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the taxpayer's purchase (or construction) costs of a new principal residence are less than the adjusted sales price (as defined in section 1034(b)) of the old residence, the tax imposed by chapter 1 of the Code for the taxable year following the taxable year during which disposition occurs is increased by an amount which bears the same ratio to the amount allowed as a credit for the purchase of the old residence as (i) the adjusted sales price of the old residence (within the meaning of section 1034), reduced (but not below zero) by the taxpayer's cost of purchasing (or constructing) the new residence (within the meaning of such section) bears to (ii) the adjusted sales price of the old residence.

(2) The rules of subparagraph (1) of this paragraph may be illustrated by the following example:

Example. On July 15, 1975, A purchases a new principal residence for a total purchase price of \$40,000. The property meets the tests of § 1.44-2, and A is allowed a credit of \$2,000 on his 1975 tax return. On January 15, 1977 (within 36 months after acquisition) A sells his residence for an adjusted sales price of \$50,000 and on March 15, 1977, purchases a new principal residence at a cost of \$40,000. Since the new principal residence was purchased within the 18-month replacement period (provided in section 1034), the amount recaptured is limited to \$400, determined by multiplying the amount of the credit allowed (\$2,000) by a fraction, the numerator of which is \$10,000 (determined by reducing the adjusted sales price of the old residence (\$50,000) by A's cost of purchasing the new principal residence (\$40,000)) and the denominator of which is \$50,000 (the adjusted sales price). Therefore, A's tax liability for 1978, the year following the taxable year in which the disposition occurred, is increased by \$400.

(c) *Certain involuntary dispositions.* Section 44(d)(1) and paragraph (a) of this section shall not apply to the following:

(1) A disposition of a residence made on account of the death of any individual having a legal or equitable interest therein occurring during the 36-month period described in paragraph (a) of this section,

(2) A disposition of the residence if it is substantially or completely destroyed by a casualty described in section 165(c)(3),

(3) A disposition of the residence if it is compulsorily and involuntarily con-

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verted within the meaning of section 1033(a), or

(4) A disposition of the residence pursuant to a settlement in a divorce or legal separation proceeding where the other spouse retains the residence as principal residence (as defined in § 1.44-5(a)).

[T.D. 7391, 40 FR 55854, Dec. 2, 1975; 40 FR 58138, Dec. 15, 1975]

§ 1.44-5 Definitions.

For purposes of section 44 and the regulations thereunder—

(a) *New principal residence.* The term "new principal residence" means a principal residence, the original use of which commences with the taxpayer. The term "principal residence" has the same meaning as under section 1034 of the Code. For this purpose, the term "residence" includes, without being limited to, a single family structure, a residential unit in a condominium or cooperative housing project, a townhouse, and a factory-made home. In the case of a tenant-stockholder in a cooperative housing corporation references to property used by the taxpayer as his principal residence and references to the residence of a taxpayer shall include stock held by the tenant-stockholder in a cooperative housing project provided, however, that the taxpayer used as his principal residence the house or apartment which he was entitled as such stockholder to occupy. "Original use" of the new principal residence by the taxpayer means that such residence has never been used as a residence prior to its use as such by the taxpayer. For this purpose, a residence will qualify if the first occupancy was by the taxpayer pursuant to a lease arrangement pending settlement under a binding contract to purchase or pursuant to a lease arrangement where a written option to purchase the then existing residence was contained in the original lease agreement.

A renovated building does not qualify as new, regardless of the extent of the renovation nor does a condominium conversion qualify.

(b) *Purchase price*—(1) *General rule.* For purposes of section 44(a) and § 1.44-1, the term "purchase price" means the

adjusted basis of the new principal residence on the date of acquisition and includes all amounts attributable to the acquisition or construction, but only to the extent that such amounts constitute capital expenditures and are not allowable as deductions in computing taxable income. Such capital expenditures include but are not limited to the cost of acquisition or construction, title insurance, attorney's fees, transfer taxes, and other costs of transfer. For these purposes the adjusted basis of a factory-made home includes the cost of moving the home and setting it up as the taxpayer's principal residence only where such cost is included in the base price of the residence; it also includes the purchase price of the land on which the home is located, but only if such land was purchased by the taxpayer after March 12, 1975 and only if the taxpayer acquired the land prior to or in conjunction with the acquisition of such factory-made home. However, the adjusted basis does not include any expenditures involved in connection with the leasing of land on which the factory-made home is located. In the case of factory-made homes the adjusted basis includes furniture only where it is included in the base price of the unit.

(2) *Sale of old principal residence.* (i) The adjusted basis is reduced by any gain from the sale or involuntary conversion of an old principal residence, which is not recognized due to the application of section 1033 or section 1034. However, no reduction will be made for any gain excluded from tax by reason of the special treatment provided under the tax laws in the case of a sale by a taxpayer who has attained age 65 (section 121 of the code).

(ii) The rules in subdivision (i) of this subparagraph are illustrated by the following examples:

Example 1. A sells an old principal residence for \$30,000 which has an adjusted basis of \$20,000. A reinvests the proceeds by purchasing a new principal residence for \$40,000 (including settlement costs which are capital in nature), and this purchase satisfies the statutory criteria under section 1034 for nonrecognition of gain. The credit under section 44 applies with respect to \$30,000 (\$40,000 costs minus \$10,000 unrecognized gain) of the cost of the new principal residence.

