

§ 1.1249-1 Gain from certain sales or exchanges of patents, etc., to foreign corporations.

(a) *General rule.* Section 1249 provides that if gain is recognized from the sale or exchange after December 31, 1962, of a patent, an invention, model, or design (whether or not patented), a copyright, a secret formula or process, or any other similar property right (not including property such as goodwill, a trademark, or a trade brand) to any foreign corporation by any United States person (as defined in section 7701(a)(30)) which controls such foreign corporation, and if such gain would (but for the provisions of section 1249) be gain from the sale or exchange of a capital asset or of property described in section 1231, then such gain shall be considered as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231. Section 1249 applies only to gain recognized in taxable years beginning after December 31, 1962.

(b) *Control.* For purposes of paragraph (a) of this section, the term *control* means, with respect to any foreign corporation, the ownership, directly or indirectly, of stock possessing more than 50 percent of the total combined voting power of all classes of stock entitled to vote. For purposes of the preceding sentence, the rules for determining ownership of stock provided by section 958 (a) and (b), and the principles for determining percentage of total combined voting power owned by United States shareholders provided by paragraphs (b) and (c) of § 1.957-1, shall apply.

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§ 1.1250-1 Gain from dispositions of certain depreciable realty.

(a) *Dispositions after December 31, 1969—(1) Ordinary income.* (i) In general, section 1250(a)(1) provides that, upon a disposition of an item of section 1250 property after December 31, 1969, the applicable percentage of the lower of:

(a) The additional depreciation (as defined in § 1.1250-2) attributable to periods after December 31, 1969 in respect of the property, or

(b) The excess of the amount realized on a sale, exchange, or involuntary conversion (or the fair market value of

the property on any other disposition) over the adjusted basis of the property, shall be treated as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231 (that is, shall be recognized as ordinary income). The amount of such gain shall be determined separately for each item (see subparagraph (2)(ii) of this paragraph) of section 1250 property. If the amount determined under (b) of this subdivision exceeds the amount determined under (a) of this subdivision, then such excess shall be treated as provided in subdivision (ii) of this subparagraph. For relation of section 1250 to other provisions, see paragraph (c) of this section.

(ii) If the amount determined under subdivision (i)(b) of this subparagraph exceeds the amount determined under subdivision (i)(a) of this subparagraph, then the applicable percentage of the lower of:

(a) The additional depreciation attributable to periods before January 1, 1970, or

(b) Such excess, shall also be recognized as ordinary income.

(iii) If gain would be recognized upon a disposition of an item of section 1250 property under subdivisions (i) and (ii) of this subparagraph, and if section 1250(d) applies, then the gain recognized shall be considered as recognized first under subdivision (i) of this subparagraph. (See example (3)(i) of paragraph (c)(4) of § 1.1250-3.)

(2) *Meaning of terms.* (i) For purposes of section 1250, the term *disposition* shall have the same meaning as in paragraph (a)(3) of § 1.1245-1. *Section 1250 property* is, in general, depreciable real property other than section 1245 property. See paragraph (e) of this section. See paragraph (d)(1) of this section for meaning of the term *applicable percentage*. If, however, the property is considered to have two or more elements with separate periods (for example, because units thereof are placed in service on different dates, improvements are made to the property, or because of the application of paragraph (h) of § 1.1250-3), see the special rules of § 1.1250-5.

(ii) For purposes of applying section 1250, the facts and circumstances of each disposition shall be considered in determining what is the appropriate item of section 1250 property. In general, a building is an item of section 1250 property, but in an appropriate case more than one building may be treated as a single item. For example, if two or more buildings or structures on a single tract or parcel (or contiguous tracts or parcels) of land are operated as an integrated unit (as evidenced by their actual operation, management, financing, and accounting), they may be treated as a single item of section 1250 property. For the manner of determining whether an expenditure shall be treated as an addition to capital account of an item of section 1250 property or as a separate item of section 1250 property, see paragraph (d)(2)(iii) of § 1.1250-5.

(3) *Sale, exchange, or involuntary conversion after December 31, 1969.* (i) In the case of a disposition of section 1250 property by a sale, exchange, or involuntary conversion after December 31, 1969, the gain to which section 1250(a)(1) applies is the applicable percentage for the property (determined under paragraph (d)(1) of this section) multiplied by the lower of (a) the additional depreciation in respect of the property attributable to periods after December 31, 1969, or (b) the excess (referred to as *gain realized*) of the amount realized over the adjusted basis of the property.

(ii) In addition to gain recognized under section 1250(a)(1) and subdivision (i) of this subparagraph, gain may also be recognized under section 1250(a)(2) and this subdivision if the gain realized exceeds the additional depreciation attributable to periods after December 31, 1969. In such a case, the amount of gain recognized under section 1250(a)(2) and this subdivision is the applicable percentage for the property (determined under paragraph (d)(2) of this section) multiplied by the lower of (a) the additional depreciation attributable to periods before January 1, 1970, or (b) the excess (referred to as *remaining gain*) of the gain realized over the additional depreciation attributable to periods after December 31, 1969.

