

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

(corporation S) who is related, within the meaning of section 179(d)(2)(B), to a person (corporation P) who used it before such acquisition.

Example 2. In 1962, corporation L leases property from corporation M. In 1964, corporation L acquires the property that it previously had been leasing. The property acquired by corporation L is not used section 38 property because such property is used after such acquisition by the same person (corporation L) who used the property before its acquisition (corporation L).

Example 3. Corporation X buys property in 1962 and leases such property to corporation Y. Corporation X in 1965 sells the property to A subject to the lease. The property acquired by A is not used section 38 property if such property continues to be used by corporation Y, because corporation Y used the property before its acquisition by A.

Example 4. A owns a bulldozer which he rents out to a number of different users, including B. In 1962, B used the bulldozer from February 16 to March 12 and again on October 15 and 16. B purchases the bulldozer from A on December 1, 1962. The prior use of the property by B does not disqualify such property as used section 38 property to B, because he used such property only on a casual basis prior to its purchase.

(b) *Cost.* (1) The cost of used section 38 property is equal to the basis of such property, but does not include so much of such basis as is determined by reference to the adjusted basis of other property (whether or not section 38 property) held at any time by the taxpayer acquiring such used section 38 property.

(2) If property (whether or not section 38 property) is disposed of by the taxpayer (other than by reason of its destruction or damage by fire, storm, shipwreck, or other casualty, or its theft) and used section 38 property similar or related in service or use is acquired as a replacement therefor in a transaction in which the basis of the replacement property is not determined by reference to the adjusted basis of the property replaced, then the cost of the used section 38 property so acquired shall be its basis reduced by the adjusted basis of the property replaced. The preceding sentence shall apply only if the taxpayer acquires (or enters into a contract to acquire) the replacement property within a period of 60 days before or after the date of the disposition.

(3) Notwithstanding subparagraphs (1) and (2) of this paragraph, the cost of used section 38 property shall not be reduced with respect to the adjusted basis of any property disposed of if, by reason of section 47, such disposition resulted in an increase of tax or a reduction of investment credit carrybacks or carryovers described in section 46(b).

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

Example 1. In 1972, A acquires machine 2 (an item of used section 38 property which has a sales price of \$5,600) by trading in machine 1 (an item of section 38 property acquired in 1962), and by paying an additional \$4,000 cash. The adjusted basis of machine 1 is \$1,600. Under the provisions of sections 1012 and 1031(d), the basis of machine 2 is \$5,600 (\$1,600 adjusted basis of machine 1 plus cash expended of \$4,000). The cost of machine 2 which may be taken into account in computing qualified investment for 1972 is \$4,000 (basis of \$5,600 less \$1,600 adjusted basis of machine 1).

Example 2. The facts are the same as in example 1 except that machine 2 has a sales price of \$6,000. The trade-in allowance on machine 1 is \$2,000. The result is the same as in example 1, that is, the basis of machine 2 is \$5,600 (\$1,600 plus \$4,000); therefore, the cost of machine 2 which may be taken into account in computing qualified investment for 1972 is \$4,000 (basis of \$5,600 less \$1,600 adjusted basis of machine 1).

Example 3. On September 18, 1962, B sells truck 1, which he acquired in 1961 and which has an adjusted basis in his hands of \$1,200. On October 15, 1962, he purchases for \$2,000 truck 2 (an item of used section 38 property) as a replacement therefor. The cost of truck 2 which may be taken into account in computing qualified investment is \$800 (\$2,000 less \$1,200).

Example 4. In 1962, C acquires property 1, an item of new section 38 property with a basis of \$12,000 and a useful life of eight years or more. He is allowed a credit under section 38 of \$840 (7 percent of \$12,000) with respect to such property. In 1968, C acquires property 2 (an item of used section 38 property) by trading in property 1 and by paying an additional amount in cash. Section 47(a) applies to the disposition of property 1 and C's tax liability for 1968 is increased by \$280. Since the application of section 47(a) results in an increase in tax, for purposes of computing qualified investment the cost of property 2 is not reduced by any part of the adjusted basis of the property traded in.

