

**§ 1.48-2 New section 38 property.**

(a) *In general.* Section 48(b) defines “new section 38 property” as section 38 property—

(1) The construction, reconstruction, or erection of which is completed by the taxpayer after December 31, 1961, or

(2) Which is acquired by the taxpayer after December 31, 1961, provided that the original use of such property commences with the taxpayer and commences after such date.

In the case of construction, reconstruction, or erection of such property commenced before January 1, 1962, and completed after December 31, 1961, 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 December 31, 1961. See § 1.48-1 for the definition of section 38 property.

(b) *Special rules for determining date of acquisition, original use, and basis attributable to construction, reconstruction, or erection.* For purposes of paragraph (a) of this section, the principles set forth in paragraphs (a) (1) and (2) of § 1.167(c)-1 shall be applied. Thus, for example, the following rules are applicable:

(1) Property is considered as constructed, reconstructed, or erected by the taxpayer if the work is done for him in accordance with his specifications.

(2) The portion of the basis of property attributable to construction, reconstruction, or erection after December 31, 1961, consists of all costs of construction, reconstruction, or erection allocable to the period after December 31, 1961, including the cost or other basis of materials entering into such work (but not including, in the case of reconstruction of property, the adjusted basis of the reconstructed property as of the time such reconstruction is commenced).

(3) It is not necessary that materials entering into construction, reconstruction, or erection be acquired after December 31, 1961, or that they be new in use.

(4) If construction or erection by the taxpayer began after December 31, 1961, the entire cost or other basis of such construction or erection may be taken

into account as the basis of new section 38 property.

(5) Construction, reconstruction, or erection by the taxpayer begins when physical work is started on such construction, reconstruction, or erection.

(6) Property shall be deemed to be acquired when reduced to physical possession, or control.

(7) The term “original use” means the first use to which the property is put, whether or not such use corresponds to the use of such property by the taxpayer. For example, a reconditioned or rebuilt machine acquired by the taxpayer will not be treated as being put to original use by the taxpayer. The question of whether property is reconditioned or rebuilt property is a question of fact. Property will not be treated as reconditioned or rebuilt merely because it contains some used parts.

If the cost of reconstruction may properly either be capitalized and recovered through depreciation or charged against the depreciation reserve, such cost may be taken into account as the basis of new section 38 property even though it is charged against the depreciation reserve.

(c) *Examples.* This section may be illustrated by the following examples:

*Example 1.* If a machine with a total cost of \$100,000 is completed after December 31, 1961, and the portion attributable to construction by the taxpayer after December 31, 1961, is determined by engineering estimates or by cost accounting records to be \$30,000, the \$30,000 amount shall be taken into account by the taxpayer in computing qualified investment in new section 38 property.

*Example 2.* In 1965, a taxpayer reconditions a machine, which he constructed and placed in service in 1962 and which has an adjusted basis in 1965 of \$10,000. The cost of reconditioning amounts to an additional \$20,000. The basis of the machine which shall be taken into account in computing qualified investment in new section 38 property for 1965 is \$20,000, whether he contracts to have it reconditioned or reconditions it himself, and irrespective of whether the materials used for reconditioning are new in use.

*Example 3.* In 1961, a taxpayer pays the entire purchase price of \$10,000 for section 38 property to be delivered in 1962. In 1962 he takes possession of the property and commences the original use of the asset in that year. The \$10,000 amount shall be taken into account in computing qualified investment in new section 38 property for 1962.

*Example 4.* A taxpayer, instead of reconditioning his old machine, buys a “factory reconditioned” or “rebuilt” machine in 1962 to replace it. The reconditioned or rebuilt machine is not new section 38 property since such taxpayer is not the first user of the machine. See, however, § 1.48-3 (relating to used section 38 property).

*Example 5.* In 1962, a taxpayer buys from X for \$20,000 an item of section 38 property which has been previously used by X. The taxpayer in 1962 makes an expenditure on the property of \$5,000 of the type that must be capitalized. Regardless of whether the \$5,000 is added to the basis of such property or is capitalized in a separate account, such amount shall be taken into account by the taxpayer in computing qualified investment in new section 38 property for 1962. No part of the \$20,000 purchase price may be taken into account for such purpose. See, however, § 1.48-3 (relating to used section 38 property).

(d) *Special rule for qualified rehabilitated buildings.* Notwithstanding the rules in paragraphs (a) through (c) of this section, that portion of the basis of a qualified rehabilitated building attributable to qualified rehabilitation expenditures is treated as new section 38 property. See section 48(a)(1)(E) and (g), and § 1.48-11.

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#### § 1.48-3 Used section 38 property.

(a) *In general.* (1) Section 48(c) provides that “used section 38 property” means section 38 property acquired by purchase after December 31, 1961, which is not “new section 38 property.” See §§ 1.48-1 and 1.48-2, respectively, for definitions of section 38 property and new section 38 property. In determining whether property is acquired by purchase, the provisions of paragraph (c)(1) of § 1.179-3 shall apply, except that (i) “1961” shall be substituted for “1957”, and (ii) the definition of “component member” of a controlled group of corporations in paragraph (d)(4) of this section shall be substituted for the definition of such term in paragraph (e) of § 1.179-3.

(2)(i) Property shall not qualify as used section 38 property if, after its acquisition by the taxpayer, it is used by (a) a person who used such property before such acquisition, or (b) a person who bears a relationship described in section 179(d)(2) (A) or (B) to a person who used such property before such ac-

quisition. Thus, for example, if property is used by a person and is later sold by him under a sale and lease-back arrangement, such property in the hands of the purchaser-lessor is not used section 38 property because the property, after its acquisition, is being used by the same person who used it before its acquisition. Similarly, where a lessee has been leasing property and subsequently purchases it (whether or not the lease contains an option to purchase), such property is not used section 38 property with respect to the purchaser because the property is being used by the same person who used it before its acquisition. In addition, if property owned by a lessor is sold subject to the lease, or is sold upon the termination of the lease, the property will not qualify as used section 38 property with respect to the purchaser if, after the purchase, the property is used by a person who used the property as a lessee before the purchase.

(ii) For purposes of applying subdivision (i) of this subparagraph, property shall not be considered as used by a person before its acquisition if such property was used only on a casual basis by such person.

(iii) In determining whether a person bears a relationship described in section 179(d)(2) (A) or (B) to a person who used property before its acquisition by the taxpayer, the provisions of paragraphs (c)(1) (i) and (ii) of § 1.179-3 shall apply, except that the definition of “component member” of a controlled group of corporations in paragraph (d)(4) of this section shall be substituted for the definition of such term in paragraph (e) of § 1.179-3.

(3) The provisions of this paragraph may be illustrated by the following examples:

*Example 1.* Corporation P acquires properties 1 and 2 in 1960 and uses them in its trade or business until 1962. In 1962, corporation P sells such properties to corporation Y, which leases back property 1 to corporation P and leases property 2 to corporation S, a wholly owned subsidiary of corporation P. Property 1 is not used section 38 property in the hands of corporation Y because, after its acquisition by corporation Y, it is used by a person (corporation P) who used it prior to such acquisition. Property 2 is not used section 38 property because, after its acquisition by corporation Y, it is used by a person