year in which the property is placed in service.

(3) *Public utility property.* * * *

(C) In the case of any interest in a submarine cable circuit used to furnish telegraph service between the United States and a point outside the United States of a taxpayer engaged in furnishing international telegraph service (if the rates for such furnishing have been established or approved by a governmental unit, agency, instrumentality, commission, or similar body described in subparagraph (B)), the qualified investment shall not exceed the qualified investment attributable to so much of the interest of the taxpayer in the circuit as does not exceed 50 percent of all interests in the circuit.

(4) [Deleted]

(d) *Limitations with respect to certain persons.* * * *

(3) *Noncorporate lessors.* A credit shall be allowed by section 38 to a person which is not a corporation with respect to property of which such person is the lessor only if—

(A) The property subject to the lease has been manufactured or produced by the lessor, or

(B) The term of the lease (taking into account options to renew) is less than 50 percent of the useful life of the property, and for the period consisting of the first 12 months after the date on which the property is transferred to the lessee the sum of the deductions with respect to such property which are allowable to the lessor solely by reason of section 162 (other than rents and reimbursed amounts with respect to such property) exceeds 15 percent of the rental income produced by such property.

In the case of property of which a partnership is the lessor, the credit otherwise allowable under section 38 with respect to such property to any partner which is a corporation shall be allowed notwithstanding the first sentence of this paragraph. For pur-

poses of this paragraph, an electing small business corporation (as defined in section 1371) shall be treated as a person which is not a corporation.

[Sec. 46 as added by sec. 2(b), Rev. Act 1962 (76 Stat. 963); as amended by sec. 201(d)(4), Rev. Act 1964 (78 Stat. 32); sec. 3, Act of November 8, 1966 (Public Law 89-800, 80 Stat. 1514); sec. 2(a), Act of December 27, 1967 (Public Law 90-225, 81 Stat. 731); secs. 301(b)(4), 401(e)(1), and 703(b), Tax Reform Act 1969 (83 Stat. 585, 603, and 666); secs. 102(a)(1), (b), 105(b)(3), 106 (a), (b), (c), 107(a), and 108(a), Rev. Act 1971 (85 Stat. 499, 503, 506, 507)]

PAR. 2. Section 1.46-1 is amended by adding the following new sentence at the end of paragraph (b)(1):

§ 1.46-1 Determination of amount.

* * * * *

(b) *Limitation based on amount of tax*—(1) *In general.* * * * For a taxable year beginning after December 31, 1970, such excess shall be determined by reducing the limitation described in this paragraph by the amount of any unused credit for a taxable year ending before January 1, 1971, which may, under section 46(b), be added to the amount allowable as a credit for such taxable year beginning after December 31, 1970.

* * * * *

PAR. 3. Section 1.46-2 is amended by revising subparagraphs (2) and (5) of paragraph (a), by adding paragraph (a)(6), by revising subparagraph (2) of paragraph (b), by adding paragraph (b)(3), and by revising examples (3) and (4) of and adding examples (5) and (6) to paragraph (g). The revised and added provisions read as follows:

§ 1.46-2 Carryback and carryover of unused credit.

(a) * * *

(2) *Taxable years to which unused credit may be carried.* Except as provided in subparagraphs (3), (4), (5), and (6) of this paragraph, an unused credit shall be an investment credit carryback to each of the 3 taxable years preceding the unused credit year and an investment credit carryover to each of the 7 taxable years (or 10 taxable years in cases to which subparagraph (5) or (6) of this paragraph applies) succeeding the unused credit year. An unused credit must be carried first to the earliest of the 10 (or 13) taxable years to which it may be carried, and then to each of the other 9 (or 12) taxable years (in order of time) to the extent that the unused credit may not be added (because of the limitations contained in paragraph (b) of this section) to the amount allowable as a credit under section 38 for a prior taxable year.

* * * * *

(5) *Additional 3-year carryover period in certain cases.* Any portion of an unused credit which is an investment credit carryback or carryover to any taxable year beginning after December 31, 1968, and before January 1, 1971, and ending after April 18, 1969, and which may be added to the amount allowable as a credit for such taxable year under the limitation provided in subparagraph (1) of paragraph (b) of this section but may not be added solely because of the limitation provided in subparagraph (2) of such paragraph shall be an investment credit carryover to each of the 10 taxable years succeeding the unused credit year. If a portion of an unused credit from any particular unused credit year is, under this subparagraph, an investment credit carryover to each of the 10 taxable years succeeding such unused credit year, and if a part of such unused credit may, under paragraph (b)(1) of this section, be added to the amount allowable as a credit under section 38 for any of the 7 taxable years succeeding such unused credit year, such part shall be considered to consist of ratable portions of (i) the portion of such unused credit which is an investment credit carryover to each of the 10 taxable years succeeding such unused credit year, and (ii) the remainder of such unused credit (i.e., the portion of such unused credit which is an investment credit carryover to each of the 7 taxable years succeeding such unused credit year).

(6) *Extension of carryover period.* Any portion of an unused credit from an unused credit year ending before January 1, 1971, which, without regard to this subparagraph, may be carried over to a taxable year beginning after December 31, 1970, under subparagraph (2) of this paragraph shall be an investment credit carryover to each of the 10 taxable years succeeding the unused credit year.

(b) * * *

(2) *Taxable years beginning after December 31, 1968, and ending after April 18, 1969, and before January 1, 1972.* The total amount of investment credit carryovers and carrybacks which may be added to the amount allowable as a credit under section 38 for any taxable year beginning after December 31, 1968, and ending after April 18, 1969, and before January 1, 1972, shall not exceed 20 percent of the higher of (i) the aggregate of the investment credit carryovers and carrybacks to the taxable year, or (ii) the aggregate of the investment credit carryovers and carrybacks to any preceding taxable year that began after December 31, 1968, and ended after April 18, 1969. In the case of a fractional part of a year which is considered as a taxable year under sections 441(b) and 7701(a)(23), the preceding sentence shall be applied by substituting for 20 percent the percentage determined by multiplying 1⅔ percent by the number of calendar months (or portions thereof) included in such taxable year. In the case of a taxable year ending after August 15, 1971, and before January 1, 1972, the preceding sentences shall be applied by increasing the percentage determined thereunder by 6 percentage points for each calendar month (or portion thereof) in the taxable year after August 15, 1971. For purposes of this subparagraph, the investment credit carrybacks to a taxable year shall be determined without regard to subparagraph (3) of this paragraph and the last sentence of paragraph (b)(1) of § 1.46-1.

(3) *Special rule for carryovers from pre-1971 unused credit years.* In the case of an unused credit arising in an unused credit year ending before January 1, 1971, which may be carried to a taxable year beginning after December 31, 1970, the amount which may be added to the amount allowable as a credit for such succeeding taxable year shall be determined without regard to the credit earned for such succeeding year. Thus, in determining the amount, if any, of an unused credit from a particular unused credit year ending before January 1, 1971, which shall be added to the amount allowable as a credit for a taxable year beginning after December 31, 1970, only unused credits originating in taxable years prior to the particular unused credit year shall be applied against the limitation based on amount of tax for such succeeding taxable year and the credit earned for such succeeding year shall not be so applied.

* * * * *

(g) *Examples.* * * *

Example (3). A, a calendar year taxpayer, has a total of $500 in investment credit carryovers to 1969, composed of a $150 unused credit from 1962 and a $350 unused credit from 1968. A's limitation based on amount of tax for 1969 is $135. Under paragraph (b)(2) of this section, A is limited to the use of only $100 (20 percent of $500) of his unused credits in 1969. Since, in the absence of the 20-percent limitation, A could have used $135 of the carryover from 1962, $35 of such carryover (*i.e.*, the portion that cannot be used in 1969 solely because of the 20-percent limitation) qualifies for the additional 3-year carryover period provided in paragraph (a)(5) of this section.

Example (4). The facts are the same as in example (3) except that in 1972 A places in service property eligible for the investment credit producing a credit earned of $300. A had no credit earned or tax liability in 1970 and 1971. A's tax liability in 1972 is $100. Under paragraph (b)(2) of this section, the limitation on the use of carryovers and carrybacks to 1969 is retroactively increased to $140, i.e., 20 percent of $700, the sum of $500 in carryovers and $200 in carrybacks to 1969. (The amount of the carryback from 1972 is determined without regard to the carryovers from 1962 and 1968 that may be carried to 1972.) Therefore, an additional $35 of the carryover from 1962 becomes usable in 1969. Since the remaining $15 of the carryover from 1962 is not usable because of the limitation provided in paragraph (b)(1) of this section, such $15 amount does not qualify for the additional 3-year carryover period provided in paragraph (a)(5) of this section.

Example (5). (a) B, a calendar year taxpayer that began business on January 1, 1970, has the following amounts of liability for tax and credit earned for its taxable years 1970, 1971, and 1972.

Taxable year	Credit earned	Liability for tax
1970	$1,000	$300
1971	400	600
1972	1,000	1,200

(b) For 1970, B has an unused credit of $700, the excess of $1,000 (the credit earned) over $300 (the limitation based on amount of tax), which, under paragraph (a)(6) of this section, is an investment credit carry-

over to the 10 taxable years succeeding 1970.

