

sales or exchanges have been made for 5 years, under section 1237(c), and (2) more than 5 lots or parcels have been sold or exchanged from the same tract, under section 1237(b)(1). Thus, if the taxpayer sold 5 lots from a single tract in 1950, and another lot is sold in 1954, the lot sold in 1954 constitutes the *sixth* lot sold from the original tract. On the other hand, if the first 5 lots were sold in 1948, the sale made in 1954 shall be deemed to have been made from a new tract.

[T.D. 6500, 25 FR 12016, Nov. 26, 1960]

§ 1.1238-1 Amortization in excess of depreciation.

(a) *In general.* Section 1238 provides that if a taxpayer is entitled to a deduction for amortization of an emergency facility under section 168, and if the facility is later sold or exchanged, any gain realized shall be considered as ordinary income to the extent that the amortization deduction exceeds normal depreciation. Thus, under section 1238 gain from a sale or exchange of property shall be considered as ordinary income to the extent that its adjusted basis is less than its adjusted basis would be if it were determined without regard to section 168. If an entire facility is certified under section 168(e), the taxpayer may use allowances for depreciation based on any rate and method which would have been proper if the basis of the facility were not subject to amortization under section 168, in determining what the adjusted basis of the facility would be if it were determined without regard to section 168. If only a portion of a facility is certified under section 168(e), allowances for depreciation based on the rate and method properly used with respect to the uncertified part of the facility are used in determining what the adjusted basis of the facility would be if it were determined without regard to section 168. The principles of this paragraph may be illustrated by the following examples:

Example 1. On December 31, 1954, a taxpayer making his income tax returns on a calendar year basis acquires at a cost of \$20,000 an emergency facility (used in his business) 50 percent of the adjusted basis of which has been certified under section 168(e). The facility would normally have a useful life of 20

years and a salvage value of \$2,000 allocable equally between the certified and uncertified portions. Under section 168 the taxpayer elects to begin the 60-month amortization period on January 1, 1955. He takes amortization deductions with respect to the certified portion in the amount of \$4,000 for the years 1955 and 1956 (24 months). On December 31, 1956, he sells the facility for a price of \$19,000 which is allocable equally between the certified and uncertified portions. The adjusted basis of the certified portion on that date is \$6,000 (\$10,000 cost, less \$4,000 amortization). With respect to the uncertified portion, the straight line method of depreciation is used and a deduction for depreciation in the amount of \$450 is claimed and allowed for the year 1955. The adjusted basis of the uncertified portion on January 1, 1956, is \$9,550 (\$10,000 cost, less \$450 depreciation). The depreciation allowance for the uncertified portion for the year 1956 would be limited to \$50, the amount by which the adjusted basis of such portion at the beginning of the year exceeded its aliquot portion of the sales price. Thus, on December 31, 1956, the adjusted basis of the uncertified portion would be \$9,500. Without regard to section 168, and using the rate and method the taxpayer properly applied to the uncertified portion of the facility, the adjusted basis of the certified portion on December 31, 1956, would be \$9,500, computed in the same manner as the adjusted basis of the uncertified portion. The difference between the facility's actual adjusted basis (\$15,500) and its adjusted basis determined without regard to section 168 (\$19,000), is \$3,500. Accordingly, the entire \$3,500 gain on the sale of the facility (\$19,000 sale price, less \$15,500 adjusted basis) is treated as ordinary income.

Example 2. Assume that the entire facility in example (1) had been certified under section 168(e) and that, therefore, the adjusted basis of the facility on December 31, 1956, is \$12,000. Assume further that the taxpayer adopts straight line depreciation as a proper method of depreciation for determining the adjusted basis of the facility without regard to section 168. Thus, the adjusted basis, without regard to section 168, would be \$19,000. This amount is \$7,000 more than the \$12,000 adjusted basis under section 168. Hence, the entire \$7,000 gain on the sale of the facility (\$19,000 sale price less \$12,000 adjusted basis) is treated as ordinary income.

(b) *Substituted basis.* If a taxpayer acquires other property in an exchange for an emergency facility with respect to which amortization deductions have been allowed or allowable, and if the basis in his hands of the other property is determined by reference to the basis of the emergency facility, then the

basis of the other property is determined with regard to section 168, and therefore the provisions of section 1238 apply with respect to gain realized on a subsequent sale or exchange of the other property. The provisions of section 1238 also apply to gain realized on the sale or exchange of an emergency facility (or other property acquired, as described in the preceding sentence, in exchange for an emergency facility) by a taxpayer in whose hands the basis of the facility (or other property) is determined by reference to its basis in the hands of another person to whom deductions were allowable or allowed with respect to the facility under section 168.

[T.D. 6500, 25 FR 12020, Nov. 26, 1960, as amended by T.D. 6825, 30 FR 7281, June 2, 1965]

§ 1.1239-1 Gain from sale or exchange of depreciable property between certain related taxpayers after October 4, 1976.

(a) *In general.* In the case of a sale or exchange of property, directly or indirectly, between related persons after October 4, 1976 (other than a sale or exchange made under a binding contract entered into on or before that date), any gain recognized by the transferor shall be treated as ordinary income if such property is, in the hands of the transferee, subject to the allowance for depreciation provided in section 167. This rule also applies to property which would be subject to the allowance for depreciation provided in section 167 except that the purchaser has elected a different form of deduction, such as those allowed under sections 169, 188, and 191.

(b) *Related persons.* For purposes of paragraph (a) of this section, the term *related persons* means:

(1) A husband and wife,

(2) An individual and a corporation 80 percent or more in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual, or

(3) Two or more corporations 80 percent or more in value of the outstanding stock of each of which is owned, directly or indirectly, by or for the same individual.

(c) *Rules of construction—(1) Husband and wife.* For purposes of paragraph (b)(1) of this section, if on the date of the sale or exchange a taxpayer is legally separated from his spouse under an interlocutory decree of divorce, the taxpayer and his spouse shall not be treated as husband and wife, provided the sale or exchange is made pursuant to the decree and the decree subsequently becomes final. Thus, if pursuant to an interlocutory decree of divorce, an individual transfers depreciable property to his spouse and, because of this section, the gain recognized on the transfer of the property is treated as ordinary income, the individual may, if the interlocutory decree becomes final after his tax return has been filed, file a claim for a refund.

(2) *Sales between commonly controlled corporations.* In general, in the case of a sale or exchange of depreciable property between related corporations (within the meaning of paragraph (b)(3) of this section), gain which is treated as ordinary income by reason of this section shall be taxable to the transferor corporation rather than to a controlling shareholder. However, such gain shall be treated as ordinary income taxable to a controlling shareholder rather than the transferor corporation if the transferor corporation is used by a controlling shareholder as a mere conduit to make a sale to another controlled corporation, or the entity of the corporate transferor is otherwise properly disregarded for tax purposes. Sales between two or more corporations that are related within the meaning of paragraph (b)(3) of this section may also be subject to the rules of section 482 (relating to allocation of income between or among organizations, trades, or businesses which are commonly owned or controlled), and to rules requiring constructive dividend treatment to the controlling shareholder in appropriate circumstances.

(3) *Relationship determination for transfers made after January 6, 1983—taxpayer and an 80-percent owned entity.* For purposes of paragraph (b)(2) of this section with respect to transfers made after January 6, 1983—

(i) If the transferor is an entity, the transferee and such entity are related