(c) *Dollar limitation*—(1) *In general.* Section 48(c)(2) provides that the aggregate cost of used section 38 property which may be taken into account for any taxable year in computing qualified investment under section 46(c)(1)(B) shall not exceed \$50,000. If the total cost of used section 38 property exceeds \$50,000, there must be selected, in the manner provided in subparagraph (4) of this paragraph, the particular items of used section 38 property the cost of which is to be taken into account in computing qualified investment. The cost of used section 38 property that may be taken into account by a person in applying the \$50,000 limitation for any taxable year includes not only the cost of used section 38 property placed in service by such person during such taxable year, but also the cost of used section 38 property apportioned to such person. For purposes of this section, the cost of used section 38 property apportioned to any person means the cost of such property apportioned to him by a trust, estate, or electing small business corporation (as defined in section 1371(b)), and his share of the cost of partnership used section 38 property, with respect to the taxable year of such trust, estate, corporation or partnership ending with or within such person's taxable year. Thus, if an individual places in service during his taxable year used section 38 property with a cost of \$25,000, if the cost of used section 38 property apportioned to him by an electing small business corporation for such year is \$30,000, and if his share for such year of the cost of used section 38 property placed in service by a partnership is \$20,000, he may select from the used section 38 property with a total cost of \$75,000 the particular used section 38 property the cost of which he wishes to take into account. No part of the excess of \$25,000 (\$75,000 cost minus \$50,000 annual limitation) may be taken into account in any other taxable year. For determining the amount of the cost to be apportioned by an electing small business corporation, see paragraph (a)(2) of § 1.48-5; in the case of estates and trusts, see paragraph (a)(2) of § 1.48-6. See paragraph (e) of this section for application of

\$50,000 limitation in the case of affiliated groups.

(2) *Married individuals filing separate returns.* In the case of a husband or wife who files a separate return, the aggregate cost of used section 38 property which may be taken into account for the taxable year to which such return relates cannot exceed \$25,000. The preceding sentence shall not apply, however, unless the taxpayer's spouse places in service (or is apportioned the cost of) used section 38 property for the taxable year of such spouse which ends with or within the taxpayer's taxable year. Thus, if a husband and wife who file separate returns on a calendar year basis both place in service used section 38 property during the taxable year, the maximum cost of used section 38 property which may be taken into account by each is \$25,000. However, in such case, if only one spouse places in service (or is apportioned the cost of) used section 38 property during the taxable year, such spouse may take into account a maximum of \$50,000 for such year. The determination of whether an individual is married shall be made under the principles of section 143 and the regulations thereunder.

(3) *Partnerships.* In the case of a partnership, the aggregate cost of used section 38 property placed in service by the partnership (or apportioned to the partnership) which may be taken into account by the partners with respect to any taxable year of the partnership may not exceed \$50,000. If such aggregate cost exceeds \$50,000, the partnership must make a selection in the manner provided in subparagraph (4) of this paragraph. The \$50,000 limitation applies to each partner, as well as to the partnership.

(4) *Selection of \$50,000 cost.* (i) If the sum of (a) the cost of used section 38 property placed in service during the taxable year by any person, (b) such person's share of the cost of partnership used section 38 property placed in service during the taxable year of a partnership ending with or within such person's taxable year, and (c) the cost of used section 38 property apportioned to such person for such taxable year by an electing small business corporation, estate, or trust, exceeds \$50,000, such person must make a selection for such

taxable year in the manner provided in subdivision (ii) of this subparagraph.