(c) Under paragraph (b)(3) of this section, all $700 of the unused credit for 1970 is carried to 1971 and is added to the amount allowable as a credit for 1971 before any of the $400 credit earned for 1971 is so allowable. However, under paragraph (b)(2) of this section, only 50 percent (i.e., 20 percent plus 6 percent for each of the five full or partial months in the taxable year after August 15, 1971) of the $700 unused credit for 1970, or $350, may be added to the amount allowable as a credit for 1971. Accordingly, $250 of the credit earned for 1971 (the excess of $600 (the limitation based on amount of tax for 1971) over $350 (the portion of the unused credit for 1970 which may be added to the amount allowable for 1971)) may be added to the amount allowable for 1971. Thus, for 1971, B has an unused credit of $150, the excess of $400 (the credit earned for 1971) over $250 (the excess of the limitation based on amount of tax for 1971 over the portion of the unused credit for 1970 which may be added to the amount allowable for 1971). In addition, the remaining $350 of the unused credit for 1970 may be carried to 1972.

(d) (1) B has no unused credit for 1972 without regard to paragraph (b)(3) of this section and the last sentence of paragraph (b)(1) of § 1.46-1, since the limitation based on amount of tax for 1972 exceeds the credit earned for 1972. Thus, for purposes of paragraph (b)(2) of this section, the aggregate of the investment credit carryovers and carrybacks to 1971 continues to be $700. The limitation under paragraph (b)(2) of this section on the portion of the unused credit for 1970 which may be added to the amount allowable for 1971 continues to be $350.

(2) Under paragraph (b)(3) of this section, the remaining $350 of the unused credit for 1970 is added to the amount allowable as a credit for 1972 before any of the $1,000 credit earned for 1972 is so allowable. However, the remaining $150 carryover from 1971 may not be added to the amount allowable as a credit for 1972 until after the credit earned in 1972 is so added. Accordingly, $850 of the credit earned for 1972 (the excess of $1,200 (the limitation based on amount of tax) over $350 (the unused credit for 1970 which is added to the amount allowable for 1972)) may be added to the amount allowable for 1972. B thus has an unused credit of $150 for 1972, the excess of $1,000 (the credit earned for 1972) over $850 (the excess of the limitation based on amount of tax for 1972 over the portion of the unused credit for 1970 which is added to the amount allowable for 1972), and in addition, the $150 unused credit for 1971 remains as a carryover to years subsequent to 1972.

Example (6). (a) The facts are the same as in example (5) except that B's liability for tax for 1971 and 1972 is $1,200 and $600, respectively.

(b) For 1970, B has an unused credit of $700 which is an investment credit carryover to the 10 taxable years succeeding 1970. See paragraph (b) of example (5).

(c) Under paragraph (b)(3) of this section, all $700 of the unused credit for 1970 is carried to 1971 and is added to the amount allowable as a credit for 1971 before any of the $400 credit earned for 1971 is so allowable. However, under paragraph (b)(2) of this section only $350 of the unused credit for 1970 may be added to the amount allowable for 1971. Accordingly, the entire $400 credit earned for 1971 may be added to the amount allowable for 1971 since it is less than $850, the excess of $1,200 (the limitation based on amount of tax) over $350 (the portion of the unused credit for 1970 which may be added to the amount allowable for 1971). Thus, B has no unused credit for 1971.

(d) (1) The amount of B's unused credit for 1972 and carryback to 1971 without regard to paragraph (b)(3) of this section and the last sentence of paragraph (b)(1) of § 1.46-1 is $400, the excess of $1,000 (the credit earned for 1972) over $600 (the limitation based on amount of tax for 1972). Thus, for purposes of paragraph (b)(2) of this section, the aggregate of the investment credit carryovers and carrybacks to 1971 is $1,100, the sum of the $700 carryover from 1970 to 1971 and the $400 carryback from 1972 to 1971. Thus, under paragraph (b)(2) of this section, the portion of the unused credit for 1970 which may be added to the amount allowable for 1971 is increased from $350 to $550 (50 percent of $1,100). The entire $400 credit earned for 1971 may continue to be added to the amount allowable for 1971 since it is less than $650, the excess of $1,200 (the limitation based on amount of tax for 1971) over $550 (the recomputed portion of the unused credit for 1970 which may be added to the amount allowable for 1971), and B thus has no unused credit for 1971.

(2) Under paragraph (b)(3) of this section, the remaining $150 of the unused credit for 1970 is added to the amount allowable as a credit for 1972 before any of the $1,000 credit earned for 1972 is so allowable. Accordingly, $450 of the credit earned for 1972 (the excess of $600 (the limitation based on amount of tax for 1972) over $150 (the unused credit for 1970 which is added to the amount allowable for 1972)) may be added to the amount allowable for 1972.

(3) B thus has an unused credit of $550 for 1972, the excess of $1,000 (the credit earned for 1972) over $450 (the excess of the limitation based on amount of tax for 1972 over the portion of the unused credit for 1970 which is added to the amount allowable for 1972).

* * * * *

PAR. 4. Section 1.46-3 is amended by revising paragraph (b), by redesignating subparagraph (1) of paragraph (e) as subparagraph (1)(i) and adding a new subdivision (ii), by adding paragraph (e)(7), by revising paragraph (f)(2)(iii)(b), by adding subparagraph (5) to paragraph (g), and by revising so much of paragraph (h)(1)(i) as precedes (*a*) thereof. The revised and added provisions read as follows:

§ 1.46-3 Qualified investment.

* * * * *

(b) *Applicable percentage.* The applicable percentage to be applied to the basis (or cost) of property is 33⅓ percent if the estimated useful life of the property is 3 years or more but less than 5 years; 66⅔ percent if the estimated useful life is 5 years or more but less than 7 years; or 100 percent if the estimated useful life is 7 years or more. In the case of property which is not described in section 50, the preceding sentence shall be applied by substituting "4 years" for "3 years", "6 years" for "5 years", and "8 years" for "7 years". The provisions of this paragraph may be illustrated by the following example:

Example. Corporation Y acquires and places in service during 1972 the following new and used section 38 properties:

Property	Estimated useful life	Basis (or cost)
A (new)	4 years	$60,000
B (new)	10 years	90,000
C (new)	6 years	150,000
D (used)	3 years	30,000

Corporation Y's qualified investment for 1972 is $220,000 determined in the following manner:

Property	Basis (or cost)	Applicable percentage	Qualified investment
A	$60,000	33⅓	$20,000
B	90,000	100	90,000
C	150,000	66⅔	100,000
D	30,000	33⅓	10,000
Total			220,000

* * * * *

(e) * * *

(f) * * *

(ii) Except as provided in subparagraph (7), this paragraph shall not apply to property described in section 50.

* * * * *

(7) *Section 50 property.* (i) The provisions of this subparagraph and subparagraphs (4) and (6) of this paragraph shall apply to property which is described in section 50.

(ii) The estimated useful life of property for purposes of computing qualified investment shall be the useful life used or to be used by the taxpayer in computing the allowance for depreciation with respect to such property under section 167 for the taxable year in which the property is placed in service. Thus, if property is placed in service by a taxpayer in a taxable year but the period for depreciation with respect to such property does not begin until a succeeding taxable year (see paragraph (d)(1) of this section), the estimated useful life for purposes of computing qualified investment must be the estimated useful life that the taxpayer uses in computing the allowance for depreciation. See subdivision (iv) of this subparagraph for rules for determining the estimated useful life of property with respect to which the allowance for depreciation under section 167 is computed under the unit of production method, the income-forecast method, or any other method which does not measure the useful life of the property in terms of years.

(iii) (*a*) The estimated useful life of any section 38 property to which an election under section 167(m) applies shall be the asset depreciation period selected for such property under § 1.167(a)-11(b)(4), whether or not such property constitutes mass assets (as defined in § 1.47-1(e)(4)).

(*b*) The estimated useful life of any section 38 property to which an election under section 167(m) does not apply and which is placed in a multiple asset account for which a group, classified, or composite rate is used in computing depreciation (or in single asset accounts for which an average life rate is used) shall be determined individually for each

asset on the best estimate obtainable on the basis of all the facts and circumstances. The individual estimated useful life for each asset placed in a multiple asset account (including a mass asset account) must be the same as the useful life of such asset used in determining the group, classified, or composite life for the account for purposes of computing depreciation. The individual estimated useful lives of assets similar in kind may be determined in accordance with subdivisions (ii) and (iv) of subparagraph (3) of this paragraph. In the case of mass assets, subdivision (iii) of subparagraph (3) of this paragraph shall apply.

(iv) [Reserved]

(f) * * *

(2) * * *

(iii) * * *

(b) Under the partnership agreement, such partner will retire from the partnership during the taxable year or within 7 years after the end of such year; and

* * * * *

(g) * * *

(5) In the case of any interest in a submarine cable circuit which is property described in section 50 used to furnish telegraph service between the United States and a point outside the United States of a taxpayer engaged in furnishing international telegraph service (if the rates for such furnishing have been established or approved by a governmental unit, agency, instrumentality, commission, or similar body described in subparagraph (2) of this paragraph), the qualified investment shall not exceed the qualified investment attributable to so much of the interest of the taxpayer in the circuit as does not exceed 50 percent of all interests in the circuit.

