

§ 1.47-2

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qualified as three year recovery property under section 168(c)(2)(A)(i). The amount of qualified investment for the vehicle under section 46(c) (1) and (6) is \$10,000. For the taxable year 1982, X Corporation's credit earned was \$1,000 (10 percent of \$10,000) and X Corporation was allowed under section 38 a \$1,000 credit against its 1982 tax liability. During the taxable year 1984, the vehicle undergoes a change in use but does not cease to be section 38 property. The vehicle is treated as section 38 property which is not a qualifying commuter highway vehicle for its entire useful life. The recomputed qualified investment for the vehicle is \$6,000 (60 percent of \$10,000) and X Corporation's recomputed credit earned is \$600 (10 percent of \$6,000). The income tax imposed by chapter 1 of the Code on X Corporation for 1984 is increased by the \$400 decrease in its credit earned for 1982 (\$1,000 - \$600).

(2) *Change in use*—(i) A qualifying commuter highway vehicle undergoes a change in use if the vehicle does not meet the commuter use requirement (as defined in § 1.46-11(d)) for each computation period.

(ii) Each of the following is a computation period:

(A) The period beginning on the date the vehicle was placed in service and ending on the last day of the taxpayer's taxable year in which the vehicle was placed in service;

(B) Each of the taxpayer's taxable years beginning after the date the vehicle was placed in service and ending before the end of the first 36 months after the vehicle was placed in service; and

(C) The period ending at the end of the first 36 months after the vehicle was placed in service and beginning on the first day of the taxpayer's taxable year in which the end of those first 36 months falls.

(iii) The following example illustrates this paragraph (m)(2).

Example. (a) Z Corporation, a calendar year taxpayer, acquired and placed in service a qualifying commuter highway vehicle on January 15, 1979. Z Corporation used the vehicle as set forth in the following table:

Taxable year ending	Total miles	Commuter miles	Ratio
1979	10,000	9,000	.90
1980	10,000	8,000	.80
1981	10,000	8,000	.80
1982 (1-14)	1,000	100	.10

(b) The first computation period begins on the date the vehicle is placed in service, in this example 1-15-79, and ends 12-31-79. In

that computation period, the ratio of commuter miles to total miles is .90 (9,000 miles÷10,000 miles). Therefore, the vehicle meets the commuter use requirement for that period and has not undergone a change in use. Similar calculations for the computation periods 1-1-80 to 12-31-80 and 1-1-81 to 12-31-81 produce the same result.

(c) As of the computation period beginning 1-1-82 and ending 1-14-82, the ratio of commuter use to total mileage is .10 (100 miles ÷1,000 miles). Since that ratio is less than .80, the vehicle does not meet the commuter use requirement for the period and the vehicle has undergone a change in use.

(Secs. 38(b) (76 Stat. 963, 26 U.S.C. 38(b)), 48(1)(16) (94 Stat. 264, 26 U.S.C. 48(1)(16)), and 7805 (68A Stat. 917, 26 U.S.C. 7805))

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§ 1.47-2 “Disposition” and “Cessation”.

(a) *General rule*—(1) “Disposition”. For purposes of this section and § 1.47-1 and §§ 1.47-3 through 1.47-6, the term “disposition” includes a sale in a sale-and-leaseback transaction, a transfer upon the foreclosure of a security interest and a gift, but such term does not include a mere transfer of title to a creditor upon creation of a security interest. See paragraph (g) of § 1.47-3 for treatment of certain sale-and-leaseback transactions.

(2) “Cessation”. (i) A determination of whether section 38 property ceases to be section 38 property with respect to the taxpayer must be made for each taxable year subsequent to the credit year. Thus, in each such taxable year the taxpayer must determine, as if such property were placed in service in such taxable year, whether such property would qualify as section 38 property (within the meaning of § 1.48-1) in the hands of the taxpayer for such taxable year.