(ii) For purposes of computing qualified investment (or, in the case of a partnership, electing small business corporation, estate, or trust, for purposes of selecting used section 38 property the cost of which may be taken into account by the partners, shareholders, or estate or trust and its beneficiaries) any person to whom subdivision (i) of this subparagraph applies must select a total cost of \$50,000 from (a) the cost of specific used section 38 property placed in service by such person, (b) such person's share of the cost of specific used section 38 property placed in service by a partnership and (c) the cost of used section 38 property apportioned to such person by an electing small business corporation, estate, or trust. When a particular property is selected, the entire cost (or entire share of cost of a particular property in the case of partnership property) of such property must be taken into account unless, as a result of the selection of such particular property, the \$50,000 limitation is exceeded. Likewise, in the case of an apportionment from an electing small business corporation, estate, or trust, when the cost in a particular useful life category is selected, the entire cost in such category must be taken into account unless, as a result of the selection of such cost, the \$50,000 limitation is exceeded. Thus, if a person places in service during the taxable year three items of used section 38 property, each with a cost of \$20,000, he must select the entire cost of two of the items and only \$10,000 of the cost of the third item; he may not select a portion of the cost of each of the three items. The selection by any person shall be made by taking the cost of used section 38 property into account in computing qualified investment (or in selecting the used section 38 property the cost of which may be taken into account by the partners, etc.), and if such property was placed in service by such person, he must maintain records which permit specific

identification of any item of used section 38 property selected.

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

Example 1. H, who operates a sole proprietorship, purchases and places in service in 1963 used section 38 property with a cost of \$60,000. His spouse, W, is a shareholder in an electing small business corporation which purchases and places in service during its fiscal year ending June 30, 1963, used section 38 property with a cost of \$50,000. Both spouses file separate returns on a calendar year basis. W, as a 60 percent shareholder on the last day of the taxable year of the corporation, is apportioned \$30,000 (60 percent of \$50,000) of the cost of the used section 38 property placed in service by the corporation. The cost of used section 38 property that may be taken into account by H on his separate return is \$25,000. The cost of used section 38 property that may be taken into account by W on her separate return is \$25,000. On the other hand, if the corporation had made no investment in used section 38 property, H could take \$50,000 of the \$60,000 cost into account.

Example 2. Partners X, Y, and Z share the profits and losses of partnership XYZ in the ratio of 50 percent, 30 percent, and 20 percent, respectively. The partnership and each partner make returns on the basis of the calendar year. Each partner also operates a sole proprietorship. In 1963, the partnership and the partners purchase and place in service the following used section 38 property:

Property	Estimated useful life (years)	Cost
Partnership XYZ		
Property No. 1	9	\$10,000
Property No. 2	7	50,000
Property No. 3	7	50,000
Property No. 4	5	30,000
Partner X		
Property No. 5	6	30,000
Partner Y		
Property No. 6	10	60,000
Partner Z		
Property No. 7	4	36,000

(i) *Selection by partnership.* In accordance with subparagraph (4)(ii) of this paragraph, the partnership selects property No. 1 and \$40,000 of the cost of property No. 2 to be taken into account. Therefore, each partner's share of cost of the property selected by the partnership is as follows:

Property No.	Estimated useful life (years)	Selected cost	Partner's share of cost		
			X (50%)	Y (30%)	Z (20%)
1	9	\$10,000	\$5,000	\$3,000	\$2,000

Property No.	Estimated useful life (years)	Selected cost	Partner's share of cost		
			X (50%)	Y (30%)	Z (20%)
2	7	40,000	20,000	12,000	8,000
Total		50,000	25,000	15,000	10,000

(ii) *Selection by partners.* In accordance with subparagraph (4)(ii) of this paragraph, the partners make the following selections: Partner X selects property No. 5 (\$30,000), his share of the cost of property No. 1 (\$5,000), and \$15,000 of his share of the cost of property No. 2. Partner Y selects \$50,000 of the cost of property No. 6, and no part of his share of the cost of partnership property.

Partner Z, having an aggregate cost of used section 38 property of only \$46,000 (partnership property of \$10,000 and individually owned property of \$36,000), takes into account the entire \$46,000.