(h) *Certain replacement property.* (1) (i) If section 38 property is placed in service by the taxpayer to replace property (whether or not section 38 property) similar or related in service or use, which was destroyed or damaged before August 16, 1971, by fire, storm, shipwreck, or other casualty, or was stolen before such date, then for purposes of paragraph (a) of this section the basis (or cost) of the replacement section 38 property otherwise determined under paragraph (c) of this section shall be reduced by an amount equal to the lesser of—

* * * * *

PAR. 5. Section 1.46–4 is amended by adding paragraph (d) to read as follows:

§ 1.46–4 Limitations with respect to certain persons.

* * * * *

(d) *Noncorporate lessors.* (1) In the case of a lease entered into after September 22, 1971, a credit is allowed under section 38 to a noncorporate lessor of property with respect to the leased property only if—

(i) Such property has been manufactured or produced by the lessor in the ordinary course of his business, or

(ii) The term of the lease (taking into account any options to renew) is less than 50 percent of the estimated useful life of the property (determined under § 1.46–3(e)), and for the period consisting of the first 12 months after the date on which the property is transferred to the lessee the sum of the deductions with respect to such property which are allowable to the lessor solely by reason of section 162 (other than rents and reimbursed amounts with respect to such property) exceeds 15 percent of the rental income produced by such property.

In the case of property of which a partnership is the lessor, the credit otherwise allowable under section 38 with respect to such property to any partner which is a corporation shall be allowed notwithstanding the first sentence of this subparagraph. For purposes of this subparagraph, an electing small business corporation (as defined in section 1371) shall be treated as a person which is not a corporation. This paragraph shall not apply to property used by the taxpayer in his trade or business (other than the leasing of property) for a period of at least 24 months preceding the day on which any lease of such property is entered into.

(2) For purposes of subparagraph (1) (ii) of this paragraph, if at the time the lessor files his income tax return for the taxable year in which the property is placed in service, the lessor is unable to show that the more-than-15-percent test has been satisfied, then no credit may be claimed by the lessor on such return with respect to such property unless (i) taking into account the lessor's obligations under the lease it is reasonable to believe that the more-than-15-percent test will be satisfied, and (ii) the lessor files a statement with his return from which it may be determined that he expects to satisfy the more-than-15-percent test. If the more-than-15-percent test is not satisfied with respect to the property, the taxpayer must file an amended return for the year in which the property is placed in service.

(3) (i) The more-than-15-percent test described in subparagraph (1) (ii) of this paragraph is based on the relationship of the expenses of the lessor relating to or attributable to the property to the gross income from rents of the taxpayer produced by the property. The test is applied with respect to such expenses and gross income as are properly attributable to the period consisting of the first 12 months after the date on which the property is transferred to the lessee. When more than one property is subject to a single lease and, pursuant to subparagraph (4) of this paragraph, the arrangement is considered to be a separate lease of each property, the test is applied separately to each such lease by making an apportionment of the payments received and expenses incurred with respect to each such property, considering all relevant factors. Such apportionment is made in accordance with any reasonable method selected and consistently applied by the taxpayer. For example, under subparagraph (4) of this paragraph, where a taxpayer leases an airplane which he owns to an airline along with a baggage truck, he is treated as having made two separate leases, one covering the airplane and one covering the baggage truck. Thus, the test will be applied by apportioning the related income and expenses between the two leases. Similarly, where a taxpayer leases a factory building erected by him containing section 38 property (machinery and equipment), the test will be applied to the taxpayer as though he had leased (to the lessee) the building and the section 38 property separately. Thus, the rental income and expenses are apportioned between the building and the section 38 property.

(ii) Only those deductions allowable solely by reason of section 162 are taken into account in applying the more-than-15-percent test. Hence, depreciation allowable by reason of section 167 (including amortization allowable in lieu of depreciation); interest allowable by reason of section 163; taxes allowable by reason of section 164; and depletion allowable by reason of section 611 are examples of deductions which are not taken into account in applying the test. Moreover, rents and reimbursed amounts paid or payable by the lessor are not taken into account notwithstanding that a deduction in respect of such rents or reimbursed amounts is allowable solely by reason of section 162. For purposes of this paragraph, a reimbursed amount is any expense for which the lessee or some other party is obligated to reimburse the lessor. Section 162 expenses paid or payable by any person other than the lessor are not taken into account unless the lessor is obligated to reimburse the person paying the expense. Further, if the lessee is obligated to pay to the lessor a charge for services which is separately stated or determinable, the expenses incurred by the lessor with respect to those services are not taken into account.

(iii) For purposes of the more-than-15-percent test, the gross income from rents of the lessor produced by the property is the total amount which is payable to the lessor by reason of the lease agreement other than reimbursements of section 162 expenses and charges for services which are separately stated or determinable. The fact that such amount depends, in whole or in part, on the sales or profits of the lessee or the performance of significant services by the lessor shall not affect the characterization of such amounts as gross income from rents for purposes of this paragraph. Gross income from rents also includes any taxes imposed on the lessor by local law but which are paid directly by the lessee on behalf of the lessor.

(4) For purposes of determining under this paragraph whether property is subject to a lease, the provisions of § 1.57–3(d)(1) (relating to definition of a lease) shall apply. If a noncorporate lessor enters into two or more successive leases with respect to the same or substantially similar items of section 38 property, the terms of such leases shall be aggregated and such leases shall be considered one lease for the purpose of determining whether the term of such leases is less than 50 percent of the esti-

mated useful life of the property subject to such leases. Thus, for example, if an individual owns an airplane with an estimated useful life of 7 years and enters into three successive 3-year leases of such airplane, such leases will be considered to be one lease for a term of nine years for the purpose of determining whether the term of the lease is less than 3½ years (50 percent of the 7-year estimated useful life).

PAR. 6. Section 1.47 is amended by deleting paragraphs (4) and (5) of section 47(a), by revising section 47(a)(6)(A), and by revising the historical note. The revised provisions read as follows:

§ 1.47 Statutory provisions; certain dispositions, etc., of section 38 property.

SEC. 47. *Certain dispositions, etc., of section 38 property*—(a) *General rule.* * * *

(4) [Deleted]

(5) [Deleted]

(6) *Aircraft used outside the United States after April 18, 1969*—(A) *General rule.* Any aircraft which was new section 38 property for the taxable year in which it was placed in service and which is used outside the United States under a qualifying lease or leases shall be treated as not ceasing to be section 38 property by reason of such use until such aircraft has been so used for a period or periods exceeding 3½ years in total. For purposes of the preceding sentence, the registration of such aircraft under the laws of a foreign country shall be treated as use outside the United States.

* * * * *

[Sec. 47 as added by sec. (2)(b), Rev. Act 1962 (76 Stat. 963); as amended by sec. 703 (c), Tax Reform Act 1969 (83 Stat. 666); sec. 1, Public Law 91-676 (84 Stat. 2060); secs. 102(c) and 107 (a) and (b), Rev. Act 1971 (85 Stat. 500, 507)]

PAR. 7. Section 1.47-1 is amended by revising paragraph (a)(2)(i), by adding subdivision (iii) to paragraph (a)(2), by revising so much of paragraph (e)(2)(ii) as precedes subdivision (*a*), by adding a new sentence at the end of paragraph (e)(2)(iii), by adding a new sentence at the end of paragraph (e)(2)(iv), by adding subdivision (vi) to paragraph (e)(2), and by revising paragraph (f). The revised and added provisions read as follows:

§ 1.47-1 Recomputation of credit allowed by section 38.

(a) * * *

(2) *Rules for applying subparagraph (1).* For purposes of subparagraph (1) of this paragraph—

(i) In determining whether section 38 property is disposed of, or otherwise ceases to be section 38 property with respect to the taxpayer, before the close of the estimated useful life which was taken into account in computing the taxpayer's qualified investment, the term "estimated useful life" means the shortest life of the useful life category within which falls the estimated useful life which was assigned to such property under paragraph (e) of § 1.46-3. Thus, section 38 property which is assigned, under paragraph (e) of § 1.46-3, an estimated useful life of 6 years shall not be treated, for purposes of subparagraph (1) of this paragraph, as having been disposed of before the close of its estimated useful life if such property is sold 5 years (that is, the shortest life of the 5 years or more but less than 7 years useful life category) after the date on which it was placed in service. Likewise, section 38 property with an estimated useful life of 15 years which is placed in service on January 1, 1972, shall not be treated as having been disposed of before the close of its estimated useful life if such property is sold at any time after January 1, 1979 (that is, 7 years or more after the date on which it was placed in service).

* * * * *

(iii) In determining the recomputed qualified investment with respect to property which ceases to be section 38 property with respect to the taxpayer after August 15, 1971, or which becomes public utility property after such date, such property shall be treated as if it were property described in section 50 at the time is was placed in service (whether or not it was property described in section 50 at such time). Thus, if property was placed in service on October 15, 1968, and was assigned an estimated useful life of 4 years, there would be no increase in tax under section 47 if the property were disposed of at any time after October 14, 1971, that is, 3 years or more after the property was placed in service.

* * * * *

(e) * * *

(2) * * *

(ii) Subdivision (i) of this subparagraph shall not apply with respect to assets placed in service in a taxable year ending on or after June 30, 1967, and beginning before January 1, 1971, or with respect to assets placed in service for a taxable year beginning after December 31, 1970, for which the taxpayer has not made the election provided by section 167(m), unless the estimated useful lives which were assigned to such assets for purposes of determining qualified investment—

* * * * *

(iii) * * * In the case of a table which is to apply to property which is described in section 50 or to property which is treated as property described in section 50 under paragraph (a)(2)(iii) of this section, this subdivision shall be applied by substituting "3 years" for "4 years", "5 years" for "6 years", and "7 years" for "8 years".