(ii) Section 38 property does not cease to be section 38 property with respect to the taxpayer in any taxable year subsequent to the credit year merely because under the taxpayer's depreciation practice no deduction for depreciation with respect to such property is allowable to the taxpayer for the taxable year, provided that the

property continues to be used in the taxpayer's trade or business (or in the production of income) and otherwise qualifies as section 38 property with respect to the taxpayer.

(iii) This subparagraph may be illustrated by the following examples:

Example 1. A, an individual who makes his returns on the basis of the calendar year, on January 1, 1962, acquired and placed in service in his trade or business an item of section 38 property with an estimated useful life of eight years. On January 1, 1965, A removes the item of section 38 property from use in his trade or business by converting such item to personal use. Therefore no deduction for depreciation with respect to such item of property is allowable to A for the taxable year 1965. On January 1, 1965, such item of property ceases to be section 38 property with respect to A.

Example 2. On January 1, 1965, A placed in service an item of section 38 property with a basis of \$10,000 and an estimated useful life of 4 years. A depreciates such item, which has a salvage value of \$2,000 (after taking into account section 167(f)), on the declining balance method at a rate of 50 percent (that is, twice the straight line rate of 25 percent). With respect to such item, A is allowed deductions for depreciation of \$5,000 for 1965, \$2,500 for 1966, and \$500 for 1967. A is not allowed a deduction for depreciation for 1968 although he continues to use such item in his trade or business. Such item does not cease to be section 38 property with respect to A in 1968.

(b) *Leased property*—(1) *In general.* For purposes of paragraph (a) of § 1.47-1, generally the mere leasing of section 38 property by a lessor who took the basis of such property into account in computing his qualified investment for the credit year shall not be considered to be a disposition. However, in a case where a lease is treated as a sale for income tax purposes such transaction is considered to be a disposition. Leased section 38 property ceases to be section 38 property with respect to the lessor if, in any taxable year subsequent to the credit year, such property would not qualify as section 38 property (as defined in § 1.48-1) in the hands of the lessor, the lessee, or any sublessee. Thus, if, in a taxable year subsequent to the credit year, a lessee uses the property predominantly outside the United States, such property shall be considered to have ceased to be section 38 property with respect to the lessor.

(2) *Where lessor elects to treat lessee as purchaser.* For purposes of paragraph (a) of § 1.47-1, if, under § 1.48-4, the lessor of new section 38 property made a valid election to treat the lessee as having purchased such property for purposes of the credit allowed by section 38, the following rules apply in determining whether such property is disposed of, or otherwise ceases to be section 38 property with respect to the lessee:

(i) Generally, a mere disposition by the lessor of property subject to a lease shall not be considered to be a disposition by the lessee.

(ii) If the lessor makes a disposition of property subject to a lease to a person who may not, under § 1.48-4, make a valid election to treat the lessee as having purchased such property for purposes of the credit allowed by section 38 (such as a person described in paragraph (a)(5) of § 1.48-4), such property shall be considered to have ceased to be section 38 property with respect to the lessee on the date of such disposition.

(iii) If a lease is terminated and the property is transferred by the lessee to the lessor or to any other person, such transfer shall be considered to be a disposition by the lessee.

(iv) If the lessee actually purchases such property in the credit year or in a taxable year subsequent to the credit year, such purchase shall not be considered to be a disposition.

(v) The property ceases to be section 38 property with respect to the lessee if in any taxable year subsequent to the credit year such property would not qualify as section 38 property (as defined in § 1.48-1) in the hands of the lessor, the lessee, or any sublessee. Thus, for example, if, in a taxable year subsequent to the credit year, a sublessee uses the property predominantly outside the United States, the property ceases to be section 38 property with respect to the lessee.

