

life of the property used in making the decreases in rental deductions, the amount of the increase in rental deductions described in subdivision (i) of this subparagraph and not previously taken into account shall be allowed as a deduction for the taxable year in which such termination occurs.

(v) The rental deductions with respect to any section 38 property are not to be increased under this paragraph if the lessee dies in a taxable year beginning before January 1, 1964.

(vi) The increase in rental deductions described in subdivision (i) of this subparagraph shall ordinarily be taken into account by the lessee treated as the purchaser, that is, the lessee entitled to the credit. However, if the property under the lease is transferred by the lessee to a successor lessee in a transaction described in section 47(b) (other than a transfer by reason of death) under which the successor lessee assumes the lessee's obligations under the lease, such increase in rental deductions shall be taken into account by the successor lessee in the manner prescribed in this paragraph.

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

Example 1. (a) X Corporation acquired on January 1, 1962, an item of new section 38 property with a basis of \$24,000 and with a useful life to the lessor of 10 years. Y Corporation, which makes its returns on the basis of a calendar year, leased such property from X Corporation and placed it in service on January 2, 1962. Under this section, X Corporation made a valid election to treat Y Corporation as having purchased such property for purposes of the credit allowed by section 38 and supplied the lessee with information that the property had a useful life of 10 years. The amount of the credit earned with respect to such property was \$1,680 (7 percent of \$24,000). For each of the taxable years 1962 and 1963, Y Corporation decreased, under paragraph (k)(2) of this section, its deductions otherwise allowable under section 162 with respect to such property by \$168 (\$1,680 multiplied by $\frac{1}{10}$).

(b) For each of the taxable years 1964 through 1971, Y Corporation increases its deductions otherwise allowable under section 162 for amounts paid to X Corporation under the lease by \$42 (\$336 (that is, \$168 multiplied by 2) divided by the remaining useful life of 8 years).

Example 2. (a) The facts are the same as in example 1 except that the lease is terminated on January 3, 1965.

(b) For the taxable year 1964, Y Corporation increases its deductions otherwise allowable under section 162 by \$42.

(c) For the taxable year 1965, Y Corporation increases its deductions otherwise allowable under section 162 for the portion of the increase which had not been taken into account as of the time of the termination of the lease. Thus, the amount of such increase for the taxable year 1965 is \$294 (\$336 minus \$42).

(Sec. 38, 76 Stat. 963; 26 U.S.C. 38)

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§ 1.48-5 Electing small business corporations.

(a) *In general.* (1) In the case of an electing small business corporation (as defined in section 1371(b)), the basis of "new section 38 property" and the cost of "used section 38 property" placed in service during the taxable year shall be apportioned pro rata among the persons who are shareholders of such corporation on the last day of such corporation's taxable year. Section 38 property shall not (by reason of such apportionment) lose its character as new section 38 property or used section 38 property, as the case may be. The estimated useful life of such property in the hands of a shareholder shall be deemed to be the estimated useful life of such property in the hands of the electing small business corporation. The bases of all new section 38 properties which have a useful life falling within a particular useful life category shall be aggregated; likewise, the cost of all used section 38 properties which have a useful life falling within a particular useful life category shall be aggregated. The total bases of new section 38 properties within each useful life category and the total cost of used section 38 properties within each useful life category shall be apportioned separately. 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. There shall be apportioned to each person who is a shareholder of the electing small business corporation on the last

day of the taxable year of such corporation, for his taxable year in which or with which the taxable year of such corporation ends, his pro rata share of the total bases of new section 38 properties within each useful life category, and his pro rata share of the total cost of used section 38 properties within each useful life category. In determining who are shareholders of an electing small business corporation on the last day of its taxable year, the rules of paragraph (d)(1) of § 1.1371-1 and of paragraph (a)(2) of § 1.1373-1 shall apply.

(2) The total cost of used section 38 property that may be apportioned by an electing small business corporation to its shareholders for any taxable year of such corporation shall not exceed \$50,000. If the total cost of used section 38 property placed in service during the taxable year by the electing small business corporation exceeds \$50,000 such corporation must select, under paragraph (c)(4) of § 1.48-3, the used section 38 property the cost of which is to be apportioned to its shareholders.

(3) A shareholder to whom the basis (or cost) of section 38 property is apportioned shall, for purposes of the credit allowed by section 38, be treated as the taxpayer with respect to such property. Thus, the total cost of used section 38 property apportioned to him by the electing small business corporation must be taken into account as cost of used section 38 property in determining whether the \$50,000 limitation on the cost of used section 38 property which may be taken into account by the shareholder in computing qualified investment for any taxable year is exceeded. If a shareholder takes into

account in determining his qualified investment any portion of the basis (or cost) of section 38 property placed in service by an electing small business corporation and if such property subsequently is disposed of or otherwise ceases to be section 38 property in the hands of the corporation, such shareholder shall be subject to the provisions of section 47. See § 1.47-4.

(b) *Summary statement.* An electing small business corporation shall attach to its return a statement showing the apportionment to each shareholder of the total bases of new, and the total cost of used, section 38 properties within each useful life category.