(iv) * * * In the case of property which is described in section 50 or property which is treated as property described in section 50 under paragraph (a)(2)(iii) of this section (other than property the qualified investment with respect to which was determined by use of the standard or an appropriate mortality dispersion table), this subdivision shall be applied by substituting "3-year period" for "4-year period", "5-year period" for "6-year period", and "7-year period" for "8-year period".

* * * * *

(vi) Subdivision (i) of this subparagraph shall not apply with respect to section 38 property to which an election under section 167(m) applies unless the taxpayer assigns actual retirements of such section 38 property for all taxable years to the same vintage account for purposes of section 47 and for purposes of computing the allowance for depreciation under section 167. The assignment of actual retirements of section 38 property for a taxable year to particular vintage accounts may be made on the basis of an appropriate mortality dispersion table (based on an acceptable sampling of the taxpayer's actual experience or other statistical or engineering techniques) or on the basis of a standard mortality dispersion table prescribed by the Commissioner. If the taxpayer assigns actual retirements for any taxable year to particular vintage accounts on the basis of such standard mortality dispersion table, actual retirements for all subsequent taxable years must be assigned to particular vintage accounts on the basis of such table. Actual retirements of section 38 property for a taxable year shall be assigned to particular vintage accounts by—

(*a*) Determining the expected retirements for such taxable year from each vintage account containing such section 38 property, and

(*b*) Ratably allocating such actual retirements to each vintage account containing such section 38 property.

However, the unadjusted basis of retired assets assigned to any particular vintage account shall not exceed the unadjusted basis of the property contained in such account.

* * * * *

(f) *Public utility property*—(1) *Recomputed qualified investment.* In recomputing qualified investment with respect to section 38 property which becomes public utility property (as defined in paragraph (g) of § 1.46-3)—

(i) If such property becomes public utility property less than 3 years from the date on which it was placed in service, then such property shall be treated as public utility property for its entire useful life.

(ii) If such property becomes public utility property 3 years or more but less than 5 years from the date on which it was placed in service, then such property shall be treated as section 38 property which is not public utility property for the first 3 years of its estimated useful life and as public utility property for the remaining period of its estimated useful life.

(iii) If such property becomes public utility property 5 years or more but less than 7 years from the date on which it was placed in service, then such property shall be treated as section 38 property which is not public utility property for the first 5 years of its estimated useful life and as public utility property for the remaining period of its estimated useful life.

If property becomes public utility property before August 16, 1971, this subparagraph shall be applied by substituting "4

years" for "3 years", "6 years" for "5 years", and "8 years" for "7 years".

(2) *Examples.* Subparagraph (1) of this paragraph may be illustrated by the following examples:

Example (1). (i) X Corporation, which makes its returns on the basis of the calendar year, acquired and placed in service on January 1, 1969, an item of section 38 property with a basis of $12,000 and an estimated useful life of 8 years. The amount of qualified investment with respect to such property was $12,000. For the taxable year 1969, X Corporation's credit earned was $840 (7 percent of $12,000) and for such taxable year X Corporation was allowed under section 38 a credit of $840 against its liability for tax. During the taxable year 1972 such property becomes public utility property (as defined in paragraph (g) of § 1.46–3) with respect to X Corporation.

(ii) Such item of section 38 property is treated as section 38 property which is not public utility property for the first 3 years of its 8-year estimated useful life and is treated as public utility property for the remaining 5 years. The recomputed qualified investment with respect to such item of section 38 property is $7,428, computed as follows:

$12,000 basis × 33⅓ percent applicable percentage	$4,000
$12,000 basis × ⅔ × 66⅔ percent applicable percentage	3,428
Total recomputed qualified investment	7,428

X Corporation's recomputed credit earned for the taxable year 1969 is $520 (7 percent of $7,428). The income tax imposed by chapter 1 of the Code on X Corporation for the taxable year 1972 is increased by the $320 decrease in its credit earned for the taxable year 1969 (that is, $840 original credit earned minus $520 recomputed credit earned).

Example (2). (i) The facts are the same as in example (1) and in addition the item of section 38 property which became public utility property in 1972 is sold to Y Corporation on January 2, 1975.

(ii) The actual useful life of such item of property is 6 years. For the first 3 years of its 8-year estimated useful life such item is treated as section 38 property which is not public utility property and for the remaining 3 years is treated as public utility property. The recomputed qualified investment with respect to such item of property is $5,714, computed as follows:

$12,000 basis × 33⅓ percent applicable percentage	$4,000
$12,000 basis × ⅔ × 33⅓ percent applicable percentage	1,714
Total recomputed qualified investment	5,714

X Corporation's recomputed credit earned for the taxable year 1969 is $400 (7 percent of $5,714). The income tax imposed by chapter 1 of the Code on X Corporation for the taxable year 1975 is increased by $120 (that is, $440 ($840 original credit earned minus $400 recomputed credit earned) minus $320 increase in tax for 1969).

§ 1.47–2 [Amended]

PAR. 8. Paragraph (c)(1) of § 1.47–2 is amended by deleting "4 years" and inserting in lieu thereof "3 years".

§ 1.47–3 [Amended]

PAR. 9. Section 1.47–3 is amended as follows:

1. Paragraph (c)(1) is amended to read as follows.

(c) *Property destroyed by casualty—*(1) *Dispositions after April 18, 1969.* Notwithstanding the provisions of § 1.47–2, relating to "disposition" and "cessation", paragraph (a) of § 1.47–1 shall not apply to property which, after April 18, 1969, and before August 16, 1971, is disposed of or otherwise ceases to be section 38 property with respect to the taxpayer on account of its destruction or damage by fire, storm, shipwreck, or other casualty, or by reason of its theft.

2. The example in paragraph (h)(1)(ii) of § 1.47–3 is amended by deleting "January 15, 1972" and inserting in lieu thereof "January 15, 1971".

PAR. 10. Section 1.48 is amended by revising paragraph (1) of section 48(a), by striking out "and" at the end of paragraph (2)(B)(vi) of section 48(a), by striking out the period at the end of paragraph (2)(B)(vii) of section 48(a) and inserting in lieu thereof a semicolon, by adding subdivisions (viii), (ix), and (x) at the end of paragraph (2)(B) of section 48(a), by revising paragraphs (3), (5), and (6) of section 48(a), by adding paragraphs (7), (8), and (9) to section 48(a), by revising section 48(d), and by revising the historical note. The revised and added provisions read as follows:

§ 1.48 Statutory provisions; definitions; special rules.

SEC. 48. *Definitions; special rules*—(a) *Section 38 property*—(1) *In general.* Except as provided in this subsection, the term "section 38 property" means—

(A) Tangible personal property, or

(B) Other tangible property (not including a building and its structural components) but only if such property—

(i) Is used as an integral part of manufacturing, production, or extraction or of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services, or

(ii) Constitutes a research facility used in connection with any of the activities referred to in clause (i), or

(iii) Constitutes a facility used in connection with any of the activities referred to in clause (i) for the bulk storage of fungible commodities (including commodities in a liquid or gaseous state), or

(C) Elevators and escalators, but only if—

(i) The construction, reconstruction, or erection of the elevator or escalator is completed by the taxpayer after June 30, 1963, or

(ii) The elevator or escalator is acquired after June 30, 1963, and the original use of such elevator or escalator commences with the taxpayer and commences after such date.

Such term includes only property with respect to which depreciation (or amortization in lieu of depreciation) is allowable and having a useful life (determined as of the time such property is placed in service) of 3 years or more.

(2) *Property used outside the United States.* * * *

(B) *Exceptions.* * * *

(viii) Any communications satellite (as defined in section 103(3) of the Communications Satellite Act of 1962, 47 U.S.C., sec. 702(3)), or any interest therein, of a U.S. person;

(ix) Any cable, or any interest therein, of a domestic corporation engaged in furnishing telephone service to which section 46(c)(3)(B)(iii) applies (or of a wholly owned domestic subsidiary of such a corporation), if such cable is part of a submarine cable system which constitutes part of a communication link exclusively between the United States and one or more foreign countries; and

(x) Any property (other than a vessel or an aircraft) of a U.S. person which is used in international or territorial waters for the purpose of exploring for, developing, removing, or transporting resources from ocean waters or deposits under such waters.

(3) *Property used for lodging.* Property which is used predominantly to furnish lodging or in connection with the furnishing of lodging shall not be treated as section 38 property. The preceding sentence shall not apply to—

(A) Nonlodging commercial facilities which are available to persons not using the lodging facilities on the same basis as they are available to persons using the lodging facilities,

(B) Property used by a hotel or motel in connection with the trade or business of furnishing lodging where the predominant portion of the accommodations is used by transients, and

(C) Coin-operated vending machines and coin-operated washing machines and dryers.

* * * * *

(5) *Property used by governmental units.* Property used by the United States, any State or political subdivision thereof, any international organization (other than the International Telecommunications Satellite Consortium or any successor organization), or any agency or instrumentality of any of the foregoing shall not be treated as section 38 property.