(iii) *Qualified investment of partner X.* X's total qualified investment in used section 38 property for 1963 is \$35,000, computed as follows:

Property No.	Estimated useful life (years)	Selected cost	Applicable percentage	Qualified investment
1	9	\$5,000	100	\$5,000
2	7	15,000	66⅔	10,000
5	6	30,000	66⅔	20,000
Total		50,000		35,000

(iv) *Qualified investment of partner Y.* Y's total qualified investment in used section 38 property for 1963 is \$50,000 (100 percent of \$50,000) since he selected \$50,000 of the cost of property No. 6 which has a useful life of 8 years or more.

(v) *Qualified investment of partner Z.* Z's total qualified investment in used section 38 property for 1963 is \$19,333, computed as follows:

Property No.	Estimated useful life (years)	Selected cost	Applicable percentage	Qualified investment
1	9	\$2,000	100	\$2,000
2	7	8,000	66⅔	5,333
7	4	36,000	33⅓	12,000
Total		46,000		19,333

(d) *Dollar limitation for component members of a controlled group—(1) In general.* (i) Section 48(c)(2)(C) provides that the \$50,000 limitation on the cost of used section 38 property which may be taken into account for any taxable year shall, in the case of component members of a controlled group (as defined in subparagraph (4) of this paragraph) on a particular December 31, be reduced for each such member by apportioning the \$50,000 amount among such component members for their taxable years that include such December 31 in accordance with their respective amounts of used section 38 property which may be taken into account, that is, in accordance with the total cost of

used section 38 property placed in service by each such member during its taxable year (without regard to the \$50,000 limitation or the applicable percentages to be applied in computing qualified investment).

(ii) Except as otherwise provided in this paragraph, the \$50,000 amount shall be apportioned among those corporations which are component members of the controlled group on a December 31. For the taxable year of each such member which includes such December 31, the cost of used section 38 property taken into account in computing qualified investment under section 46(c)(1)(B) shall not exceed the amount which bears the same ratio to

\$50,000 as the cost of used section 38 property placed in service by such member for such taxable year bears to the total cost of used section 38 property placed in service by all component members of the controlled group for their taxable years which include such December 31.

(iii) If a component member of the group makes its income tax return on the basis of a 52-53-week taxable year, the principles of section 441(f)(2)(A)(ii) and paragraph (b)(1) of § 1.441-2 apply in determining the last day of such a taxable year.

(2) *Statement by the "filing member"*. For purposes of this paragraph, the term "filing member" with respect to a particular December 31 means the member (or members) of a controlled group which has, among those members of the group which are apportioned part of the \$50,000 amount for their taxable years which include such December 31, the taxable year including such December 31 which ends on the earliest date. The filing member of the group shall attach to its income tax return a statement containing the name, address, and employer identification number of each component member of the controlled group on such December 31 and a schedule showing the computation of the apportionment of the \$50,000 amount among the component members of the group. Each such other member shall retain as part of its records a copy of the statement containing the apportionment schedule. Except as otherwise provided in subparagraph (3)(ii) of this paragraph, each member which is apportioned part of the \$50,000 amount shall take such apportioned amount into account in filing its return for its taxable year which includes such December 31.

(3) *Estimate of used section 38 property to be placed in service.* (i) For purposes of subparagraphs (1) and (2) of this paragraph, if on the date (including extensions of time) for filing the income tax return of the filing member of the group with respect to a particular December 31, the total cost of used section 38 property actually placed in service by any component member of the group during such member's taxable year that includes such December 31 is not known, then such member

shall estimate such cost. The estimate shall be made on the basis of the facts and circumstances known as of the time of the estimate. Any such estimate shall also be used in determining the total cost of used section 38 property placed in service by all component members for their taxable years including such December 31.

(ii) If an estimate is used by any component member of a controlled group pursuant to subdivision (i) of this subparagraph, each member may later file an original or amended return in which the apportionment of the \$50,000 amount is based upon the cost of used section 38 property actually placed in service by all component members of the group during their taxable year which include such December 31. Such amended apportionment shall be made only if each component member of the group whose limitation would be changed files an original or amended return which reflects the amended apportionment based upon the cost of the used section 38 property actually placed in service by component members of the group. In such case, the new statement reflecting the amended apportionment shall be attached to the amended return of the filing member of the group, and a copy of such statement shall be retained by each such member pursuant to the requirements of subparagraph (2) of this paragraph.

