Internal Revenue Service, Treasury

§ 1.48–5

(iv) If the lease is terminated other than by the lessee’s actual purchase of
the property during a taxable year begin-
ing after December 31, 1963, and be-
fore the end of the remaining useful
life of the property used in making the
decreases in rental deductions, the
amount of the increase in rental deduc-
tions described in subdivision (i) of this
subparagraph and not previously taken
into account shall be allowed as a de-
duction for the taxable year in which
such termination occurs.

(v) The rental deductions with re-
spect to any section 38 property are not
to be increased under this paragraph if
the lessee dies in a taxable year begin-
in before January 1, 1964.

(vi) The increase in rental deductions
described in subdivision (i) of this sub-
paragraph shall ordinarily be taken
into account by the lessee treated as
the purchaser, that is, the lessee enti-
tled to the credit. However, if the prop-
erty under the lease is transferred by
the lessee to a successor lessee in a
transaction described in section 47(b)
(other than a transfer by reason of
death) under which the successor lessee
assumes the lessee’s obligations under
the lease, such increase in rental de-
ductions shall be taken into account by
the successor lessee in the manner pre-
scribed in this paragraph.

(2) Examples. The operation of this
paragraph may be illustrated by the
following examples:

Example 1. (a) X Corporation acquired on
January 1, 1962, an item of new section 38
property with a basis of $24,000 and with a
useful life to the lessor of 10 years. Y Cor-
poration, which makes its returns on the
basis of a calendar year, leased such property
from X Corporation and placed it in service
on January 3, 1962. Under this section, X Cor-
poration made a valid election to treat Y
Corporation as having purchased such prop-
erty for purposes of the credit allowed by
section 38 and supplied the lessee with infor-
mation that the property had a useful life
of 10 years. The amount of the credit earned
with respect to such property was $1,680 (7
percent of $24,000). For each of the taxable
years 1962 and 1963, Y Corporation decreased,
under paragraph (k)(2) of this section, its de-
ductions otherwise allowable under section
162 for amounts paid to X Corporation under
the lease by $42 ($336 (that is, $168 multiplied
by 2) divided by the remaining useful life of
8 years).

Example 2. (a) The facts are the same as in
example 1 except that the lease is termi-

(b) For the taxable year 1964, Y Corpora-
tion increases its deductions otherwise al-
lowable under section 162 by $42.

(c) For the taxable year 1965, Y Corpora-
tion increases its deductions otherwise al-
lowable under section 162 for the portion of
the increase which had not been taken into
account as of the time of the termination of
the lease. Thus, the amount of such increase
for the taxable year 1965 is $294 ($336 minus
$42).

(See. 38, 76 Stat. 963; 26 U.S.C. 38)

[T.D. 6731, 29 FR 6080, May 8, 1964; 29 FR 7671,
June 16, 1964, as amended by T.D. 6838, 30 FR
9060, July 29, 1965; T.D. 7203, 37 FR 17151,
17152, Aug. 25, 1972]

§ 1.48–5 Electing small business cor-
porations.

(a) In general. (1) In the case of an
electing small business corporation (as
defined in section 1271(b)), the basis of
“new section 38 property” and the cost
of “used section 38 property” placed in
service during the taxable year shall be
apportioned pro rata among the per-
sons who are shareholders of such cor-
poration on the last day of such cor-
poration’s taxable year. Section 38
property shall not (by reason of such
apportionment) lose its character as
new section 38 property or used section
38 property, as the case may be. The es-
timated useful life of such property in
the hands of a shareholder shall be
deemed to be the estimated useful life
of such property in the hands of the
electing small business corporation.
The bases of all new section 38 prop-
erties which have a useful life falling
within a particular useful life category
shall be aggregated; likewise, the cost
of all used section 38 properties which
have a useful life falling within a par-
ticular useful life category shall be ag-
gregated. The total bases of new sec-
tion 38 properties within each useful
life category and the total cost of used
section 38 properties within each useful
life category shall be apportioned sepa-
rately. The useful life categories are:
(i) 3 years or more but less than 5
years; (ii) 5 years or more but less than
7 years; and (iii) 7 years or more. There
shall be apportioned to each person who is a shareholder of the electing small business corporation on the last day of the taxable year of such corporation, for his taxable year in which or with which the taxable year of such corporation ends, his pro rata share of the total bases of new section 38 properties within each useful life category, and his pro rata share of the total cost of used section 38 properties within each useful life category. In determining who are shareholders of an electing small business corporation on the last day of its taxable year, the rules of paragraph (d)(1) of §1.1371–1 and of paragraph (a)(2) of §1.1373–1 shall apply.

(2) The total cost of used section 38 property that may be apportioned by an electing small business corporation to its shareholders for any taxable year of such corporation shall not exceed $50,000. If the total cost of used section 38 property placed in service during the taxable year by the electing small business corporation exceeds $50,000 such corporation must select, under paragraph (c)(4) of §1.48–3, the used section 38 property the cost of which is to be apportioned to its shareholders.