(6) *Livestock.* Livestock (other than horses) acquired by the taxpayer shall be treated as section 38 property, except that if substantially identical livestock is sold or otherwise disposed of by the taxpayer during the 1-year period beginning 6 months before the date of such acquisition and if section 47(a) (relating to certain dispositions, etc., of section 38 property) does not apply to such sale or other disposition, then, unless such sale or other disposition constitutes an involuntary conversion (within the meaning of section 1033), the cost of the livestock acquired shall, for purposes of this subpart, be reduced by an amount equal to the amount realized on such sale or other disposition. Horses shall not be treated as section 38 property.

(7) *Property completed abroad or predominantly of foreign origin*—(A) *In general.* Property (other than pretermination property) shall not be treated as section 38 property if—

(i) Such property was completed outside the United States, or

(ii) Less than 50 percent of the basis of such property is attributable to value added within the United States.

For purposes of this subparagraph, the term "United States" includes the Commonwealth of Puerto Rico and the possessions of the United States.

(B) *Period of application of paragraph.* Except as provided in subparagraph (D), subparagraph (A) shall apply only with respect to property described in section 50—

(i) The construction, reconstruction, or erection of which by the taxpayer is begun after August 15, 1971, and on or before the date of termination of Proclamation 4074, or

(ii) Which is acquired pursuant to an order placed on or before the date of termination of Proclamation 4074, unless acquired pursuant to an order which the taxpayer establishes was placed before August 16, 1971.

(C) *President may exempt articles.* If the President of the United States shall at any time determine that the application of sub-

paragraph (A) to any article or class of articles is not in the public interest, he may by Executive order specify that subparagraph (A) shall not apply to such article or class of articles. Subparagraph (A) shall not apply to an article or class of articles for the period specified in such Executive order. Any period specified under the preceding sentence shall not apply to property ordered before (or to property the construction, reconstruction, or erection of which began before) the date of the Executive order specifying such period, except that, if the President determines it to be in the public interest, such period shall apply to property ordered (or property the construction, reconstruction, or erection of which began) after a date (before the date of the Executive order) specified in the Executive order.

(D) *Countries maintaining trade restrictions or engaging in discriminatory acts.* If, on or after the date of the termination of Proclamation 4074, the President determines that a foreign country—

(i) Maintains nontariff trade restrictions, including variable import fees, which substantially burden U.S. commerce in a manner inconsistent with provisions of trade agreements, or

(ii) Engages in discriminatory or other acts (including tolerance of international cartels) or policies unjustifiably restricting U.S. commerce,

he may provide by Executive order for the application of subparagraph (A) to any article or class of articles manufactured or produced in such foreign country for such period as may be provided by Executive order.

(8) *Amortized property.* Any property with respect to which an election under section 167(k), 169, 184, 187, or 188 applies shall not be treated as section 38 property. In the case of any property to which section 169 applies, the preceding sentence shall apply only to so much of the adjusted basis of the property as (after the application of section 169(f)) constitutes the amortizable basis for purposes of section 169.

(9) *Railroad track.* In the case of a railroad (including a railroad switching or terminal company) which uses the retirement-replacement method of accounting for depreciation of its railroad track, the term "section 38 property" includes replacement track material, if—

(A) The replacement is made pursuant to a scheduled program for replacement,

(B) The replacement is made pursuant to observations by maintenance-of-way personnel of specific track material needing replacement,

(C) The replacement is made pursuant to the detection by a rail-test car of specific track material needing replacement, or

(D) The replacement is made as a result of a casualty. Replacements made as a result of a casualty shall be section 38 property only to the extent that, in the case of each casualty, the qualified investment with respect to the replacement track material exceeds $50,000. For purposes of this paragraph, the term "track material" includes ties, rail, other track material, and ballast.

* * * * *

(d) *Certain leased property*—(1) *General rule.* A person (other than a person referred to in section 46(d)(1)) who is a lessor of property may (at such time, in such manner, and subject to such conditions as are provided by regulations prescribed by the Secretary or his deligate) ject with respect to any new section 88 property (other than property described in paragraph (4)) to treat the lessee as having acquired such property for an amount equal to—

(A) Except as provided in subparagraph (B), the fair market value of such property, or

(B) If the property is leased by a corporation which is a component member of a controlled group (within the meaning of section 46(a)(5)) to another corporation which is a component member of the same controlled group, the basis of such property to the lessor.

(2) *Special rule for certain short term leases.* (A) *In general.* A person (other than a person referred to in section 46(d)(1)) who is a lessor of property described in paragraph (4) may (at such time, in such manner, and subject to such conditions as are provided by regulations prescribed by the Secretary or his delegate) elect with respect to such property to treat the lessee as having acquired a portion of such property for the amount determined under subparagraph (B).

(B) *Determination of lessee's investment.* The amount for which a lessee of property described in paragraph (4) shall be treated as having acquired a portion of such property is an amount equal to a fraction, the numerator of which is the term of the lease and the denominator of which is the class life of the property leased (determined under section 167(m)), of the amount for which the lessee would be treated as having acquired the property under paragraph (1).

(C) *Determination of lessor's qualified investment.* The qualified investment of a lessor of property described in paragraph (4) in any such property with respect to which he has made an election under this paragraph is an amount equal to his qualified investment in such property (as determined under section 46(c)) multiplied by a fraction equal to the excess of one over the fraction used under subparagraph (B) to determine the lessee's investment in such property.

(3) *Limitations.* The elections provided by paragraphs (1) and (2) may be made with respect to property which would be new section 38 property if acquired by the lessee. For purposes of the preceding sentence and section 46(c), the useful life of property in the hands of the lessee is the useful life of such property in the hands of the lessor. If a lessor makes the election provided by paragraph (1) with respect to any property, the lessee shall be treated for all purposes of this subpart as having acquired such property. If a lessor makes the election provided by paragraph (2) with respect to any property, the lessee shall be treated for all purposes of this subpart as having acquired a fractional portion of such property equal to the fraction determined under paragraph 2(B) with respect to such property.

(4) *Property to which paragraph (2) applies.* Paragraph (2) shall apply only to property which—

(A) Is new section 38 property,

(B) Has a class life (determined under section 167(m)) in excess of 14 years,

(C) Is leased for a period which is less than 80 percent of its class life, and

(D) Is not leased subject to a net lease (within the meaning of section 57(c)(2)).

* * * * *

[Sec. 48 as added by sec. 2(b), Rev. Act 1962 (76 Stat. 963); as amended by sec. 203(a)(1) and (3)(A), (b), and (c), Rev. Act 1964 (78 Stat. 33, 34); sec. 1, Act of November 8, 1966 (Public Law 89-800, 80 Stat. 1508); sec. 201(a), Act of November 13, 1966 (Public Law 89-809, 80 Stat. 1575, 1576); secs. 1, 2(a), and (3), Act of June 13, 1967 (Public Law 90-26, 81 Stat. 57, 58); sec. 401(e)(2), (3), and (4), Tax Reform Act 1969 (83 Stat. 603); secs. 102(a), 103, 104(a)(1), (b), (c), (d), (e), (f), and (g), Rev. Act 1971 (83 Stat. 499-502)]

PAR. 11. Section 1.48-1 is amended as follows:

1. Paragraph (a) is amended by deleting "4 years" and inserting in lieu thereof "3 years", and by adding a new sentence at the end thereof as set forth below.

2. Paragraph (d)(5) is redesignated as paragraph (d)(5)(i) and new subdivision (ii) is added.

3. The next to the last sentence and the last sentence of paragraph (e)(1) are deleted and new material is inserted in lieu thereof as set forth below.

4. Paragraph (g)(2) is amended by deleting "and" at the end of subdivision (vi), by deleting the period at the end of subdivision (vii) and inserting a semicolon in lieu thereof, and by adding new subdivisions (viii), (ix), and (x).

5. New subdivision (iii) is added to paragraph (h)(2).

6. The first sentence of paragraph (k) is revised to read as set forth below.

7. Paragraph (l) is revised to read as set forth below.

8. New paragraphs (n) and (o) are added.

§ 1.48-1 Definition of section 38 property.

(a) * * * In the case of property which is not described in section 50, this paragraph shall be applied by substituting "4 years" for "3 years".

* * * * *

(d) * * *

(5) * * *

(ii) In the case of property described in section 50, property will constitute a storage facility only if the facility is used principally for the bulk storage of fungible commodities. Bulk storage means the storage of a commodity in a large mass prior to its consumption or utilization. Thus, if a facility is used to store oranges that have been sorted and boxed, it is not used for bulk storage.

(e) *Definition of building and structural components.* (1) * * * Such term does not include (i) a structure which is essentially an item of machinery or equipment, or (ii) a structure which houses property used as an integral part of an activity specified in section 48(a)(1)(B)(i) if the use of the structure is so closely related to the use of such property that the structure clearly can be expected to be replaced when the property it initially houses is replaced. Factors which indicate that a structure is closely related to the use of the property it houses include the fact that the structure is specifically designed to provide for the stress and other demands of such property and the fact that the structure could not be economically used for other purposes. Thus, the term "building" does not include such structures as oil and gas storage tanks, grain storage bins, silos, fractionating towers, blast furnaces, basic oxygen furnaces, coke ovens, brick kilns, and coal tipples.

