

§ 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 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, communications, 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.

(2) *Examples.* The provisions of subparagraph (1) of this paragraph may be illustrated by the following examples:

Example 1. A places section 1245 property in trust to pay the income from the property to B for his life, and after B's death to distribute the property to C. If the basis of the property to the fiduciary and to C is determined under the uniform basis rules prescribed in paragraph (b) of § 1.1015-1, and under paragraph (c) of § 1.1015-1 the time the fiduciary and C acquire their interests in the property is the time the donor relinquished dominion over the property, then section 1245(a)(1) does not apply to the transfer by A to the trust or to the distribution to C.

Example 2. Assume the same facts as in example (1), except that the fiduciary sells the section 1245 property and reinvests the proceeds in other section 1245 property which is

distributed to C upon B's death. Assume further that under paragraph (f) of § 1.1015-1 C's basis for the distributed property is the cost or other basis to the fiduciary. Section 1245(a)(1) applies to the sale but not to the distribution.

(3) *Disposition in part a sale or exchange and in part a gift.* Where a disposition of property is in part a sale or exchange and in part a gift, the gain to which section 1245(a)(1) applies is the amount by which (i) the lower of the amount realized upon the disposition of the property or the recomputed basis of the property, exceeds (ii) the adjusted basis of the property. For determination of the recomputed basis of the property in the hands of the transferee, see paragraph (c)(2) of § 1.1245-2.

(4) *Example.* The provisions of subparagraph (3) of this paragraph may be illustrated by the following example:

Example: (i) Smith transfers section 1245 property, which he has held in excess of 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977), to his son for \$60,000. Immediately before the transfer the property in the hands of Smith has an adjusted basis of \$30,000, a fair market value of \$90,000, and a recomputed basis of \$110,000. Since the amount realized upon disposition of the property (\$60,000) is lower than its recomputed basis (\$110,000), the excess of the amount realized over adjusted basis, or \$30,000, is treated as ordinary income under section 1245(a)(1) and not as gain from the sale or exchange of property described in section 1231. Smith has made a gift of \$30,000 (\$90,000 fair market value minus \$60,000 amount realized) to which section 1245(a)(1) does not apply.

(ii) Immediately before the transfer, the amount of adjustments reflected in the adjusted basis of the property was \$80,000. Under paragraph (c)(2) of § 1.1245-2, \$50,000 of adjustments are reflected in the adjusted basis of the property immediately after the transfer, that is, \$80,000 of such adjustments immediately before the transfer, minus \$30,000 gain taken into account under section 1245(a)(1) upon the transfer. Thus, the recomputed basis of the property in the hands of the son is \$110,000.

(b) *Exception for transfers at death*—(1) *General rule.* Section 1245(b)(2) provides that, except as provided in section 691 (relating to income in respect of a decedent), no gain shall be recognized under section 1245(a)(1) upon a transfer at death. For purposes of this paragraph, the term *transfer at death* means