(3) A shareholder to whom the basis (or cost) of section 38 property is apportioned shall, for purposes of the credit allowed by section 38, be treated as the taxpayer with respect to such property. Thus, the total cost of used section 38 property apportioned to him by the electing small business corporation must be taken into account as cost of used section 38 property in determining whether the $50,000 limitation on the cost of used section 38 property which may be taken into account by the shareholder in computing qualified investment for any taxable year is exceeded. If a shareholder takes into account in determining his qualified investment any portion of the basis (or cost) of section 38 property placed in service by an electing small business corporation and if such property subsequently is disposed of or otherwise ceases to be section 38 property in the hands of the corporation, such shareholder shall be subject to the provisions of section 47. See §1.47–4.

(b) Summary statement. An electing small business corporation shall attach to its return a statement showing the apportionment to each shareholder of the total bases of new, and the total cost of used, section 38 properties within each useful life category.

(c) Example. This section may be illustrated by the following example:

Example. 1 X Corporation, an electing small business corporation which makes its return on the basis of the calendar year, acquires and places in service on June 1, 1962, three new assets which qualify as new section 38 property and three used assets which qualify as used section 38 property. The basis of each new, and the cost of each used, section 38 property and the estimated useful life of each property are as follows:

<table>
<thead>
<tr>
<th>Asset No.</th>
<th>Basis (or cost)</th>
<th>Estimated useful life</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 (new)</td>
<td>$30,000</td>
<td>4 years</td>
</tr>
<tr>
<td>2 (new)</td>
<td>$30,000</td>
<td>4 years</td>
</tr>
<tr>
<td>3 (new)</td>
<td>$30,000</td>
<td>8 years</td>
</tr>
<tr>
<td>4 (used)</td>
<td>$12,000</td>
<td>6 years</td>
</tr>
<tr>
<td>5 (used)</td>
<td>$12,000</td>
<td>6 years</td>
</tr>
<tr>
<td>6 (used)</td>
<td>$12,000</td>
<td>8 years</td>
</tr>
</tbody>
</table>

On December 31, 1962, X Corporation has 10 shares of stock outstanding which are owned as follows: A owns 3 shares, B owns 2 shares, and C owns 5 shares.

(2) Under this section, the total bases of the new, and the total cost of the used, section 38 properties are apportioned to the shareholders of X Corporation as follows:

<table>
<thead>
<tr>
<th>Shareholder</th>
<th>Basis (or cost)</th>
<th>Estimated useful life</th>
</tr>
</thead>
<tbody>
<tr>
<td>A (3/10)</td>
<td>$18,000</td>
<td>4 years</td>
</tr>
<tr>
<td>B (2/10)</td>
<td>$12,000</td>
<td>6 years</td>
</tr>
<tr>
<td>C (5/10)</td>
<td>$30,000</td>
<td>8 years</td>
</tr>
</tbody>
</table>

Assume that shareholders A, B and C did not place in service during their taxable years in which falls December 31, 1962 (the last day of X Corporation’s taxable year) any section 38 property and that such shareholders did not own any interests in other electing small business corporations, partnerships, estates, or trusts. Under section 46(c), the qualified
§ 1.48–6 Estates and trusts.

(a) In general. (1) In the case of an estate or trust, the basis of “new section 38 property” and the cost of “used section 38 property” placed in service during the taxable year shall be apportioned among the estate or trust and its beneficiaries on the basis of the income of such estate or trust allocable to each. Section 38 property shall not (by reason of such apportionment) lose its character as new section 38 property or used section 38 property, as the case may be. The estimated useful life of such property in the hands of a beneficiary shall be deemed to be the estimated useful life of such property in the hands of the estate or trust. The bases of all new section 38 properties which have a useful life falling within a particular useful life category shall be aggregated; likewise, the cost of all used section 38 properties which have a useful life falling within a particular useful life category shall be aggregated. The total bases of new section 38 properties within each useful life category shall be apportioned separately. The useful life categories are:

(i) 3 years or more but less than 5 years; (ii) 5 years or more but less than 7 years; and (iii) 7 years or more. There shall be apportioned to the estate or trust for its taxable year, and to each beneficiary of such estate or trust for his taxable year in which or with which the taxable year of such estate or trust ends, his share (as determined under paragraph (b) of this section) of the total bases of new section 38 properties within each useful life category, and his share of the total cost of used section 38 properties within each useful life category.

(2) The total cost of used section 38 property that may be apportioned among an estate or trust and its beneficiaries for any taxable year of such estate or trust shall not exceed $50,000. If the total cost of used section 38 property placed in service during the taxable year by the estate or trust exceeds $50,000, such estate or trust must select, under paragraph (c)(4) of § 1.48–3, the used section 38 property the cost of which is to be apportioned among such estate or trust and its beneficiaries.

(3) A beneficiary to whom the basis (or cost) of section 38 property is apportioned shall, for purposes of the credit allowed by section 38, be treated as the taxpayer with respect to such property. Thus, the total cost of used section 38 property apportioned to him by the estate or trust must be taken into account as cost of used section 38 property in determining whether the $50,000 limitation on the cost of used property which may be taken into account by a beneficiary in computing qualified investment for any taxable year is exceeded. If a beneficiary takes into account in determining his qualified investment any portion of the basis (or cost) of section 38 property placed in service by an estate or trust and if such property subsequently is disposed of or otherwise ceases to be section 38 property in the hands of estate or trust, such beneficiary shall be subject to the provisions of section 47. See §1.47–5.

(4) For purposes of this section, the term “beneficiary” includes heir, legatee, and devisee.