* * * * *

(g) * * *
(2) * * *

(viii) Any communications satellite (as defined in section 103(3) of the Communications Satellite Act of 1962, 47 U.S.C., sec. 702(3)), or any interest therein, of a U.S. person;

(ix) Any cable which is property described in section 50, or any interest therein, of a domestic corporation engaged in furnishing telephone service to which section 46(c)(3)(B)(iii) applies (or of a wholly owned domestic subsidiary of such corporation), if such cable is part of a submarine cable system which constitutes part of a communications link exclusively between the United States and one or more foreign countries; and

(x) Any property described in section 50 (other than a vessel or an aircraft) of a U.S. person which is used in international or territorial waters for the purpose of exploring for, developing, removing, or transporting resources from ocean waters or deposits under such waters.

(h) * * *
(2) * * *

(iii) *Coin-operated machines.* In the case of property which is described in section 50, coin-operated vending machines and coin-operated washing machines and dryers shall not be considered as property which is used predominantly to furnish lodging or predominantly in connection with the furnishing of lodging.

* * * * *

(k) *Property used by governmental units.* The term "section 38 property" does not include property used by the United States, any State (including the District of Columbia) or political subdivision thereof, any international organization (as defined in section 7701(a)(18)) other than the International Telecommunications Satellite Consortium or any successor organization, or any agency or instrumentality of the United States, of any State or political subdivision thereof, or of any such international organization. * * *

(l) *Livestock*—(1) *In general.* The term "section 38 property" does not include horses but such term does include all other livestock that is property described in section 50. The term "livestock" includes cattle, hogs, sheep, goats, and mink and other fur-bearing animals.

(2) *Cost.* For purposes of computing qualified investment under section 46(c) with respect to livestock, the cost of livestock acquired by the taxpayer shall be reduced by any amount realized on the sale or other disposition of substantially identical livestock which is sold or otherwise disposed of by the taxpayer during the 1-year period beginning 6 months before the date of such acquisition, except that no reduction shall be made on account of a sale or other disposition to which section 47(a) (relating to recapture) applies or which constitutes an involuntary conversion (within the meaning of section 1033). If a particular sale or other disposition of substantially identical livestock falls within 2 or more 1-year periods relating to separate acquisitions, the amount realized from such sale or other disposition shall be applied in order of time beginning with the earliest acquisition of livestock which is section 38 property. If there is more than one sale or other disposition of substantially identical livestock during a particular 1-year period, the sales or dispositions are to be taken into account in order of time beginning with the earliest. If an amount realized from a sale or other disposition has been taken into account to reduce the cost of acquired livestock, such amount is not to be taken into account to reduce the cost of any other acquired livestock. If a taxpayer claims a credit for any livestock acquired in a taxable year and if the amount realized on any sale or other disposition of substantially identical livestock in a subsequent taxable year is applied to reduce the cost of the acquired livestock, the taxpayer must file an amended return for the year in which the credit was claimed.

(3) *Substantially identical.* In determining whether livestock sold or otherwise disposed of by the taxpayer is substantially identical to livestock acquired by the taxpayer, the sex and age of the livestock and the use to which it is put are taken into account. Thus, if the taxpayer sells a cow used for breeding purposes and acquires another cow of approximately the same age to be used for breeding purposes, the two cows are substantially identical. However, a cow suitable for dairy purposes which is acquired by the taxpayer to replace a cow no longer suitable for dairy purposes is not substantially identical to the replaced cow.

(4) *Original use.* For purposes of determining whether livestock is "new section 38 property," that is, whether the original use of livestock commences with the taxpayer under § 1.48-2(b)(7), the original use of a breeding or dairy animal for breeding or dairy purposes begins at the time the animal first becomes suitable for such purposes unless the animal has previously been used for other purposes. Thus, if a taxpayer acquires for dairy purposes an animal that previously has not been used for any purpose, the animal will be new section 38 property at the time it first gives milk. However, if the taxpayer acquires an animal for breeding purposes which previously had been used for dairy purposes, the animal will not be new section 38 property when it is first used for breeding purposes.

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

Example (1). (a) Individual A, a farmer and calendar year taxpayer, owns three dairy cows which he purchased in 1970 for $250 each. In 1971, A buys three dairy cows, one each on October 1, November 1, and December 1, for $290 each. On October 15, 1971, A sells for $300 one of the cows purchased in 1970, and on November 15, 1971, he sells for $300 another of the cows purchased in 1970. All of the cows bought and sold by A are substantially identical. The cows purchased by A have an estimated useful life of 5 years.

(b) Of the $300 realized from the October 15 sale, $290 is applied to reduce the cost of the cow purchased October 1 to zero. The remaining $10 realized from the October 15 sale and $280 of the $300 realized from the November 15 sale are applied to reduce the cost of the cow purchased November 1 to zero. The remaining $20 realized from the November 15 sale is applied to reduce the cost of the cow purchased December 1 to $270.

(c) Since the basis of the cows purchased October 1 and November 1 is zero for investment credit purposes, no credit is allowable with respect to those two cows. The cow purchased December 1 has a basis for investment credit purposes of $270. Since the useful life of the cow purchased December 1 is at least 5 years but less than 7 years, the qualified investment of A with respect to the cow is $180 (⅔ × $270).

Example (2). Assume the same facts as in example (1) except that on May 1, 1972, A sells for $300 the third cow purchased in 1970. Since the third cow is sold within 6 months of the acquisition of the cow purchased December 1, 1971, the amount realized on such sale is applied to reduce the cost of the cow purchased December 1, 1971, to zero. Consequently, A must file an amended return for 1971 and claim no investment credit for the cow purchased December 1, 1971.

* * * * *

(n) *Amortized property.* Any property with respect to which an election under 167(k), 169, 184, 187, or 188 applies shall not be treated as section 38 property. In the case of any property to which section 169 applies, the preceding sentence shall apply only to so much of the adjusted basis of the property as (after the application of section 169(f)) constitutes the amortizable basis for purposes of section 169. This paragraph shall not apply to property with respect to which an election under section 167(k), 184, 187, or 188 applies unless such property is described in section 50.

(o) *Property of foreign origin*—(1) *In general.* Property (other than pretermination property) shall not be treated as section 38 property if (i) such property was completed outside the United States, or (ii) less than 50 percent of the basis or cost of such property is attributable to value added within the United States. For purposes of this paragraph, the term "United States" includes the Commonwealth of Puerto Rico and the possessions of the United States.

(2) *Period of application.* (i) Subparagraph (1) of this paragraph shall apply only to property described in section 50—

(*a*) The construction, reconstruction, or erection of which by the taxpayer is begun after August 15, 1971, and before December 20, 1971, or

(*b*) Which is acquired pursuant to an order placed before December 20, 1971, unless acquired pursuant to an order which the taxpayer establishes was placed before August 16, 1971.

The principles of § 1.48-2 (b) and (c) shall be applied in determining when construction, reconstruction, or erection by the taxpayer begins. An order is any directive, written or oral, to another person reasonably designed to effect the acquisition of property at a later date. An order need not be a binding contract. Where an order placed during the sur-

charge period (August 16, 1971, through December 19, 1971) is canceled and a reorder is placed which is substantially the reinstitution of the original order, the property acquired as a result of the reorder is considered to be acquired pursuant to the original order.

(ii) See section 48(a)(7)(C) and (D) for circumstances under which the President of the United States may provide by Executive order for the period specified in such order that (*a*) section 48(a)(7)(A) shall not apply to certain property, or (*b*) such section shall apply to certain property notwithstanding the termination of Proclamation 4074.

(3) *Property completed outside the United States.* Property is completed outside the United States if it enters the country in a form which is operational for the purposes for which it is intended or designed, regardless of the United States content of the property. Property is in an operational state even though it is necessary to perform minor activities such as packaging, labeling, testing, or adjusting. On the other hand, substantial assembly of an article in the United States, such as in the case of aircraft, the installation of the customer's engines, or the installation of navigation equipment and the completion of the seating and interior arrangements, is to be considered completion of the article in the United States, rather than outside the United States.

(4) *Value added within the United States.* In determining whether less than 50 percent of the basis of property is attributable to value added within the United States, shipping and insurance costs incurred in transporting any part of such property to the United States and any duty payable upon entry of the property into the United States are treated as value added without the United States. Profit realized on the sale of property completed in the United States, and any profit attributable to any other U.S. activity, is treated as value added within the United States. The cost of any component part of the property (whether added to the property within or without the United States) which originates and is completed in the United States and meets the United States value added test is treated as value added within the United States.

PAR. 12. Section 1.48–4 is amended by revising paragraphs (a), (c), (d), (e), (f)(1)(v) and (vi) and (2), and (g)(2) and (4) to read as follows:

§ 1.48–4 Election of lessor of new section 38 property to treat lessee as purchaser.

(a) *In general*—(1) *Lessee treated as purchaser.* Under section 48(d), a lessor of property may elect to treat the lessee of such property as having purchased such property (or, in the case of short-term lease property described in subparagraph (2) of this paragraph, a portion of such property) for purposes of the credit allowed by section 38 if the following conditions are satisfied:

(i) The property must be "section 38 property" in the hands of the lessor; that is, it must be property with respect to which depreciation (or amortization in lieu of depreciation) is allowable to the lessor, it must have a useful life of 3 years (4 years in the case of property which is not described in section 50) or more in his hands, and in every other respect it must meet the requirements of § 1.48–1. Thus, for example, property leased by a municipality to a taxpayer for use in what is commonly known as an "industrial park" is not eligible for the election since, under paragraph (k) of § 1.48–1, property used by a governmental unit is not section 38 property. In addition, property used by the lessee predominantly outside the United States is not eligible for the election since, under paragraph (g) of § 1.48–1, such property is not section 38 property. For purposes of this subdivision, if the lessor is an estate or trust, depreciation (or amortization in lieu of depreciation) will be considered allowable to the estate or trust even if it is apportioned to the beneficiaries or other persons.