(iii) The provisions of this subparagraph may be illustrated by the following examples:

Example 1. Section 1250 property which has an adjusted basis of \$500,000 is sold for \$650,000 after December 31, 1969, and thus the gain realized is \$150,000. At the time of the sale the additional depreciation in respect of the property attributable to periods after December 31, 1969, is \$190,000 and the applicable percentage is 100 percent (paragraph (d)(1)(i)(e) of this section). Since the gain realized (\$150,000), is lower than the additional depreciation (\$190,000), the amount of gain recognized as ordinary income under section 1250(a)(1) is \$150,000 (that is, 100 percent of \$150,000). No gain is recognized under section 1250(a)(2).

Example 2. Section 1250 property which has an adjusted basis of \$440,000 is sold for \$500,000 on December 31, 1974, and thus the gain realized is \$60,000. The property was acquired on March 31, 1966. At the time of the sale, the additional depreciation attributable to periods after December 31, 1969, is \$20,000, and the additional depreciation attributable to periods before January 1, 1970, is \$60,000. The property qualified as residential rental property for each taxable year ending after December 31, 1969, and the applicable percentage is 95 percent (paragraph (d)(1)(i)(c) of this section). The applicable percentage under paragraph (d)(2) of this section is 15 percent. Since the additional depreciation attributable to periods after December 31, 1969 (\$20,000), is lower than the gain realized (\$60,000), the amount of gain recognized as ordinary income under section 1250(a)(1) is \$19,000 (that is, 95 percent of \$20,000). In addition, gain is recognized under section 1250(a)(2) since there is remaining gain of \$40,000 (that is, the gain realized (\$60,000) minus the additional depreciation attributable to periods after December 31, 1969 (\$20,000)). Since the remaining gain of \$40,000 is lower than the additional depreciation attributable to periods before January 1, 1970 (\$60,000), the amount of gain recognized as ordinary income under section 1250(a)(2) is \$6,000 (that is, 15 percent of \$40,000). The remaining \$35,000 (that is, gain realized \$60,000, minus gain recognized under section 1250(a), \$25,000) of the gain may be treated as gain from the sale or exchange of property described in section 1231.

(4) *Other dispositions after December 31, 1969.* (i) In the case of a disposition of section 1250 property after December 31, 1969, other than by way of a sale, exchange, or involuntary conversion, the gain to which section 1250(a)(1) applies is the applicable percentage for the property (determined under paragraph (d)(1) of this section) multiplied by the

lower of (a) the additional depreciation in respect of the property attributable to periods after December 31, 1969, or (b) the excess (referred to as *potential gain*) of the fair market value of the property over its adjusted basis. In addition, if the potential gain exceeds the additional depreciation attributable to periods after December 31, 1969, then the gain to which section 1250(a)(2) applies is the applicable percentage for the property (determined under paragraph (d)(2) of this section) multiplied by the lower of (c) the additional depreciation attributable to periods before January 1, 1970, or (d) the excess (referred to as *remaining potential gain*) of the potential gain over the additional depreciation attributable to periods after December 31, 1969. If property is transferred by a corporation to a shareholder for an amount less than its fair market value in a sale or exchange, for purposes of applying section 1250 such transfer shall be treated as a disposition other than by way of a sale, exchange, or involuntary conversion.

(ii) The provisions of this subparagraph may be illustrated by the following examples:

Example 1. Section 1250 property having an adjusted basis of \$500,000 and a fair market value of \$550,000 is distributed by a corporation to a stockholder in complete liquidation of the corporation after December 31, 1969, and thus the potential gain is \$50,000. At the time of the liquidation, the additional depreciation for the property attributable to periods after December 31, 1969, is \$80,000 and the applicable percentage is 100 percent (paragraph (d)(1)(i)(e) of this section). Since the potential gain of \$50,000 is lower than the additional depreciation attributable to periods after December 31, 1969 (\$80,000), the amount of gain recognized as ordinary income under section 1250(a)(1) is \$50,000 (that is, 100 percent of \$50,000) even though in the absence of section 1250, section 336 would preclude recognition of gain to the corporation.

Example 2. The facts are the same as in example (1) except that the fair market value of the property is \$650,000, and thus the potential gain is \$150,000. Since the additional depreciation attributable to periods after December 31, 1969 (\$80,000), is lower than the potential gain of \$150,000, the amount of gain recognized as ordinary income under section 1250(a)(1) is \$80,000 (that is, 100 percent of \$80,000). In addition, section 1250(a)(2) applies since there is remaining potential gain of \$70,000, that is, potential gain (\$150,000) minus additional depreciation attributable

to periods after December 31, 1969 (\$80,000). The additional depreciation attributable to periods before January 1, 1970, is \$90,000 and the applicable percentage under paragraph (d)(2) of this section is 50 percent. Since the remaining potential gain of \$70,000 is lower than the additional depreciation attributable to periods before January 1, 1970 (\$90,000), the amount of gain recognized as ordinary income under section 1250(a)(2) is \$35,000 (that is, 50 percent of \$70,000). Thus under section 1250(a), \$115,000 (that is, \$80,000 under section 1250(a)(1), plus \$35,000 under section 1250(a)(2)) is recognized as ordinary income, even though in the absence of section 1250, section 336 would preclude recognition of gain to the corporation.

