

3 is zero (\$15,000 share of basis multiplied by zero applicable percentage) and for the taxable year 1962 each shareholder's recomputed credit earned is \$1,050 (7 percent of \$15,000). The income tax imposed by chapter 1 of the Code on each of the shareholders for the taxable year 1965 is increased by the \$1,050 decrease in his credit earned for the taxable year 1962 (that is, \$2,100 original credit earned minus \$1,050 recomputed credit earned).

*Example 2.* (i) On December 3, 1964, shareholder A sells 5 of his 10 shares of stock in X Corporation to C, and on December 3, 1965, A sells his remaining 5 shares of stock to D. In addition, on January 2, 1966, X Corporation sells asset No. 3 to Y Corporation.

(ii) Under paragraph (a)(2) of this section, on December 3, 1964, 50 percent of the share of the basis of each of the three items of section 38 property ceases to be section 38 property with respect to shareholder A since immediately after the December 3, 1964, sale A's proportionate stock interest in X Corporation is reduced to 50 percent of the proportionate stock interest in X Corporation which he held on December 31, 1962. The actual useful life of the share of the bases of the section 38 properties which cease to be section 38 property with respect to A is two years and six months (that is, the period beginning with June 1, 1962, and ending with December 3, 1964). A's recomputed qualified investment with respect to such properties is \$15,000, computed as follows:

Basis	Applicable percentage	Recomputed qualified investment
\$7,500 .....	33⅓%	\$2,500
\$7,500 .....	66⅔%	5,000
\$7,500 .....	100	7,500
		15,000

For the taxable year 1962 shareholder A's recomputed credit earned is \$1,050 (7 percent of \$15,000). The income tax imposed by chapter 1 of the Code on shareholder A for the taxable year 1964 is increased by the \$1,050 decrease in his credit earned for the taxable year 1962 (that is, \$2,100 original credit earned minus \$1,050 recomputed credit earned).

(iii) Under paragraph (a)(2) of this section, on December 3, 1965, the remaining 50 percent of the share of the basis of each of the three items of section 38 property ceases to be section 38 property with respect to shareholder A since immediately after the December 3, 1965, sale A's proportionate stock interest in X Corporation is reduced to zero. The actual useful life of the share of the bases of the section 38 properties which cease to be section 38 property with respect to A is three years and six months (that is, the pe-

riod beginning with June 1, 1962, and ending with December 3, 1965). A's recomputed qualified investment with respect to such properties is zero. For the taxable year 1962 shareholder A's recomputed credit earned is zero. The income tax imposed by chapter 1 of the Code on shareholder A for the taxable year 1965 is increased by \$1,050 (that is, \$2,100 original credit earned minus zero recomputed credit earned) reduced by the \$1,050 increase in tax for 1964).

(iv) The actual useful life of asset No. 3 which was sold on January 2, 1966, is three years and seven months. The recomputed qualified investment with respect to B's share of the basis of asset No. 3 is zero (\$15,000 share of basis multiplied by zero applicable percentage) and for the taxable year 1962, B's recomputed credit earned is \$1,050 (7 percent of \$15,000). The income tax imposed by chapter 1 of the Code on shareholder B for the taxable year 1966 is increased by the \$1,050 decrease in his credit earned for the taxable year 1962 (\$2,100 original credit earned minus \$1,050 recomputed credit earned). The sale of asset No. 3 on January 2, 1966, by X Corporation has no effect on A.

(d) *Termination or revocation of an election under section 1372.* Section 38 property shall not be considered to be disposed of or to have ceased to be section 38 property solely by reason of a termination or revocation of a corporation's election under section 1372.