(ii) The property must be "new section 38 property" (within the meaning of § 1.48–2) in the hands of the lessor, and the original use of such property must commence with the lessor. See paragraph (b) of this section for the application of the rules relating to "original use" in the case of leased property.

(iii) The property would constitute "new section 38 property" to the lessee if such lessee had actually purchased the property. Thus, the election is not available if the lessee is not the original user of the property. See paragraph (b) of this section for the application of the rules relating to "original use" in the case of leased property. See paragraph (d) of this section for the determination of the estimated useful life of leased property in the hands of the lessee.

(iv) A statement of election to treat the lessee as a purchaser has been filed in the manner and within the time provided in paragraph (f) or (g) of this section.

(v) The lessor is not a person referred to in section 46(d)(1), that is, a mutual savings bank, cooperative bank, or domestic building and loan association to which section 593 applies; a regulated investment company or real estate investment trust subject to taxation under subchapter M, chapter 1 of the Code; or a cooperative organization described in section 1381(a).

The election may be made on a property-by-property basis or a general election may be made with respect to each taxable year of a particular lessee. If the conditions of this subparagraph have been met, the lessee shall be treated as though he were the actual owner of all or a portion of the property for purposes of the credit allowed by section 38. Thus, the lessee shall be entitled to a credit allowed by section 38 with respect to such property for the taxable year in which he places such property in service, and the lessor shall not be entitled to a credit allowed by section 38 with respect to such property unless the property is short-term lease property (as defined in subparagraph (2) of this paragraph). Moreover, if the leased property is disposed of, or if it otherwise ceases to be section 38 property, the property will be subject to the provisions of section 47 (relating to early dispositions, etc.).

(2) *Short-term lease property.* For purposes of this section, the term "short-term lease property" means property which—

(i) Is new section 38 property;

(ii) Has a class life (determined under section 167(m)) in excess of 14 years;

(iii) Is leased under a lease entered into after November 8, 1971, for a period which is less than 80 percent of the class life of such property; and

(iv) Is not leased subject to a net lease within the meaning of section 57(c)(1)(B) and the regulations thereunder.

The class life of property shall be determined under section 167(m) and the regulations prescribed in connection with that section, except that such class life shall be determined without regard to any variance from the class life permitted under such section. If a class life has not been prescribed for property under section 167(m) on the date such property is leased, the class life of the property shall be the estimated useful life used to compute the allowance for depreciation with respect to such property under section 167. For purposes of subdivision (iii) of this subparagraph, the period for which a lease is entered into shall be determined without regard to any option on the part of the lessee to extend or renew such lease, and without regard to any option on the part of the lessee to cancel the lease after a specified period if under the terms of such lease, such a cancellation would result in the imposition of a substantial penalty upon the lessee. Generally, a penalty equal to 25 percent of the total remaining rental payments due under the lease will be regarded as substantial.

* * * * *

(c) *Qualified investment*—(1) *In general.* If a valid election is made under this section, the amount of qualified investment under section 46(c) with respect to the leased property shall be determined under this paragraph and paragraphs (d) and (e) of this section.

(2) *Nonshort-term lease property.* In the case of property which is not short-term lease property, the lessee is treated as having acquired the entire property for an amount equal to—

(i) The fair market value of such property on the date possession is transferred to the lessee, or

(ii) If the property is leased by a component member of a controlled group to another component member of the same controlled group (within the meaning of paragraph (f)(4) of § 1.46–1) on the date possession of the property is transferred to the lessee, the basis of the property in the hands of the lessor.

(3) *Short-term lease property.* (i) In the case of short-term lease property, the lessee is treated as having acquired a portion of such property. The amount for which the lessee is treated as having acquired such portion is an amount equal

to a fraction, the numerator of which is the term of the lease and the denominator of which is the class life of the property leased, of the amount for which the lessee would be treated as having acquired the property under subparagraph (2) of this paragraph if the property were not short-term lease property.

(ii) In the case of short-term lease property, the qualified investment of the lessor is an amount equal to his qualified investment in such property determined under section 46(c) multiplied by a fraction, the numerator of which is the class life of the property leased minus the term of the lease and the denominator of which is the class life of such property.

(4) *Example.* The provisions of this paragraph may be illustrated by the following example:

Example. (a) On December 1, 1971, X corporation completed construction of an item of new section 38 property with a basis of $10,000. Under section 167(m), the property has a class life of 16 years. On December 1, 1971, X leases the property to individual A for 4 years and A immediately places the property in service. The lease is not a net lease within the meaning of section 57(c)(1)(B). On the date of the lease, the fair market value of the property is $12,000. The property would qualify as new section 38 property in A's hands if it had been purchased by A. Under this section, the property is short-term lease property. X makes the election under this section to treat A as having acquired a portion of the property.

(b) A is treated as having acquired from X a portion of the property for $3,000 (the fair market value of the property, $12,000, multiplied by a fraction, 4/16, the numerator of which is the term of the lease and the denominator of which is the class life of the leased property). Since under paragraph (d) of this section the useful life of such property in the hands of A is the same as the useful life of such property in the hands of X, and such useful life is at least 7 years, A's qualified investment with respect to the property is $3,000.

(c) The qualified investment of X is $7,500 (the qualified investment of X under section 46(c), $10,000, multiplied by a fraction, 12/16, the numerator of which is the class life of the leased property, 16, minus the term of the lease, 4, and the denominator of which is the class life of the property).

(d) *Estimated useful life of leased property.* The estimated useful life to the lessee of property subject to the election shall be deemed to be the estimated useful life in the hands of the lessor for purposes of computing depreciation, regardless of the term of the lease. The lessor shall determine the estimated useful life of each leased property on an individual basis even though multiple asset accounts are used. However, in the case of assets similar in kind contained in a multiple asset account, the lessor shall assign to each of such assets the average useful life of such assets used in computing depreciation. Thus, for example, if during a taxable year a lessor leases 10 similar trucks with an average estimated useful life for depreciation purposes of 6 years, based on an estimated range of 5 to 7 years, he must assign a useful life of 6 years to each of the 10 trucks.

(e) *Lessor itself a lessee*—(1) *In general.* If the lessee of property is treated, under this section, as having purchased all or a portion of such property and if such lessee leases such property to a sublessee, the qualified investment with respect to such property in the hands of the sublessee shall be determined under paragraphs (c) and (d) of this section as if the original lessor had leased the property directly to the sublessee for the term of the sublessee's lease on the date possession of the property is transferred to the sublessee. For this purpose, property which is short-term lease property in the hands of the lessee shall be treated as short-term lease property in the hands of the sublessee regardless of whether such property is leased to the sublessee subject to a net lease (within the meaning of section 57(c)(1)(B)). In the case of property which is short-term lease property in the hands of the sublessee, the amount for which the lessee is treated as having acquired such property under paragraph (c) of this section shall be reduced by an amount equal to such amount multiplied by a fraction, the numerator of which is the term of the lease of the sublessee and the denominator of which is the term of the lease of the lessee.

(2) *Example.* The provisions of this paragraph may be illustrated by the following example:

Example. (a) On December 1, 1971, corporation X completes construction of a machine at a cost of $10,000. The machine has a class life under section 167(m) of 20 years. On December 1, 1971, X leases the machine to corporation Y for 12 years, and Y immediately subleases the machine to individual A for 8 years. X and Y are component members of the same controlled group. The lease between X and Y is not a net lease within the meaning of section 57(c)(1)(B). The fair market value of the property on December 1, 1971, is $16,000. Both X and Y make valid elections under this section.

(b) The property is short-term lease property and this paragraph applies.

(c) The qualified investment of A is $6,400. Such amount is determined by multiplying $16,000, the amount for which A would be treated under paragraph (c)(2) of this section as having acquired the property if it were not short-term lease property, by 8/20.

(d) The qualified investment of Y is $2,000. Such amount is determined by multiplying $10,000, the amount for which Y would be treated under paragraph (c)(2) of this section as having acquired the property if it were not short-term lease property, by 12/20, and by reducing the amount so determined ($6,000) by 8/12 of such amount ($4,000) to $2,000.

(e) The qualified investment of X is $4,000. Such amount is determined by multiplying the amount of X's qualified investment determined under section 46(c) without regard to this section ($10,000) by 8/20.

(f) * * *

(1) * * *

(v) The estimated useful life category of the property (or properties) in the hands of the lessor, that is, 3 years or more but less than 5 years, 5 years or more but less than 7 years, or 7 years or more;

(vi) The amount for which the lessee (or sublessee) is treated as having acquired the leased property under paragraph (c)(2) or (3) of this section; and

* * * * *

(2) *Time for making election.* The statement referred to in subparagraph (1) of this paragraph shall be filed with the lessee on or before the due date (including any extensions of time) of the lessee's return for the lessee's taxable year during which possession of the property is transferred to the lessee, except that if such taxable year ends after March 31, 1971, and before December 11, 1971, the statement shall be filed with the lessee on or before the due date (including any extensions of time) of the lessee's return for such taxable year, or on or before October 24, 1972, whichever is later.