(5) *Instances of nonapplication.* (i) Section 1250(a)(1) does not apply to losses. Thus, section 1250(a)(1) does not apply if a loss is realized upon a sale, exchange, or involuntary conversion of property, all of which is considered section 1250 property, nor does the section apply to a disposition of such property other than by way of sale, exchange, or involuntary conversion if at the time of the disposition the fair market value of such property is not greater than its adjusted basis.

(ii) In general, in the case of section 1250 property with a holding period under section 1223 of more than 1 year, section 1250(a)(1) does not apply if for periods after December 31, 1969, there are no *depreciation adjustments in excess of straight line* (as computed under section 1250(b) and paragraph (b) of § 1.1250-2).

(6) *Allocation rules.* (i) In the case of a sale, exchange, or involuntary conversion of section 1250 property and non-section 1250 property in one transaction after December 31, 1969, the total amount realized upon the disposition shall be allocated between the section 1250 property and the other property in proportion to their respective fair market values. Such allocation shall be made in accordance with the principles set forth in paragraph (a)(5) of § 1.1245-1 (relating to allocation between section 1245 property and non-section 1245 property).

(ii) If an item of section 1250 property has two (or more) applicable percentages because one subdivision of paragraph (d)(1)(i) of this section applies to one portion of the taxpayer's holding period (determined under § 1.1250-4) and another subdivision of such paragraph

applies with respect to another such portion, then the gain realized on a sale, exchange, or involuntary conversion, or the potential gain in the case of any other disposition, shall be allocated to each such portion of the taxpayer's holding period after December 31, 1969, in the same proportion as the additional depreciation with respect to such item for such portion bears to the additional depreciation with respect to such item for the entire holding period after December 31, 1969.

(b) *Dispositions before January 1, 1970—*

(1) *Ordinary income.* In general, section 1250(a)(2) provides that, upon a disposition of an item of section 1250 property after December 31, 1963, and before January 1, 1970, the applicable percentage of the lower of:

(i) The additional depreciation (as defined in §1.1250-2) attributable to periods before January 1, 1970, in respect of the property, or

(ii) The excess of the amount realized on a sale, exchange, or involuntary conversion (or the fair market value of the property on any other disposition) over the adjusted basis of the property, shall be treated as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231 (that is, shall be recognized as ordinary income). The amount of such gain shall be determined separately for each item (see subparagraph (2)(ii) of this paragraph) of section 1250 property. For relation of section 1250 to other provisions, see paragraph (c) of this section.

(2) *Meaning of terms.* (i) For purposes of section 1250, the term *disposition* shall have the same meaning as in paragraph (a)(3) of §1.1245-1. *Section 1250 property* is, in general, depreciable real property other than section 1245 property. See paragraph (e) of this section. For purposes of this paragraph, the term *applicable percentage* means 100 percent minus 1 percentage point for each full month the property was held after the date on which the property was held 20 full months. See paragraph (d)(2) of this section. If, however, the property is considered to have two or more elements with separate holding periods (for example, because units thereof are placed in service on different dates, or improvements are

made to the property), see the special rules of §1.1250-5.

(ii) For purposes of applying section 1250, the facts and circumstances of each disposition shall be considered in determining what is the appropriate item of section 1250 property. In general, a building is an item of section 1250 property, but in an appropriate case more than one building may be treated as a single item. For manner of determining whether an expenditure shall be treated as an addition to the capital account of an item of section 1250 property or as a separate item of section 1250 property, see paragraph (d)(2)(iii) of §1.1250-5.

(3) *Sale, exchange, or involuntary conversion before January 1, 1970.* (i) In the case of a disposition of section 1250 property by a sale, exchange, or involuntary conversion before January 1, 1970, the gain to which section 1250(a)(2) applies is the applicable percentage for the property multiplied by the lower of (a) the additional depreciation in respect of the property or (b) the excess (referred to as *gain realized*) of the amount realized over the adjusted basis of the property.

(ii) The provisions of this subparagraph may be illustrated by the following example:

Example: Section 1250 property, which has an adjusted basis of \$200,000, is sold for \$290,000 before January 1, 1970. At the time of the sale the additional depreciation in respect of the property is \$130,000 and the applicable percentage is 60 percent. Since the gain realized (\$90,000, that is, amount realized, \$290,000, minus adjusted basis, \$200,000) is lower than the additional depreciation (\$130,000), the amount of gain recognized as ordinary income under section 1250(a)(2) is \$54,000 (that is, 60 percent of \$90,000). The remaining \$36,000 (\$90,000 minus \$54,000) of the gain may be treated as gain from the sale or exchange of property described in section 1231.