(c) *Example.* This section may be illustrated by the following example:

Example. 1 X Corporation, an electing small business corporation which makes its return on the basis of the calendar year, acquires and places in service on June 1, 1962, three new assets which qualify as new section 38 property and three used assets which qualify as used section 38 property. The basis of each new, and the cost of each used, section 38 property and the estimated useful life of each property are as follows:

Asset No.	Basis (or cost)	Estimated useful life
1 (new)	\$30,000	4 years.
2 (new)	30,000	4 years.
3 (new)	30,000	8 years.
4 (used)	12,000	6 years.
5 (used)	12,000	6 years.
6 (used)	12,000	8 years.

On December 31, 1962, X Corporation has 10 shares of stock outstanding which are owned as follows: A owns 3 shares, B owns 2 shares, and C owns 5 shares.

(2) Under this section, the total bases of the new, and the total cost of the used, section 38 properties are apportioned to the shareholders of X Corporation as follows:

Useful life category	New—4 to 6 years	New—8 years or more	Used—6 to 8 years	Used—8 years or more
Total bases or total cost	\$60,000	\$30,000	\$24,000	\$12,000
Shareholder A (3/10)	18,000	9,000	7,200	3,600
Shareholder B (2/10)	12,000	6,000	4,800	2,400
Shareholder C (5/10)	30,000	15,000	12,000	6,000

Assume that shareholders A, B and C did not place in service during their taxable years in which falls December 31, 1962 (the last day of X Corporation's taxable year) any section 38 property and that such shareholders did not own any interests in other electing small

business corporations, partnerships, estates, or trusts. Under section 46(c), the qualified investment of shareholder A is \$23,400, of shareholder B is \$15,600, and of shareholder C is \$39,000, computed as follows:

Basis (or cost)	Applicable percentage	Qualified investment
SHAREHOLDER A		
\$18,000 (new)	33 $\frac{1}{3}$	\$6,000
\$9,000 (new)	100	9,000
\$7,200 (used)	66 $\frac{2}{3}$	4,800
\$3,600 (used)	100	3,600
Total		23,400
SHAREHOLDER B		
\$12,000 (new)	33 $\frac{1}{3}$	\$4,000
\$6,000 (new)	100	6,000
\$4,800 (used)	66 $\frac{2}{3}$	3,200
\$2,400 (used)	100	2,400
Total		15,600
SHAREHOLDER C		
\$30,000 (new)	33 $\frac{1}{3}$	\$10,000
\$15,000 (new)	100	15,000
\$12,000 (used)	66 $\frac{2}{3}$	8,000
\$6,000 (used)	100	6,000
Total		39,000

[T.D. 6731, 29 FR 6082, May 8, 1964, as amended by T.D. 6931, 32 FR 14040, Oct. 10, 1967; T.D. 7203, 37 FR 17133, Aug. 25, 1972]

§ 1.48-6 Estates and trusts.

(a) *In general.* (1) In the case of an estate or trust, the basis of "new section 38 property" and the cost of "used section 38 property" placed in service during the taxable year shall be apportioned among the estate or trust and its beneficiaries on the basis of the income of such estate or trust allocable to each. Section 38 property shall not (by reason of such apportionment) lose its character as new section 38 property or used section 38 property, as the case may be. The estimated useful life of such property in the hands of a beneficiary shall be deemed to be the estimated useful life of such property in the hands of the estate or trust. The bases of all new section 38 properties which have a useful life falling within a particular useful life category shall be aggregated; likewise, the cost of all used section 38 properties which have a useful life falling within a particular useful life category shall be aggregated. The total bases of new section 38 properties within each useful life category and the total cost of used section 38 properties within each useful life category shall be apportioned separately. 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. There shall be apportioned to the estate or trust for its taxable year, and to each beneficiary of such estate or trust for his taxable year in which or with which the taxable year of such estate or trust ends, his share (as determined under paragraph (b) of this section) of the total bases of new section 38 properties within each useful life category, and his share of the total cost of used section 38 properties within each useful life category.

(2) The total cost of used section 38 property that may be apportioned among an estate or trust and its beneficiaries for any taxable year of such estate or trust shall not exceed \$50,000. If the total cost of used section 38 property placed in service during the taxable year by the estate or trust exceeds \$50,000, such estate or trust must select, under paragraph (c)(4) of § 1.48-3, the used section 38 property the cost of which is to be apportioned among such estate or trust and its beneficiaries.

(3) A beneficiary to whom the basis (or cost) of section 38 property is apportioned shall, for purposes of the credit allowed by section 38, be treated as the taxpayer with respect to such property. Thus, the total cost of used section 38 property apportioned to him by the estate or trust must be taken into account as cost of used section 38 property in determining whether the \$50,000 limitation on the cost of used property which may be taken into account by the beneficiary in computing qualified investment for any taxable year is exceeded. If a beneficiary takes into account in determining his qualified investment any portion of the basis (or cost) of section 38 property placed in service by an estate or trust and if such property subsequently is disposed of or otherwise ceases to be section 38 property in the hands of estate or trust, such beneficiary shall be subject to the provisions of section 47. See § 1.47-5.

(4) For purposes of this section, the term "beneficiary" includes heir, legatee, and devisee.

(5) If during the taxable year of an estate or trust a beneficiary's interest in