Example 2. B and C, two sisters, purchase a new principal residence as joint tenants with the right of survivorship for a total purchase price of \$40,000. B has previously sold her old principal residence for \$25,000 and a \$10,000 gain on the sale has qualified for nonrecognition under section 1034. B contributes \$25,000 and C contributes \$15,000. The adjusted basis of the new principal residence is \$30,000 representing the total purchase price of \$40,000 less \$10,000 representing unrecognized gain under section 1034. The total credit allowable, therefore, is \$1,500. Since joint tenants are treated as equal owners and since allocation of the credit is made in proportion to the taxpayer's respective ownership interests in such residence B and C each will receive a credit of \$750.

Example 3. Taxpayer D is 65 years old and sells his old principal residence for \$20,000 excluding all gain under section 121. He then purchases a new principal residence for \$30,000. D's adjusted basis in his new principal residence is \$30,000, and he is allowed a credit of \$1,500.

(3) *Tie-in sales.* In the case of a purchase of a new principal residence which is tied in to the transfer of other property by the seller to the purchaser, whether purportedly by sale or gift, the adjusted basis of the residence is reduced by the amount of the excess of the fair market value of such other property received over the amount, if any, purportedly paid for it by the purchaser of the residence. For example, if a taxpayer receives a new car with a fair market value of \$2,500 upon the purchase of a condominium apartment for a total purchase price of \$40,000 (including settlement costs which are capital in nature) his adjusted basis in the residence for computation of the credit is \$37,500.

(4) *Basis of new principal residence.* The taxpayer's basis in his new principal residence is not in any way affected by the allowance of the credit.

(c) *Purchase—(1) General rule.* Except as provided in subparagraph (2) of this paragraph, the term "purchase" means any acquisition of property.

(2) *Exceptions.* (i) An acquisition does not qualify as a purchase for the purpose of this paragraph if the property is acquired from a person whose relationship to the person acquiring it would result in the disallowance of losses under section 267 or 707(b). Such persons include—

(A) The purchaser's spouse, ancestors and lineal descendants,

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(B) Related corporations as provided under section 267(b)(2),

(C) Related trusts as provided under section 267(b), (4), (5), (6), and (7),

(D) Related charitable organizations as provided under section 267(b)(9), and

(E) Related partnerships as provided under section 707(b)(1).

For purposes of this subdivision the constructive ownership rules of section 267(c) shall apply except that paragraph (4) of section 267(c) shall be treated as providing that the family of an individual shall include only his spouse, ancestors, and lineal descendants.

(ii) An acquisition does not qualify as a purchase for the purpose of this paragraph if the basis of the property in the hands of the person acquiring such property is determined—

(A) In whole or in part by reference to the adjusted basis of such property in the hands of the person from whom acquired (e.g., a gift under section 1015), or

(B) Under section 1014(a) (relating to property acquired from a decedent).

(d) *Self-construction.* The term “self-construction” means the construction of a residence (other than a factory-made home) to the taxpayer’s specifications on land already owned or leased by the taxpayer at the time of commencement of construction. Thus, where a taxpayer purchases land and either builds a residence himself or hires an architect and a contractor to build a residence on that land, the taxpayer has “self-constructed” the residence.

(e) *Factory-made home.* The term “factory-made homes” includes mobile homes, houseboats and prefabricated and modular homes.

(f) *Lowest offer.* The term “lowest offer” means the lowest price at which the residence was offered for sale after February 28, 1975.

[T.D. 7391, 40 FR 55855, Dec. 2, 1975]

§ 1.44A-1 Expenses for household and dependent care services necessary for gainful employment.

(a) *In general.* (1) This section applies only for expenses incurred in taxable years beginning after December 31, 1975. For deductibility of expenses incurred in taxable years beginning be-

fore January 1, 1972, see § 1.214-1. For deductibility of expenses incurred in taxable years beginning after December 31, 1971, and before January 1, 1976, see §§ 1.214A-1 through 1.214A-5.

(2) Section 44A allows a credit against the tax imposed by chapter 1 of the Code to an individual who maintains a household (within the meaning of paragraph (d) of this section) which includes as a member one or more qualifying individuals (as defined in paragraph (b) of this section). The amount of the credit is equal to the applicable percentage of the employment-related expenses (as defined in paragraph (c) of this section) paid by the individual during the taxable year (but subject to the limits prescribed in § 1.44A-2(a)). However, the credit cannot exceed the tax imposed by chapter 1, reduced by the sum of the allowable credits enumerated in section 44A(b). The term “applicable percentage” means 30 percent reduced by 1 percentage point for each \$2,000 (or fraction thereof) by which the taxpayer’s adjusted gross income for the taxable year exceeds \$10,000, but in no event shall the percent be less than 20 percent. Thus, for example, if a taxpayer’s adjusted gross income is over \$10,000, but less than \$12,000.01, the applicable percentage is 29 percent. (For expenses incurred in taxable years beginning before January 1, 1982, the applicable percentage is a flat 20 percent.)

(3) Generally, the credit for employment-related expenses is allowable, regardless of the taxpayer’s method of accounting, only for expenses which are actually paid during the taxable year and which are incurred during the taxable year or were incurred during a prior taxable year beginning after December 31, 1975. If the expenses are incurred but not paid during the taxable year, no credit may be taken for that year on account of those expenses. Thus, if an expense is incurred in the last month of a taxable year but not paid until the following taxable year, a credit for the expense is not allowed for the earlier taxable year but is allowed for the following taxable year. However, if an expense is incurred in a taxable year beginning before January 1, 1976, and paid in a later taxable year, no credit is allowed with respect to the