(4) *Other dispositions before January 1, 1970.* (i) In the case of a disposition of section 1250 property before January 1, 1970, other than by way of a sale, exchange, or involuntary conversion, the gain to which section 1250(a)(2) applies is the applicable percentage for the property multiplied by the lower of (a) the additional depreciation in respect of the property, or (b) the excess (referred to as *potential gain*) of the fair

market value of the property on the date of disposition over its adjusted basis. If property is transferred by a corporation to a shareholder for an amount less than its fair market value in a sale or exchange, for purposes of applying section 1250 such transfer shall be treated as a disposition other than by way of a sale, exchange, or involuntary conversion.

(ii) The provisions of this subparagraph may be illustrated by the following example:

Example: Assume the same facts as in the example in subparagraph (3)(ii) of this paragraph except that the property is distributed by a corporation to a stockholder before January 1, 1970, in complete liquidation of the corporation, and that at the time of the distribution the fair market value of the property is \$370,000. Since the additional depreciation (\$130,000) is lower than the potential gain of \$170,000 (that is, fair market value, \$370,000, minus adjusted basis, \$200,000), the amount of gain recognized as ordinary income under section 1250(a)(2) is \$78,000 (that is, 60 percent of \$130,000) even though, in the absence of section 1250, section 336 would preclude recognition of gain to the corporation.

(5) *Instances of nonapplication.* (i) Section 1250(a)(2) does not apply to losses. Thus, section 1250(a)(2) does not apply if a loss is realized upon a sale, exchange, or involuntary conversion of property, all of which is considered section 1250 property, nor does the section apply to a disposition of such property other than by way of sale, exchange, or involuntary conversion if at the time of the disposition the fair market value of such property is not greater than its adjusted basis.

(ii) In general, in the case of section 1250 property with a holding period under section 1223 of more than one year, section 1250(a)(2) does not apply if for periods after December 1, 1963, there are no *depreciation adjustments in excess of straight line* (as computed under section 1250(b) and paragraph (b) of § 1.1250-2).

(iii) In a case in which section 1250 property (including each element thereof, if any) has a holding period under § 1.1250-4 (or paragraph (a)(2)(ii) of § 1.1250-5) of at least 10 years, section 1250(a)(2) does not apply. If within the 10-year period preceding the date the property is disposed of, an element is

added to the property by reason, for example, of an addition to capital account, see § 1.1250-5.

(6) *Allocation rule.* In the case of a sale, exchange, or involuntary conversion of section 1250 property and nonsection 1250 property in one transaction before January 1, 1970, the total amount realized upon the disposition shall be allocated between the section 1250 property and the other property in proportion to their respective fair market values. Such allocation shall be made in accordance with the principles set forth in paragraph (a)(5) of § 1.1245-1 (relating to allocation between section 1245 property and nonsection 1245 property).

(c) *Relation of section 1250 to other provisions—*(1) *General.* The provisions of section 1250 apply notwithstanding any other provision of subtitle A of the Code. See section 1250(i). Thus, unless an exception or limitation under section 1250(d) and § 1.1250-3 applies, gain under section 1250(a) is recognized notwithstanding any contrary nonrecognition provision or income characterizing provision. For example, since section 1250 overrides section 1231 (relating to property used in the trade or business), the gain recognized under section 1250(a) upon a disposition will be treated as ordinary income and only the remaining gain, if any, from the disposition may be considered as gain from the sale or exchange of a capital asset if section 1231 is applicable. See the example in paragraph (b)(3)(ii) of this section.

(2) *Nonrecognition sections overridden.* The nonrecognition provisions of subtitle A of the Code which section 1250 overrides include, but are not limited to, sections 267(d), 311(a), 336, 337, 501(a), and 512(b)(5). See section 1250(d) for the extent to which section 1250(a) overrides sections 332, 351, 361, 371(a), 374(a), 721, 731, 1031, 1033, 1039, 1071, and 1081 (b)(1) and (d)(1)(A). For amount of additional depreciation in respect of property disposed of by an organization exempt from income taxes (within the meaning of section 501(a)), see paragraph (d)(6) of § 1.1250-2.

(3) *Exempt income.* The fact that section 1250 provides for recognition of gain as ordinary income does not

change into taxable income any income which is exempt under section 115 (relating to income of States, etc.), 892 (relating to income of foreign governments), or 894 (relating to income exempt under treaties).