[T.D. 6931, 32 FR 14035, Oct. 10, 1967]

**§ 1.47-5 Estates and trusts.**

(a) *In general*—(1) *Disposition or cessation in hands of estate or trust.* If an estate or trust disposes of any section 38 property (or if any section 38 property otherwise ceases to be section 38 property in the hands of the estate or trust) before the close of the estimated useful life which was taken into account in computing qualified investment with respect to such property, a recapture determination shall be made with respect to the estate or trust, and each beneficiary who is treated, under § 1.48-6, as a taxpayer with respect to such property. Each such recapture determination shall be made with respect to the share of the basis (or cost) of such property taken into account by such estate or trust and such beneficiary in computing its or his each such recapture determination the actual useful life of such property shall be the period beginning with the date on which it was placed in service by

the estate or trust and ending with the date of the disposition or cessation. In making a recapture determination under this subparagraph with respect to a taxpayer there shall be taken into account any prior recapture determinations made with respect to such taxpayer in connection with the same property. For definition of "recapture determination" see paragraph (a)(1) of § 1.47-1.

(2) *Disposition of interest.* (i) If—

(a) The basis (or cost) of section 38 property is apportioned, under § 1.48-6, to an estate or trust which, or to a beneficiary of an estate or trust who, takes such basis (or cost) into account in computing his qualified investment, and

(b) After the date on which such section 38 property was placed in service by the estate or trust and before the close of the estimated useful life of the property, such estate's, trust's, or such beneficiary's proportionate interest in the income of the estate or trust is reduced (for example, by a sale, or by the terms of the estate or trust instrument) below the percentage specified in subdivision (ii) of this subparagraph, then, on the date of such reduction, such section 38 property ceases to be section 38 property with respect to such estate, trust, or beneficiary to the extent of the actual reduction in such estate's, trust's, or beneficiary's proportionate interest in the income of the estate or trust. (For example, if \$100 of the basis of section 38 property was apportioned to a beneficiary and if his proportionate interest in the income of the estate or trust is reduced from 60 percent to 30 percent (that is, 50 percent of his original interest), then such property shall be treated as having ceased to be section 38 property to the extent of \$50). Accordingly, a recapture determination shall be made with respect to such estate, trust, or beneficiary. For purposes of such recapture determination the actual useful life of such property shall be the period beginning with the date on which it was placed in service by the estate or trust and ending with the date on which it is treated as having ceased to be section 38 property with respect to the estate, trust, or beneficiary. In making a recapture determination

under this subparagraph there shall be taken into account any prior recapture determination made with respect to the estate, trust, or beneficiary in connection with the same property.

(ii) The percentage referred to in subdivision (i)(b) of this subparagraph is 66⅔ percent of the estate's, trust's, or beneficiary's proportionate interest in the income of the estate or trust for the taxable year of the apportionment under § 1.48-6. However, once property has been treated under this subparagraph as having ceased to be section 38 property to any extent the percentage referred to shall be 33⅓ percent of the estate's, trust's, or beneficiary's proportionate interest in the income of the estate or trust for the taxable year of the apportionment under § 1.48-6.

(iii) In determining a beneficiary's proportionate interest in the income of an estate or trust for purposes of this subparagraph, the beneficiary shall be considered to own any interest in such an estate or trust which he owns directly or indirectly (through ownership in other entities provided such other entities' bases in such interest are determined in whole or in part by reference to the basis of such interest in the hands of the beneficiary). For example, if A, whose proportionate interest in the income of trust X is 30 percent, transfers all of such interest to corporation Y in exchange for all of the stock of Y in a transaction to which section 351 applies, then, for purposes of subdivision (i) of this subparagraph, A shall be considered to own a 30-percent interest in trust X. Any taxpayer who seeks to establish his interest in an estate or trust under the rule of this subdivision shall maintain adequate records to demonstrate his indirect interest in the estate or trust after any such transfer or transfers.

