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Certain sales of low-income housing projects.

(a) Nonrecognition of gain. Section 1039 provides rules under which the taxpayer may elect not to recognize gain in certain cases where a qualified housing project is sold or disposed of after October 9, 1969, in an approved disposition and another such qualified housing project or projects (referred to as the replacement project) is acquired, constructed, or reconstructed within a specified reinvestment period. If the requirements of section 1039 are met, and if the taxpayer makes an election in accordance with the provisions of paragraph (b)(4) of this section, then the gain realized upon the sale or disposition is recognized only to the extent that the net amount realized on such sale or disposition exceeds the cost of the replacement project. However, notwithstanding section 1039, gain may be recognized by reason of the application of section 1245 or 1250 to the sale or disposition. (See §1.1245–6(b) and §1.1250–3(b). The terms qualified housing project, approved disposition, reinvestment period, and net amount realized are defined in paragraph (c) of this section.

(b) Rules of application—(1) In general. The election under section 1039(a) may be made only by the taxpayer owning the qualified housing project disposed of. Thus, if the qualified housing project disposed of is owned by a partnership, the partnership must make the election. (See section 703(b).) Similarly, if the qualified housing project disposed of is owned by a corporation or trust, the corporation or trust must make the election. In addition, the reinvestment of the taxpayer must be in such a manner that the taxpayer would be entitled to a deduction for depreciation on the replacement project. Thus, if the qualified housing project disposed of is owned by individual A, the purchase by A of stock in a corporation owning or constructing such a project or of an interest in a partnership owning or constructing such a project will not be considered as the purchase or construction by A of such a project.

(2) Special rules. (i) The cost of a replacement project acquired before the approved disposition of a qualified housing project shall be taken into account under section 1039 only if such property is held by the taxpayer on the date of the approved disposition.

(ii) Except as provided in section 1039(d), no property acquired by the taxpayer shall be taken into account for purposes of section 1039(a)(2) unless the unadjusted basis of such property is its cost within the meaning of section 1012. For example, if a qualified housing project is acquired in an exchange under section 1031, relating to exchange of property held for productive use or investment, such property will not be taken into account under section 1039(a)(2) because its basis is determined by reference to the basis of the property exchanged. (See section 1031(d).)

(3) Cost of replacement project. The taxpayer’s cost for the replacement project includes only amounts properly treated as capital expenditures by the taxpayer that are attributable to acquisition, construction, or reconstruction made within the reinvestment period (as defined in paragraph (c)(4) of this section). See section 263 for rules as to what constitutes capital expenditures. Thus, assume that a calendar year taxpayer realizes gain in 1970 upon the approved disposition of a qualified housing project occurring on January 1, 1970. If the taxpayer had begun construction of another qualified housing

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project on January 1, 1969, and completes such construction on June 1, 1972, only that portion of the cost attributable to the period before January 1, 1972, constitutes the cost of the replacement project for purposes of section 1039. For purposes of determining the cost of a replacement project attributable to a particular period, the total cost of the project may be allocated to such period on the basis of the portion of the total project actually constructed during such period.

(4) Election. (i) An election not to recognize the gain realized upon an approved disposition of a qualified housing project to the extent provided in section 1039(a) may be made by attaching a statement to the income tax return filed for the first taxable year in which any portion of the gain on such disposition is realized. Such a statement shall contain the information required by subdivision (iii) of this subparagraph. If the taxpayer does not file such a statement for the first taxable year in which any portion of the gain is realized, but fails to report a portion of the gain realized upon the approved disposition as income for such year or for any subsequent taxable year, then an election shall be deemed to be made under section 1039 (a) with respect to that portion of the gain not reported as income.

(ii) An election may be made under section 1039(a) even though the replacement project has not been acquired or constructed at the time of election. However, if an election has been made and (a) a replacement project is not constructed, reconstructed, or acquired, (b) the cost of the replacement project is lower than the net amount realized from the approved disposition, or (c) a decision is made not to construct, reconstruct, or acquire a replacement project, then the tax liability for the year or years for which the election was made shall be recomputed and an amended return filed. An election may be made even though the taxpayer has filed his return and recognized gain upon the disposition provided that the period of limitation on filing claims for credit or refund prescribed by section 6511 has not expired. In such case, a statement containing the information required by subdivision (iii) of this subparagraph should be filed together with a claim for credit or refund for the taxable year or years in which gain was recognized.

(iii) The statement referred to in subdivisions (i) and (ii) of this subparagraph shall contain the following information:

(a) The date of the approved disposition;

(b) If a replacement project has been acquired, the date of acquisition and cost of the project;

(c) If a replacement project has been constructed or reconstructed by or for the taxpayer, the date construction was begun, the date construction was completed, and the percentage of construction completed within the reinvestment period;

(d) If no replacement project has been constructed, reconstructed, or acquired prior to the time of filing of the statement, the estimated cost of such construction, reconstruction, or acquisition;

(e) The adjusted basis of the project disposed of; and

(f) The amount realized upon the approved disposition and a description of the expenses directly connected with the disposition and the taxes (other than income taxes) attributable to the disposition.

(c) Definitions—(1) General. The definitions contained in subparagraphs (2) through (5) of this paragraph shall apply for purposes of this section.