(4) *Treatment of gain not recognized under section 1250.* Section 1250 does not prevent gain which is not recognized under section 1250 from being considered as gain under another provision of the Code, such as, for example, section 1239 (relating to gain from sale of depreciable property between certain related persons). Thus, for example, if section 1250 property which has an adjusted basis of \$10,000 is sold for \$17,500 in a transaction to which section 1239 applies, and if \$5,000 of the gain would be recognized under section 1250(a) then the remaining \$2,500 of the gain would be treated as ordinary income under section 1239.

(5) *Normal retirement of asset in multiple asset account.* Section 1250(a) does not require recognition of gain upon normal retirements of section 1250 property in a multiple asset account as long as the taxpayer's method of accounting, as described in paragraph (e)(2) of §1.167(a)-8 (relating to accounting treatment of asset retirements), does not require recognition of such gain.

(6) *Installment method.* Gain from a disposition to which section 1250(a) applies may be reported under the installment method if such method is otherwise available under section 453 of the Code. In such case, the income (other than interest) on each installment payment shall be deemed to consist of gain to which section 1250(a) applies until all such gain has been reported, and the remaining portion (if any) of such income shall be deemed to consist of other gain. For treatment of amounts as interest on certain deferred payments, see section 483.

(d) *Applicable percentage—(1) Definition for purposes of section 1250(a)(1).* (i) For purposes of section 1250(a)(1), the term *applicable percentage* means:

(a) In the case of property disposed of pursuant to a written contract which was, on July 24, 1969, and at all times thereafter binding on the owner of the property, 100 percent minus 1 percentage point for each full month the prop-

erty was held after the date on which the property was held 20 full months;

(b) In the case of property constructed, reconstructed, or acquired by the taxpayer before January 1, 1975, with respect to which a mortgage is insured under section 221(d)(3) or 236 of the National Housing Act, or housing is financed or assisted by direct loan or tax abatement under similar provisions of State or local laws, and with respect to which the owner is subject to the restrictions described in section 1039(b)(1)(B) (relating to approved dispositions of certain Government-assisted housing projects), 100 percent minus 1 percentage point for each full month of the taxpayer's holding period for the property (determined under §1.1250-4) during which the property qualified under this sentence, beginning after the date on which the property so qualified for 20 full months.

(c) In the case of residential rental property (as defined in section 167(j)(2)(B)) other than that covered by (a) and (b) of this subdivision, 100 percent minus 1 percentage point for each full month of the taxpayer's holding period for the property (determined under §1.1250-4) included within a taxable year for which the property qualified as residential rental property, beginning after the date on which the property so qualified for 100 full months.

(d) In the case of property with respect to which a deduction was allowed under section 167(k) (relating to the depreciation of expenditures to rehabilitate low-income rental housing), 100 percent minus 1 percentage point for each full month of the taxpayer's holding period (determined under §1.1250-4) beginning 100 full months after the date on which the property was placed in service.

(e) In the case of all other property, 100 percent.

The provisions of (a), (b), and (c) of this subdivision shall not apply with respect to additional depreciation described in section 1250(b)(4). If the taxpayer's holding period under §1.1250-4 includes a period before January 1, 1970, such period shall be taken into account in applying each provision of this subdivision.

(ii) A single item of property may have two (or more) applicable percentages under the provisions of subdivision (i) of this subparagraph. For example, if the provision of subdivision (i) of this subparagraph which applies to an item of section 1250 property (or to an element of such property if the property is treated as consisting of more than one element under §1.1250-5) in the taxable year in which the item (or element) is disposed of did not apply to the item (or element) in a prior taxable year which is included within the taxpayer's holding period under §1.1250-4 and which ends after December 31, 1969, then each provision of subdivision (i) of this subparagraph shall apply only for the period during which the property qualified under such provision.

(iii) If the taxpayer makes rehabilitation expenditures and elects to compute depreciation under section 167(k) with respect to the property attributable to the rehabilitation expenditures, such property will generally constitute a separate improvement under paragraph (c) of §1.1250-5 and therefore will constitute an element of section 1250 property. For computation of applicable percentage and gain recognized under section 1250(a) in such a case, see paragraph (a) of §1.1250-5.

(iv) The principles of this subparagraph may be illustrated by the following examples:

Example 1. Section 1250 property is sold on December 31, 1970, pursuant to a written contract which was binding on the owner of the property on July 24, 1969, and at all times thereafter. The property was acquired on July 31, 1968. The applicable percentage for the property under subdivision (i)(a) of this subparagraph is 91 percent, since the property was held 29 full months.

Example 2. Section 1250 property is sold on June 30, 1978. The property was acquired by a calendar year taxpayer on June 30, 1966. Subdivision (i)(e) of this subparagraph applies to the property in 1977 and 1978. However, subdivision (i)(c) of this subparagraph applied to the property for the taxable years of 1970 through 1976. Thus, the property has two applicable percentages under this subparagraph. The period before January 1, 1970 (42 full months), and the period from 1970 through 1976 (84 full months) are both taken into account in determining the applicable percentage under subdivision (i)(c) of this subparagraph. Thus, the applicable percentage is 74 percent (that is, 100 percent minus the excess of the holding period taken into

account (126 full months) over 100 full months). The applicable percentage for the years 1977 and 1978 is 100 percent under subdivision (i)(e) of this subparagraph.

