

*Example 2.* Assume the same facts as in example (1) except that machine A is destroyed by fire, that \$5,000 in insurance proceeds are received of which \$4,000 is used to purchase machine B, and that Smith properly elects under section 1033(a)(3)(A) to limit recognition of gain. The result is the same as in example (1), that is, the amount of adjustments reflected in the adjusted basis of machine B is \$4,000 (\$5,000 minus \$1,000).

(iv) If more than one item of section 1245 property is acquired in a transaction referred to in subdivision (i) of this subparagraph, the total amount of the adjustments reflected in the adjusted bases of the items acquired shall be allocated to such items in proportion to their respective adjusted bases.

(5) *Property after a reduction in basis pursuant to election under section 1071 or application of section 1082(a)(2).* If the basis of section 1245 property is reduced pursuant to an election under section 1071 (relating to gain from sale or exchange to effectuate policies of F.C.C.), or the application of section 1082(a)(2) (relating to sale or exchange in obedience to order of S.E.C.), then immediately after the basis reduction the amount of the adjustments reflected in the adjusted basis of the property shall be the sum of:

(i) The amount of the adjustments reflected in the adjusted basis of the property immediately before the basis reduction (but after applying subparagraph (4) of this paragraph, if applicable), plus

(ii) The amount of gain which was not recognized under section 1245(a)(1) by reason of the reduction in the basis of the property. See paragraph (e)(1) of § 1.1245-4.

(6) *Partnership property after certain transactions.* (i) For the amount of adjustments reflected in the adjusted basis of property immediately after certain distributions of the property by a partnership to a partner, see section 1245(b)(6)(B).

(ii) If under paragraph (b)(3) of § 1.751-1 (relating to certain distributions of partnership property other than section 751 property treated as sales or exchanges) a partnership is treated as purchasing section 1245 property (or a portion thereof) from a distributee who relinquishes his interest in such property (or portion), then on the date of such purchase the amount of adjust-

ments reflected in the adjusted basis of such purchased property (or portion) shall be zero.

(iii) See paragraph (e)(3)(ii) of § 1.1245-1 for the amount of adjustments reflected in the adjusted basis of partnership property in respect of a partner who acquired his partnership interest in certain transactions when an election under section 754 (relating to optional adjustments to basis of partnership property) was in effect.

[T.D. 6832, 30 FR 8578, July 7, 1965, as amended by T.D. 7084, 36 FR 268, Jan. 8, 1971; T.D. 7141, 36 FR 18793, Sept. 22, 1971; 36 FR 19160, Sept. 30, 1971; T.D. 7564, 43 FR 40496, Sept. 12, 1978; T.D. 8121, 52 FR 414, Jan. 6, 1987]

#### § 1.1245-3 Definition of section 1245 property.

(a) *In general.* (1) The term *section 1245 property* means any property (other than livestock excluded by the effective date limitation in subparagraph (4) of this paragraph) which is or has been property of a character subject to the allowance for depreciation provided in section 167 and which is either:

(i) Personal property (within the meaning of paragraph (b) of this section),

(ii) Property described in section 1245(a)(3)(B) (see paragraph (c) of this section), or

(iii) An elevator or an escalator within the meaning of subparagraph (C) of section 48(a)(1) (relating to the definition of *section 38 property* for purposes of the investment credit), but without regard to the limitations in such subparagraph (C).

(2) If property is section 1245 property under a subdivision of subparagraph (1) of this paragraph, a leasehold of such property is also section 1245 property under such subdivision. Thus, for example, if A owns personal property which is section 1245 property under subparagraph (1)(i) of this paragraph, and if A leases the personal property to B, B's leasehold is also section 1245 property under such provision. For a further example, if C owns and leases to D for a single lump-sum payment of \$100,000 property consisting of land and a fully equipped factory building thereon, and if 40 percent of the fair market value of such property is properly allocable to section 1245 property, then 40

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percent of D's leasehold is also section 1245 property. A leasehold of land is not section 1245 property.

(3) Even though property may not be of a character subject to the allowance for depreciation in the hands of the taxpayer, such property may nevertheless be section 1245 property if the taxpayer's basis for the property is determined by reference to its basis in the hands of a prior owner of the property and such property was of a character subject to the allowance for depreciation in the hands of such prior owner, or if the taxpayer's basis for the property is determined by reference to the basis of other property which in the hands of the taxpayer was property of a character subject to the allowance for depreciation. Thus, for example, if a father uses an automobile in his trade or business during a period after December 31, 1961, and then gives the automobile to his son as a gift for the son's personal use, the automobile is section 1245 property in the hands of the son.

(4) Section 1245 property includes livestock, but only with respect to taxable years beginning after December 31, 1969. For purposes of section 1245, the term *livestock* includes horses, cattle, hogs, sheep, goats, and mink and other furbearing animals, irrespective of the use to which they are put or the purpose for which they are held.

(b) *Personal property defined.* The term *personal property* means:

(1) Tangible personal property (as defined in paragraph (c) of § 1.48-1, relating to the definition of *section 38 property* for purposes of the investment credit), and

(2) Intangible personal property.

(c) *Property described in section 1245(a)(3)(B).* (1) The term *property described in section 1245(a)(3)(B)* means tangible property of the requisite depreciable character other than personal property (and other than a building and its structural components), but only if there are adjustments reflected in the adjusted basis of the property (within the meaning of paragraph (a)(2) of § 1.1245-2) for a period during which such property (or other property):

(i) Was used as an integral part of manufacturing, production, or extraction, or as an integral part of furnishing transportation, communica-

tions, electrical energy, gas, water, or sewage disposal services by a person engaged in a trade or business of furnishing any such service, or

(ii) Constituted a research or storage facility used in connection with any of the foregoing activities.

Thus, even though during the period immediately preceding its disposition the property is not used as an integral part of an activity specified in subdivision (i) of this subparagraph and does not constitute a facility specified in subdivision (ii) of this subparagraph, such property is nevertheless property described in section 1245(a)(3)(B) if, for example, there are adjustments reflected in the adjusted basis of the property for a period during which the property was used as an integral part of manufacturing by the taxpayer or another taxpayer, or for a period during which other property (which was involuntarily converted into, or exchanged in a like kind exchange for, the property) was so used by the taxpayer or another taxpayer. For rules applicable to involuntary conversions and like kind exchanges, see paragraph (d)(3) of § 1.1245-4.

(2) The language used in subparagraph (1) (i) and (ii) of this paragraph shall have the same meaning as when used in paragraph (a) of § 1.48-1, and the terms *building* and *structural components* shall have the meanings assigned to those terms in paragraph (e) of § 1.48-1.

[T.D. 6832, 30 FR 8580, July 7, 1965, as amended by T.D. 7141, 36 FR 18794, Sept. 22, 1971]

§ 1.1245-4 Exceptions and limitations.

(a) *Exception for gifts—(1) General rule.* Section 1245(b)(1) provides that no gain shall be recognized under section 1245(a)(1) upon a disposition by gift. For purposes of this paragraph, the term *gift* means, except to the extent that subparagraph (3) of this paragraph applies, a transfer of property which, in the hands of the transferee, has a basis determined under the provisions of section 1015 (a) or (d) (relating to basis of property acquired by gifts). For reduction in amount of charitable contribution in case of a gift of section 1245 property, see section 170(e) and the regulations thereunder.