(b) *Examples.* Paragraph (a) of this section may be illustrated by the following examples in each of which it is assumed that XYZ Trust, which makes its returns on the basis of the calendar year, acquired and placed in service on June 1, 1962, three items of section 38 property. The basis and estimated useful life of each item of section 38 property are as follows:

Internal Revenue Service, Treasury

§ 1.47-5

Asset No.	Basis	Estimated useful life (Years)
1 .....	\$30,000	4
2 .....	30,000	6
3 .....	30,000	8

For the taxable year 1962 the income of XYZ Trust is \$20,000, which is allocable equally to XYZ Trust and beneficiary A. Beneficiary A makes his returns on the basis of a calendar year. Under §1.48-6, the total bases of the section 38 properties was apportioned to XYZ Trust and beneficiary A as follows:

		Useful life category		
		4 to 6 years	6 to 8 years	8 years or more
Total bases .....		\$30,000	\$30,000	\$30,000
XYZ Trust .....	(\$10,000)	15,000	15,000	15,000
Beneficiary A .....	(\$20,000)	15,000	15,000	15,000
	(\$10,000)			
	(\$20,000)			

Assuming that during 1962 beneficiary A did not place in service any section 38 property and that he did not own any interests in other estates, trusts, electing small business corporations, or partnerships, the qualified investment of XYZ Trust and of beneficiary A is \$30,000 each, computed as follows:

Basis	Applicable percentage	Qualified investment
\$15,000 .....	33 $\frac{1}{3}$ %	\$5,000
\$15,000 .....	66 $\frac{2}{3}$ %	10,000
\$15,000 .....	100	15,000
		30,000

For the taxable year 1962, XYZ Trust and beneficiary A each had a credit earned of \$2,100 (7 percent of \$30,000). Each such credit earned was allowed under section 38 as a credit against the liability for tax.

*Example 1.* (i) On December 2, 1965, XYZ Trust sells asset No. 3 to X Corporation.

(ii) The actual useful life of asset No. 3 is three years and six months. The recomputed qualified investment with respect to XYZ Trust's and beneficiary A's share of the basis of asset No. 3 is zero (\$15,000 share of basis multiplied by zero applicable percentage) and for the taxable year 1962, XYZ Trust's and beneficiary A's recomputed credit earned is \$1,050 (7 percent of \$15,000). The income tax imposed by chapter 1 of the Code on XYZ Trust and on beneficiary A for the taxable year 1965 is increased by the \$1,050 decrease in his credit earned for the taxable year 1962 (that is, \$2,100 original credit earned minus \$1,050 recomputed credit earned).

*Example 2.* (i) On December 3, 1964, beneficiary A sells 50 percent of his interest in the income of XYZ Trust to B, and on December 3, 1965, A sells his remaining 50 percent interest to C. In addition, on January 2,

1966, XYZ Trust sells asset No. 3 to Y Corporation.

(ii) Under paragraph (a)(2) of this section, on December 3, 1964, 50 percent of the basis of each of the three items of section 38 property ceases to be section 38 property with respect to beneficiary A since immediately after the December 3, 1964, sale A's proportionate interest in the income of XYZ Trust is reduced to 50 percent of his proportionate interest in the income of XYZ Trust for the taxable year 1962. The actual useful life of the share of the bases of the section 38 properties which cease to be section 38 property with respect to A is two years and six months (that is, the period beginning with June 1, 1962, and ending with December 3, 1964). Beneficiary A's recomputed qualified investment with respect to such properties is \$15,000, computed as follows:

Basis	Applicable percentage	Qualified investment
\$7,500 .....	33 $\frac{1}{3}$ %	\$2,500
\$7,500 .....	66 $\frac{2}{3}$ %	5,000
\$7,500 .....	100	7,500
		15,000

For the taxable year 1962 beneficiary A's recomputed credit earned is \$1,050 (7 percent of \$15,000). The income tax imposed by chapter 1 of the Code on beneficiary A for the taxable year 1964 is increased by the \$1,050 decrease in his credit earned for the taxable year 1962 (that is, \$2,100 original credit earned minus \$1,050 recomputed credit earned).