Example 3. Section 1250 property is sold on December 31, 1978. The property was acquired by a calendar year taxpayer on December 31, 1969. The taxpayer made rehabilitation expenditures in 1973 and properly elected to compute depreciation under section 167(k) on the property attributable to the expenditures for the 60-month period beginning on January 1, 1974, the date such property was placed in service. Subdivision (i)(c) applies to the property (other than the property with respect to which a deduction was allowed under section 167(k)) for the taxable years of 1970 through 1978 (108 full months) and the applicable percentage for such property is 92 percent. The applicable percentage for the property with respect to which a deduction under section 167(k) was allowed is 100 percent under subdivision (i)(d) of this subparagraph, since the holding period for purposes of such subdivision begins on the date such property is placed in service.

Example 4. Section 1250 property is sold by a calendar year taxpayer on March 31, 1974. The property was transferred to the taxpayer by gift on December 31, 1970, and under section 1250(e)(2), the taxpayer's holding period for the property for purposes of computing the applicable percentage includes the transferor's holding period of 80 full months. Subdivision (i)(c) of this subparagraph applies to the property in the years 1970 through 1974. The applicable percentage under subdivision (i)(c) of this subparagraph is 81 percent, since the period before January 1, 1970 (68 full months), and that portion of the period after December 31, 1969, during which such subdivision applied (51 full months) are taken into account.

(2) *Definition for purposes of section 1250(a)(2).* For purposes of section 1250(a)(2), the term *applicable percentage* means:

(i) In case of property with a holding period of 20 full months or less, 100 percent;

(ii) In case of property with a holding period of more than 20 full months but less than 10 years, 100 percent minus 1 percentage point for each full month the property is held after the date on which the property is held 20 full months; and

(iii) In case of property with a holding period of at least 10 years, zero.

(3) *Holding period.* For purposes of this paragraph, the holding period of property shall be determined under the rules of §1.1250-4, and not under the rules of section 1223, notwithstanding

that the property was acquired on or before December 31, 1963. In the case of a disposition of section 1250 property which consists of 2 or more elements (within the meaning of paragraph (c) of § 1.1250-5), the holding period for each element shall be determined under the rules of paragraph (a)(2)(ii) of § 1.1250-5.

(4) *Full month.* For purposes of this paragraph, the term *full month* (or *full months*) means the period beginning on a date in 1 month and terminating on the date before the corresponding date in the next succeeding month (or in another succeeding month), or, if a particular succeeding month does not have such a corresponding date, terminating on the last day of such particular succeeding month.

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

Example 1. Property is purchased on January 17, 1959. Under paragraph (b)(1) of § 1.1250-4, its holding period begins on January 18, 1959, and thus at any time during the period beginning on October 17, 1960, and ending on November 16, 1960, the property is considered held 21 full months and has an applicable percentage under section 1250(a)(2) of 99 percent. On and after January 17, 1969, the property has a holding period of at least 120 full months (10 years) and, therefore, the applicable percentage under section 1250(a)(2) for the property is zero. Accordingly, no gain would be recognized under section 1250(a)(2) upon disposition of the property. If, however, the property consists of two or more elements, see the special rules of § 1.1250-5.

Example 2. Property is purchased on January 31, 1968. Under paragraph (b)(1) of § 1.1250-4 its holding period begins on February 1, 1968, and thus at any time during the period beginning on February 29, 1968, and ending on March 30, 1968, the property is considered held 1 full month. At any time during the period beginning on March 31, 1970, and ending on April 29, 1970, the property is considered held 26 full months. At any time during the period beginning on April 30, 1970, and ending on May 30, 1970, the property is considered held 27 full months.

(e) *Section 1250 property—(1) Definition.* The term *section 1250 property* means any real property (other than section 1245 property, as defined in section 1245(a)(3) and § 1.1245-3) which is or has been property of a character subject to the allowance for depreciation provided in section 167. See section 1250(c).

(2) *Character of property.* For purposes of subparagraph (1) of this paragraph, the term *is or has been property of a character subject to the allowance for depreciation provided in section 167* shall have the same meaning as when used in paragraph (a) (1) and (3) of § 1.1245-3. Thus, if a father uses a house in his trade or business during a period after December 31, 1963, and then gives the house to his son as a gift for the son's personal use, the house is section 1250 property in the hands of the son. For exception to the application of section 1250(a) upon disposition of a principal residence, see section 1250(d)(7).