(c) *Reduction in basis of section 38 property*—(1) *General rule.* If, in the credit year or in any taxable year subsequent to the credit year, the basis (or cost) of section 38 property is reduced, for example, as a result of a refund of part of the cost of the property, then

such section 38 property shall be treated as having ceased to be section 38 property with respect to the taxpayer to the extent of the amount of such reduction in basis (or cost) on the date the refund which results in such reduction in basis (or cost) is received or accrued, except that for purposes of § 1.47-1(a) the actual useful life of the property treated as having ceased to be section 38 property shall be considered to be less than 3 years.

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

Example. (i) On January 1, 1962, A, a cash basis taxpayer, acquired from X Cooperative an item of section 38 property with a basis of \$100 and an estimated useful life of 10 years which he placed in service on such date. The amount of qualified investment with respect to such asset was \$100. For the taxable year 1962 A was allowed under section 38 a credit of \$7 against his liability for tax. On June 1, 1963, A receives a \$10 patronage dividend from X Cooperative with respect to such asset. Under paragraph (c)(2)(i) of § 1.1385-1, the basis of the asset in A's hands is reduced by \$10.

(ii) Under subparagraph (1) of this paragraph, on June 1, 1963, the item of section 38 property ceases to be section 38 property with respect to A to the extent of \$10 of the original \$100 basis.

(d) *Retirements.* A retirement of section 38 property, including a normal retirement (as defined in paragraph (b) of § 1.167(a)-8, relating to definition of normal and abnormal retirements), whether from a single asset account or a multiple asset account, and an abandonment, are dispositions for purposes of paragraph (a) of § 1.47-1.

(e) *Conversion of section 38 property to personal use.* (1) If, for any taxable year subsequent to the credit year—

(i) A deduction for depreciation is allowable to the taxpayer with respect to only a part of section 38 property because such property is partially devoted to personal use, and

(ii) The part of the property (expressed as a percentage of its total basis (or cost)) with respect to which a deduction for depreciation is allowable for such taxable year is less than the part of the property with respect to which a deduction for depreciation was allowable in the credit year,

then such property shall be considered as having ceased to be section 38 property with respect to the taxpayer to such extent. Further, property ceases to be section 38 property with respect to the taxpayer to the extent that a deduction for depreciation thereon is disallowed under section 274 (relating to disallowance of certain entertainment, etc., expenses).

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

Example 1. (i) A, a calendar-year taxpayer, acquired and placed in service on January 1, 1962, an automobile with a basis of \$2,400 and an estimated useful life of four years. In the taxable year 1962 the automobile was used by A 80 percent of the time in his trade or business and was used 20 percent of the time for personal purposes. Thus, for the taxable year 1962 only 80 percent of the basis of the automobile qualified as section 38 property since a deduction for depreciation was allowable to A only with respect to 80 percent of the basis of the automobile. In the taxable year 1963 the automobile is used by A only 60 percent of the time in his trade or business. Thus, for the taxable year 1963 a deduction for depreciation is allowable to A only with respect to 60 percent of the basis of the automobile.

(ii) Under subparagraph (1) of this paragraph, on January 1, 1963, the automobile ceases to be section 38 property with respect to A to the extent of 20 percent (80 percent minus 60 percent) of the \$2,400 basis of the automobile.

Example 2. (i) The facts are the same as in example 1 and in addition for the taxable year 1964 a deduction for depreciation is allowable to A only with respect to 40 percent of the basis of the property.

(ii) Under subparagraph (1) of this paragraph, on January 1, 1964, the automobile ceases to be section 38 property with respect to A to the extent of 20 percent (60 percent minus 40 percent) of the \$2,400 basis of the automobile.

[T.D. 6931, 32 FR 14032, Oct. 10, 1967, as amended by T.D. 7203, 37 FR 17128, Aug. 25, 1972]

§ 1.47-3 Exceptions to the application of § 1.47-1.

(a) *In general.* Notwithstanding the provisions of § 1.47-2, relating to “disposition” and “cessation,” paragraph (a) of § 1.47-1 shall not apply if paragraph (b) of this section (relating to transfers by reason of death), paragraph (c) of this section (relating to