(iii) Under paragraph (a)(2) of this section, on December 3, 1965, the remaining 50 percent of the share of the basis of each of the three items of section 38 property ceases to be section 38 property with respect to beneficiary A since immediately after the December 3, 1965, sale A's proportionate interest in the income of XYZ Trust is reduced to zero.

The actual useful life of the share of the basis of the section 38 properties which cease to be section 38 property with respect to A is three years and six months (that is, the period beginning with June 1, 1962, and ending with December 3, 1965). A's recomputed qualified investment with respect to such properties is zero. For the taxable year 1962 beneficiary A's recomputed credit earned is zero. The income tax imposed by chapter 1 of the Code on beneficiary A for the taxable year 1965 is increased by \$1,050 (that is, \$2,100 (\$2,100 original credit earned minus zero recomputed credit earned) reduced by the \$1,050 increase in tax for 1964).

(iv) The actual useful life of asset No. 3 which was sold on January 2, 1966, is three years and seven months. The recomputed qualified investment with respect to XYZ Trust's share of the basis of asset No. 3 is zero (\$15,000 share of basis multiplied by zero applicable percentage) and for the taxable year 1962, XYZ Trust's recomputed credit earned is \$1,050 (7 percent of \$15,000). The income tax imposed by chapter 1 of the Code on XYZ Trust for the taxable year 1966 is increased by the \$1,050 decrease in its credit earned for the taxable year 1962 (\$2,100 original credit earned minus \$1,050 recomputed credit earned). The sale of asset No. 3 on January 2, 1966, has no effect on A.

[T.D. 6931, 32 FR 14037, Oct. 10, 1967]

#### § 1.47-6 Partnerships.

(a) *In general*—(1) *Disposition or cessation in hands of partnership.* If a partnership disposes of any partnership section 38 property (or if any partnership section 38 property otherwise ceases to be section 38 property in the hands of the partnership) before the close of the estimated useful life which was taken into account in computing qualified investment with respect to such property, a recapture determination shall be made with respect to each partner who is treated, under paragraph (f) of § 1.46-3, as a taxpayer with respect to such property. Each such recapture determination shall be made with respect to the share of the basis (or cost) of such property taken into account by such partner in computing his qualified investment. For purposes of each such recapture determination the actual useful life of such property shall be the period beginning with the date on which it was placed in service by the partnership and ending with the date of the disposition or cessation. In making a recapture determination under this subparagraph there shall be taken into

account any prior recapture determinations made with respect to the partner in connection with the same property. For definition of "recapture determination" see paragraph (a)(1) of § 1.47-1.

(2) *Disposition of partner's interest.* (i) If—

(a) The basis (or cost) of partnership section 38 property is taken into account by a partner in computing his qualified investment, and

(b) After the date on which such partnership section 38 property was placed in service by the partnership and before the close of the estimated useful life of the property, such partner's proportionate interest in the general profits of the partnership (or in the particular item of property) is reduced (for example, by a sale, by a change in the partnership agreement, or by the admission of a new partner) below the percentage specified in subdivision (ii) of this subparagraph, then, on the date of such reduction such partnership section 38 property ceases to be section 38 property with respect to such partner to the extent of the actual reduction in such partner's proportionate interest in the general profits of the partnership (or in the particular item of property). (For example, if \$100 of the basis of section 38 property was taken into account by a partner and if his proportionate interest in the general profits of the partnership is reduced from 60 percent to 30 percent (that is, 50 percent of his original interest), then such property shall be treated as having ceased to be section 38 property to the extent of \$50.) Accordingly, a recapture determination shall be made with respect to such partner. For purposes of such recapture determination the actual useful life of such property shall be the period beginning with the date on which it was placed in service by the partnership and ending with the date on which it is treated as having ceased to be section 38 property with respect to the partner. In making a recapture determination under this subparagraph there shall be taken into account any prior recapture determination made with respect to the partner in connection with the same property.

(ii) The percentage referred to in subdivision (i)(b) of this subparagraph is