(3) *Real property.* (i) For purposes of subparagraph (1) of this paragraph, the term *real property* means any property which is not personal property within the meaning of paragraph (b) of § 1.1245-3. The term section 1250 property includes three types of depreciable real property. The first type is intangible real property. For purposes of this paragraph, a leasehold of land or of section 1250 property is intangible real property, and accordingly such a leasehold is section 1250 property. However, a fee simple interest in land is not depreciable, and therefore is not section 1250 property. The second type is a building or its structural components within the meaning of paragraph (c) of § 1.1245-3. The third type is all other tangible real property except (a) property described in section 1245(a)(3)(B) as defined in paragraph (c)(1) of § 1.1245-3 (relating to property used as an integral part of a specified activity or as a specified facility), and (b) property described in section 1245(a)(3)(D). An elevator or escalator (within the meaning of section 1245(a)(3)(C)) is not section 1250 property.

(ii) The provisions of this subparagraph may be illustrated by the following example:

Example: A owns and leases to B for a single lump-sum payment of \$100,000 property consisting of land and a fully equipped factory building thereon. If 30 percent of the fair market value of such property is properly allocable to the land, 25 percent to section 1250 property (the building and its structural components), and 45 percent to section 1245 property (the equipment), then 55 percent of B's leasehold is section 1250 property.

(4) *Coordination with definition of section 1245 property.* (i) Property may lose its character as section 1250 property and become section 1245 property. Thus, for example, if section 1250 property of the third type described in subparagraph (3)(i)(a) of this paragraph is converted to use as an integral part of manufacturing, the property would lose its character as section 1250 property and would become section 1245 property. However, once property in the hands of a taxpayer is section 1245 property, it can never become section 1250 property in the hands of such taxpayer. See also paragraph (a) (4) and (5) of § 1.1245-2.

(f) *Treatment of partnerships and partners.* If a partnership disposes of section 1250 property, the amount of gain recognized under section 1250(a) by the partnership and by a partner shall be determined in a manner consistent with the principles provided in paragraph (e) of § 1.1245-1. Thus, for example, a partner's distributive share of gain recognized by the partnership under section 1250(a) shall be determined in the same manner as his distributive share of gain recognized by the partnership under section 1245(a)(1) is determined, and, if required, additional depreciation in respect of section 1250 property shall be allocated to the partner in the same manner as the adjustments reflected in the adjusted basis of section 1245 property are allocated to the partner. For a further example, if on the date a partner acquires his partnership interest by way of a sale or exchange the partnership owns section 1250 property and an election under section 754 (relating to optional adjustment to basis of partnership property) is in effect with respect to the partnership, then such partner's additional depreciation in respect of such property on such date is deemed to be zero. For limitation on the amount of gain recognized under section 1250(a) in respect of a partnership and for the amount of additional depreciation in respect of partnership property after certain transactions, see paragraph (f) of § 1.1250-3. For treatment of section 1250 property as an unrealized receivable, see section 751(c).

(g) *Examples.* The principles of this section may be illustrated by the following examples:

Example 1. Section 1250 property which has an adjusted basis of \$350,000 is sold for \$630,000 on December 31, 1984. The property was acquired by a calendar year taxpayer on December 31, 1969. For the taxable years from 1970 through 1980, the property qualified as residential rental property and the applicable percentage for those years is 68 percent (paragraph (d)(1)(i)(c) of this section). For taxable years from 1981 through 1984, the property did not qualify as residential rental property and the applicable percentage for those years is 100 percent (paragraph (d)(1)(i)(e) of this section). The additional depreciation for the years from 1970 through 1980 is \$120,000. The additional depreciation for the years from 1981 through 1984 is \$20,000. The gain realized is \$280,000 (that is, amount realized, \$630,000, minus adjusted basis \$350,000). The gain recognized as ordinary income under section 1250(a)(1) is computed in two steps. First, since the additional depreciation attributable to the years 1970 through 1980 (\$120,000) is lower than the gain realized attributable to such years determined under paragraph (a)(6) of this section (\$240,000, that is, gain realized, \$280,000, multiplied by $\frac{1}{4}$), the gain recognized as ordinary income under section 1250(a)(1) in the first step is \$81,600, that is, 68 percent of \$120,000. Second, since the additional depreciation attributable to the years 1981 through 1984 (\$20,000) is lower than the gain realized attributable to those years (\$40,000, that is, gain realized, \$280,000, multiplied by $\frac{1}{4}$), the gain recognized as ordinary income under section 1250(a)(1) for the years from 1981 through 1984 is \$20,000 (that is, 100 percent of \$20,000). The total gain recognized under section 1250(a)(1) is \$101,600 (that is, \$81,600 plus \$20,000).