(2) Qualified housing project. The term qualified housing project means a rental or cooperative housing project for lower income families that has been constructed, reconstructed, or rehabilitated pursuant to a mortgage which is insured under section 221(d)(3) or 236 of the National Housing Act, provided that with respect to the housing project disposed of and the replacement project constructed, reconstructed, or acquired, the owner of the project at the time of the approved disposition and prior to the close of the reinvestment period is, under such sections or regulations issued thereunder,

(i) Limited as to rate of return on his investment in the project, and

(ii) Limited as to rentals or occupancy charges for units in the project.
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If the owner of the project is organized and operated as a nonprofit cooperative or other nonprofit organization, then such owner shall be considered to meet the requirement of subdivision (i) of this subparagraph.

(3) Approved disposition. The term approved disposition means a sale or other disposition of a qualified housing project to the tenants or occupants of units in such project, or to a nonprofit cooperative or other nonprofit organization formed and operated solely for the benefit of such tenants or occupants, provided that it is approved by the Secretary of Housing and Urban Development or his delegate under section 221 (d)(3) or 236 of the National Housing Act or regulations issued under such sections. Evidence of such approval should be attached to the tax return or statement in which the election under section 1039 is made.

(4) Reinvestment period. (i) The term reinvestment period means the period beginning 1 year before the date of the disposition and ending 1 year after the close of the first taxable year in which any part of the gain from such disposition is realized, or at such later date as may be designated pursuant to an application made by the taxpayer. Such application shall be made before the expiration of one year after the close of the first taxable year in which any part of the gain from such disposition is realized, unless the taxpayer can show to the satisfaction of the district director that—

(a) Reasonable cause exists for not having filed the application within the required period, and

(b) The filing of such application was made within a reasonable time after the expiration of the required period.

The application shall contain all the information required by paragraph (b)(4) of this section and shall be made to the district director for the internal revenue district in which the return is filed for the first taxable year in which any of the gain from the approved disposition is realized.

(ii) Ordinarily, requests for extension of the reinvestment period will not be granted until near the end of such period and any extension will usually be limited to a period not exceeding one year. Although granting of an extension depends upon the facts and circumstances of a particular case, if a predominant portion of the construction of the replacement project has been completed or is reasonably expected to be completed within the reinvestment period (determined without regard to any extension thereof), an extension of the reinvestment period will ordinarily be granted. The fact that there is a scarcity of replacement property for acquisition will not be considered sufficient grounds for granting an extension.

(5) Net amount realized. (i) The net amount realized from the approved disposition of a qualified housing project is the amount realized from such disposition, reduced by—

(a) The expenses paid or incurred by the taxpayer which are directly connected with the approved disposition, and

(b) The amount of taxes (other than income taxes) paid or incurred by the taxpayer which are directly connected with the approved disposition.

(ii) Examples of expenses directly connected with an approved disposition of a qualified housing project include amounts paid for sales or other commissions, advertising, and for the preparation of a deed or other legal services in connection with the disposition. An amount paid for a repair to the building will be considered as an expense directly connected with the approved disposition under subdivision (i)(a) of this subparagraph only if such repair is required as a condition of sale, or is required by the Secretary of Housing and Urban Development or his delegate as a condition of approval of the disposition.

(iii) Examples of taxes that are attributable to the approved disposition include local property transfer taxes and stamp taxes. A local real property tax is not so attributable.

(d) Basis and holding period of replacement project—(1) Basis. If the taxpayer makes an election under section 1039, the basis of the replacement housing project shall be its cost (including costs incurred subsequent to the reinvestment period) reduced by the amount of gain not recognized under section 1039 (a). If the replacement consists of more than one housing project,
the basis determined under this sub-
paragraph shall be allocated to the
properties in proportion to their re-
spective costs.

(2) Holding period. The holding period
of the replacement housing project
shall begin on the date the taxpayer
acquires such project, that is, on the
date the taxpayer first acquires posses-
sion or control of such project and
bears the burdens and enjoys the ben-
fits of ownership of the replacement
project. (For special rule regarding the
holding period of property for purposes
of section 1250, see section 1250(e)(4).)

(e) Assessment of deficiencies—(1) Defi-
ciency attributable to gain. If a taxpayer
makes an election under section 1039(a)
with respect to an approved disposi-
tion, any deficiency attributable to the
gain on such disposition, for any tax-
able year in which any part of such
gain is realized, may be assessed at any
time before the expiration of 3 years
after the date the taxpayer first acquires
possession or control of such project and
bears the burdens and enjoys the benefits
of ownership of the replacement
project. (For special rule regarding the
holding period of property for purposes
of section 1250, see section 1250(e)(4).)

§ 1.1041–1T Treatment of transfer of
property between spouses or inci-
dent to divorce (temporary).

Q–1: How is the transfer of property
between spouses treated under section
1041?

A–1: Generally, no gain or loss is rec-
ognized on a transfer of property from
an individual to (or in trust for the
benefit of) a spouse or, if the transfer is
incident to a divorce, a former spouse.
The following questions and answers
describe more fully the scope, tax con-
sequences and other rules which apply
to transfers of property under section
1041.

(a) Scope of section 1041 in general.

Q–2: Does section 1041 apply only to
transfers of property incident to di-

A–2: No. Section 1041 is not limited to
transfers of property incident to di-

vorce. Section 1041 applies to any
transfer of property between spouses
regardless of whether the transfer is a
gift or is a sale or exchange between
spouses acting at arm’s length (includ-
ing a transfer in exchange for the relin-
quishment of property or marital
rights or an exchange otherwise gov-
erned by another nonrecognition provi-
sion of the Code). A divorce or legal
separation need not be contemplated
between the spouses at the time of the
transfer nor must a divorce or legal
separation ever occur.