(4) *Definitions of controlled group of corporations and component member of controlled group.* For purposes of this section, the terms "controlled group of corporations" and "component member" of a controlled group of corporations shall have the same meaning assigned to those terms in section 1563 (a) and (b), except that the phrase "more than 50 percent" shall be substituted for the phrase "at least 80 percent" each place it appears in section 1563(a)(1). For purposes of applying § 1.1563-1(b)(2)(ii)(c), an electing small business corporation shall be treated as an excluded member whether or not it is subject to the tax imposed by section 1378.

(5) *Members of controlled group filing a consolidated return.* For the purpose of apportioning the \$50,000 amount in the

case of component members of a controlled group which join in filing a consolidated return, all such members shall be treated as though they were a single component member of the controlled group. Thus, in determining the limitation on the cost of used section 38 property which may be taken into account by the group filing the consolidated return, the apportionment provided in subparagraph (1)(ii) of this paragraph shall be made by using the aggregate cost of such property placed in service by all members of the group filing the consolidated return. If all component members of the controlled group join in filing a consolidated return, the group may select the items to be taken into account to the extent of an aggregate cost of \$50,000; if some component members of the controlled group do not join in filing the consolidated return, then the members of the group which join in filing the consolidated return may select the items to be taken into account to the extent of the amount apportioned to such members under subparagraph (1)(ii) of this paragraph.

(6) *Examples.* This paragraph may be illustrated by the following examples:

Example 1. (i) On December 31, 1970, corporations M, N, and O are component members of the same controlled group. The taxable years of M, N, and O end, respectively, on January 31, March 31, and April 30. During the respective taxable years of each corporation which include December 31, 1970, M places in service no used section 38 property, and N and O place in service used section 38 property with respective costs of \$100,000 and \$150,000. N is the "filing member" of the group since N, among the members (N and O) which are apportioned part of the \$50,000 amount for their taxable years which include such December 31, has the taxable year ending on the earliest date.

(ii) The cost of used section 38 property taken into account by N for its taxable year ending March 31, 1971, may not exceed \$20,000, that is, an amount which bears the same ratio to \$50,000 as the cost of used section 38 property placed in service by N for its taxable year (\$100,000) bears to the total cost of used section 38 property placed in service by all component members of the controlled group (M, N, and O) for their taxable years which include December 31, 1970 (\$250,000). Similarly, the cost of used section 38 property taken into account by O for its taxable year ending April 30, 1971, may not exceed \$30,000.

Example 2. (i) On December 31, 1971, corporations S and T are component members of the same controlled group. The taxable years of corporations S and T end, respectively, on January 31 and June 30. On April 15, 1972, S files an income tax return for its taxable year ending January 31, 1972, during which year it places in service used section 38 property costing \$100,000. T estimates that it will place in service used section 38 property costing \$150,000 during its taxable year ending June 30, 1972.

(ii) S, the "filing member" of the group, must file an apportionment schedule under which it may take into account as the cost of used section 38 property an amount not in excess of \$20,000 ($\$100,000/\$250,000 \times \$50,000$). If T actually places in service during its taxable year used section 38 property costing more or less than \$150,000, its income tax return for its taxable year ending June 30, 1972, may reflect the amended apportionment of the \$50,000 limitation based upon the cost of used section 38 property actually placed in service by the group, provided that S attaches a new apportionment schedule to an amended return to reflect the amended apportionment. For example, if T places in service used section 38 property costing \$200,000, the cost of used section 38 property taken into account by S and T for their respective taxable years could not exceed \$16,667 ($\$100,000/\$300,000 \times \$50,000$) and \$33,333 ($\$200,000/\$300,000 \times \$50,000$), respectively, under an amended apportionment.

(Secs. 38(b) and 7805 of the Internal Revenue Code of 1954 (76 Stat. 962, U.S.C. 38(b); 68A Stat. 917; 26 U.S.C. 7805)

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§ 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