Example 2. Section 1250 property which has an adjusted basis of \$400,000 is sold for \$472,000 on December 31, 1978. The property was acquired on December 31, 1966. The additional depreciation attributable to periods before January 1, 1970, is \$40,000 and the applicable percentage under paragraph (d)(2) of this section is zero percent. The property qualifies as residential rental property for the years 1970 through 1976, but fails to qualify for 1977 and 1978. Under paragraph (d)(1) of this section, the applicable percentage for the years 1970 through 1976 is 80 percent (paragraph (d)(1)(i)(c) of this section), and the applicable percentage for the years 1977 and 1978 is 100 percent (paragraph (d)(1)(i)(e) of this section). The additional depreciation attributable to the years 1970 through 1976 is \$50,000, and the additional depreciation attributable to the years 1977 and 1978 is \$10,000. The gain recognized as ordinary income under section 1250(a)(1) is computed in

two steps. First, since the additional depreciation attributable to the years 1970 through 1976 (\$50,000) is lower than the gain realized attributable to such years (\$60,000, that is, \$72,000 multiplied by $\frac{2}{3}$), the gain recognized under section 1250(a)(1) in the first step is \$40,000 (that is, 80 percent of \$50,000). Second, since the additional depreciation attributable to 1977 and 1978 (\$10,000) is lower than the gain realized attributable to such years (\$12,000, that is, \$72,000 multiplied by $\frac{1}{6}$), the gain recognized under section 1250(a)(1) in the second step is \$10,000 (that is, 100 percent of \$10,000). In addition, section 1250(a)(2) applies. However, since the applicable percentage is zero percent, none of the gain is recognized as ordinary income under section 1250(a)(2). Thus, the remaining \$22,000 (that is, gain realized, \$72,000, minus gain recognized under section 1250(a), \$50,000) of the gain may be treated as gain from the sale or exchange of property described in section 1231.

Example 3. The facts are the same as in example (2) except that the property is disposed of on December 31, 1980. The property qualifies as residential rental property for the years 1979 and 1980. Thus, the applicable percentage for years 1970 through 1976, 1979, and 1980 is 56 percent (paragraph (d)(1)(i)(c) of this section). The applicable percentage for the years 1977 and 1978 is 100 percent (paragraph (d)(1)(i)(e) of this section). The additional depreciation for the years 1979 and 1980 is \$8,000. The gain recognized under section 1250(a)(1) is computed in two steps. First, since the additional depreciation attributable to the years 1970 through 1976, 1979, and 1980 (\$58,000) is lower than the gain realized attributable to such years (\$61,412, that is, \$72,000 multiplied by $\frac{58,000}{68,000}$), the gain recognized under section 1250(a)(1) in the first step is \$32,480 (that is, 56 percent of \$58,000). Second, since the additional depreciation attributable to 1977 and 1978 (\$10,000) is lower than the gain realized attributable to such years (\$10,588, that is, \$72,000 multiplied by $\frac{10,000}{68,000}$) the gain recognized under section 1250(a)(1) in the second step is \$10,000 (that is, 100 percent of \$10,000). In addition section 1250(a)(2) applies. However, since the applicable percentage is zero percent, none of the gain is recognized as ordinary income under section 1250(a)(2). Thus, the remaining \$29,520 (that is, gain realized, \$72,000, minus gain recognized under section 1250(a), \$42,480) of the gain may be treated as gain from the sale or exchange of property described in section 1231.

[T.D. 7084, 36 FR 271, Jan. 8, 1971, as amended by T.D. 7193, 37 FR 12953, June 30, 1972]

§ 1.1250-2 Additional depreciation defined.

(a) *In general*—(1) *Definition for purposes of section 1250(b)(1).* Except as oth-

erwise provided in paragraph (e) of this section, for purposes of section 1250(b)(1), the term *additional depreciation* means:

(i) In the case of property which at the time of disposition has a holding period under section 1223 of not more than 1 year, the *depreciation adjustments* (as defined in paragraph (d) of this section) in respect of such property for periods after December 31, 1963, and

(ii) In the case of property which at the time of disposition has a holding period under section 1223 of more than 1 year, the depreciation adjustments in excess of straight line for periods after December 31, 1963, computed under paragraph (b)(1) of this section.

(2) *Definition for purposes of section 1250(b)(4).* Except as otherwise provided in paragraph (e) of this section, for purposes of section 1250(b)(4), the term *additional depreciation* means:

(i) In the case of property with respect to which a deduction under section 167(k) (relating to depreciation of expenditures to rehabilitate low-income rental housing) was allowed, which at the time of disposition has a holding period under section 1223 of not more than 1 year from the time the rehabilitation expenditures were incurred, the *depreciation adjustments* (as defined in paragraph (d) of this section) in respect of the property, and

(ii) In the case of property with respect to which a deduction under section 167(k) (relating to depreciation of expenditures to rehabilitate low-income rental housing) was allowed, which at the time of disposition has a holding period under section 1223 of more than 1 year from the time the rehabilitation expenditures were incurred, the depreciation adjustments in excess of straight line for the property, computed under paragraph (b)(2) of this section.

For purposes of this subparagraph, all rehabilitation expenditures which are incurred in connection with the rehabilitation of an element of section 1250 property shall be considered incurred on the date the last such expenditure is considered incurred under the accrual method of accounting, regardless of the