* * * * *

(g) * * *

(2) *Manner and time for making general election.* The general election of a lessor with respect to a taxable year of a lessee shall be made by filing a statement with the lessee, signed by the lessor and including the written consent of the lessee, on or before the due date (including any extensions of time) of the lessee's return for such taxable year, except that if such taxable year ends after March 31, 1971, and before December 11, 1971, the statement shall be filed with the lessee on or before the due date (including any extensions of time) of the lessee's return for such taxable year, or on or before October 24, 1972, whichever is later. Such statement of general election shall contain:

* * * * *

(4) *Information requirement.* If a lessor, with respect to a taxable year of the lessee, makes a general election under this paragraph, such lessor shall provide such lessee, on or before the date required for filing the statement under subparagraph (2) of this paragraph, with a statement (or statements) containing the information required by paragraph (f)(1)(iii), (iv), (v), and (vi) of this section with respect to all properties possession of which is transferred under lease by the lessor to the lessee during such taxable year.

* * * * *

PAR. 13. The third sentence of § 1.48-4(j) is deleted and the following is inserted in lieu thereof:

§ 1.48-4 Election of lessor of new section 38 property to treat lessee as purchaser.

* * * * *

(j) * * * In the case of a taxable year ending after March 31, 1971, and before December 11, 1971, a summary statement may be filed on or before the due date (including any extensions of time) of the return or on or before October 24, 1972, whichever is later, with the Internal Revenue Service Center with which the return has been filed. * * *

* * * * *

PAR. 14. Paragraph (a)(1) of § 1.48-5 is amended by revising the sixth sentence thereof to read as follows:

§ 1.48–5 Electing small business corporations.

(a) *In general.* (1) * * * The useful life categories are: (i) 3 years or more but less than 5 years; (ii) 5 years or more but less than 7 years; and (iii) 7 years or more. * * *

* * * * *

PAR. 15. Paragraph (a)(1) of § 1.48–6 is amended by revising the sixth sentence thereof to read as follows:

§ 1.48–6 Estates and trusts.

(a) *In general.* (1) * * * The useful life categories are: (i) 3 years or more but less than 5 years; (ii) 5 years or more but less than 7 years; and (iii) 7 years or more. * * *

* * * * *

PAR. 16. Section 1.49 is amended by revising the heading thereof, by revising section 49(a), by revising that part of subsection (b) of section 49 that precedes paragraph (1), by deleting subsection (d) of section 49, and by revising the historical note. The revised provisions read as follows:

§ 1.49 Statutory provisions; termination for period beginning April 19, 1969, and ending during 1971.

SEC. 49. *Termination of credit for period beginning April 19, 1969, and ending during 1971*—(a) *General rule.* For purposes of this subpart, the term "section 38 property" does not include property—

(1) The physical construction, reconstruction, or erection of which is begun after April 18, 1969, or

(2) Which is acquired by the taxpayer after April 18, 1969, other than pretermination property. This subsection shall not apply to property described in section 50.

(b) *Pretermination property.* For purposes of this subpart—* * *

(d) [Deleted]

[Sec. 49 as added by sec. 703(a), Tax Reform Act 1969 (83 Stat. 660); as amended by sec. 101(b), Rev. Act 1971 (85 Stat. 498)]

PAR. 17. There is added immediately after § 1.49 the following new sections:

§ 1.50 Statutory provisions; restoration of credit.

SEC. 50. *Restoration of credit*—(a) *General rule.* Section 49 (a) (relating to termination of credit) shall not apply to property—

(1) The construction, reconstruction, or erection of which—

(A) Is completed by the taxpayer after August 15, 1971, or

(B) Is begun by the taxpayer after March 31, 1971, or

(2) Which is acquired by the taxpayer—

(A) After August 15, 1971, or

(B) After March 31, 1971, and before August 16, 1971, pursuant to an order which the taxpayer establishes was placed after March 31, 1971.

(b) *Transitional rule.* In applying section 46(c)(1)(A) in the case of property described in subsection (a)(1)(A) the construction, reconstruction, or erection of which is begun before April 1, 1971, there shall be taken into account only that portion of the basis which is properly attributable to construction, reconstruction, or erection after August 15, 1971. This subsection shall not apply to pretermination property (within the meaning of section 49(b)).

[Sec. 50 as added by sec. 101(a), Rev. Act 1971 (85 Stat. 498)]

§ 1.50–1 Restoration of credit.

(a) *In general.* Section 49(a) (relating to termination of credit) does not apply to property—

(1) The construction, reconstruction, or erection of which by the taxpayer—

(i) Is completed after August 15, 1971, or

(ii) Is begun after March 31, 1971, or

(2) Which is acquired by the taxpayer—

(i) After August 15, 1971, or

(ii) After March 31, 1971, and before August 16, 1971, pursuant to an order which the taxpayer establishes was placed after March 31, 1971.

(b) *Transitional rule.* In the case of property (other than pretermination property) the construction, reconstruction, or erection of which by the taxpayer is begun before April 1, 1971, and completed after August 15, 1971, there shall be taken into account as the basis of new section 38 property in determining qualified investment only that portion of the basis which is properly attributable to construction, reconstruction, or erection after August 15, 1971.

(c) *Principles to be applied.* The principles of § 1.48–2 (b) and (c) shall be applied in determining when property is acquired and in determining that portion of the basis of property properly attributable to construction, reconstruction, or erection after August 15, 1971.

PAR. 18. Paragraph (b) of § 1.167(a)–1 is amended by adding the following new sentence at the end thereof:

§ 1.167(a)–1 Depreciation in general.

* * * * *

(b) * * * If a taxpayer claims an investment credit with respect to an asset for a taxable year preceding the taxable year in which the asset is considered as placed in service under § 1.167(a)–10(b) or § 1.167(a)–11(e), the useful life of the asset under this paragraph shall be the same useful life assigned to the asset under § 1.46–3(e).

§ 1.169 [Amended]

PAR. 19. Section 1.169 is amended by deleting subsection (h) of section 169.

§ 1.169–1 [Amended]

PAR. 20. Section 1.169–1 is amended by deleting subparagraph (4) of paragraph (a).

PAR. 21. Section 1.1245 is amended by revising section 1245(a)(3)(B)(ii), by adding subdivision (iii) to section 1245(a)(3)(B), and by revising the historical note. The revised and added provisions read as follows:

§ 1.1245 Statutory provisions; gain from dispositions of certain depreciable property; recomputed basis.

SEC. 1245. *Gain from dispositions of certain depreciable property*—(a) *General rule.* * * *

(3) *Section 1245 property.* * * *

(B) * * *

(ii) Constituted a research facility used in connection with any of the activities referred to in clause (i), or

(iii) Constituted a facility used in connection with any of the activities referred to in clause (i) for the bulk storage of fungible commodities (including commodities in a liquid or gaseous state),

* * * * *

[Sec. 1245 as added by sec. 13(a), Rev. Act 1962 (76 Stat. 1032); amended by sec. 203(d), Rev. Act 1964 (78 Stat. 35); amended by secs. 212(a) and 704(b)(4), Tax Reform Act 1969 (83 Stat. 571, 670); amended by sec. 104(a)(2), Rev. Act 1971 (85 Stat. 501)]

[FR Doc.72–14437 Filed 8–24–72;8:46 am]

[T.D. 7204]

65-DAY RULE

Accumulation Trusts; Credit for Taxes Paid By the Trust

On February 9, 1971, notice of proposed rule making to conform the Income Tax Regulations (26 CFR Parts 1 and 13) and the regulations on procedure and administration (26 CFR Part 301) under sections 643, 652, 663, 665, 666, 667, 668, 669, and 6401 of the Internal Revenue Code of 1954 to section 331 of the Tax Reform Act of 1969 (83 Stat. 592) was published in the FEDERAL REGISTER (36 F.R. 2607). After consideration of all such relevant matters as was presented by interested persons regarding the rules proposed, the amendments so proposed are adopted subject to the changes set forth below:

1. Section 1.643(a)–4 as set forth in paragraph 1 of the notice of proposed rule making is changed to read as set forth below.

2. Section 1.643(b)–2 as set forth in paragraph 2 of the notice of proposed rule making is changed to read as set forth below.

3. Section 1.652(b)–1 as set forth in paragraph 3 of the notice of proposed rule making is changed to read as set forth below.

4. Section 1.663(b)–1 as set forth in paragraph 4 of the notice of proposed rule making is changed by revising paragraphs (a)(1) and (a)(2)(i) to read as set forth below.

5. Section 1.663(b)–2 as set forth in paragraph 4 of the notice of proposed rule making is changed by revising paragraph (a) to read as set forth below.

6. Section 1.665(a)–0A as set forth in paragraph 5 of the notice of proposed rule making is changed by deleting paragraph (e) and by revising subparagraphs (1), (2), and (3) of paragraph (a) to read as set forth below.

7. Section 1.665(a)–1A as set forth in paragraph 5 of the notice of proposed rule making is changed by revising paragraphs (a)(2) and (c) to read as follows:

8. Section 1.665(b)–1A as set forth in paragraph 5 of the notice of proposed rule making is changed by revising paragraphs (a) and (b), by adding a new subparagraph (3) to paragraph (c), and by adding a new example (4) to paragraph (d). These revised provisions read as set forth below.

9. Section 1.665(b)–2A as set forth in paragraph 5 of the notice of proposed