

## **Treasury Decision 7986, 26 CFR IRC Sec(s). 42**

**October 24, 1984**

### **AGENCY:**

Internal Revenue Service, Treasury.

### **ACTION:**

Temporary regulations.

### **SUMMARY:**

This document contains temporary income tax regulations relating to the limitations placed on the amount of cost recovery deductions and investment tax credit allowed for taxpayers who purchase passenger automobiles for use in a trade or business or for use in the production of income. These temporary income tax regulations also relate to the limitations placed on cost recovery deductions and the investment tax credit allowed for taxpayers who use certain types of property ("listed property") for other than "qualified business" purposes. A person who leases "listed property" is similarly affected by these temporary regulations. Additionally, this document contains temporary income tax regulations relating to substantiation requirements for "listed property". The applicable law was amended by the Tax Reform Act of 1984. These regulations affect all purchasers or lessees of "listed property" (including passenger automobiles).

### **DATE:**

The temporary regulations relating to the limitations on the investment tax credit and recovery deductions are effective in general for "listed property" placed in service or leased after June 18, 1984 (§§1.280F-1T-1.280F-6T). Those regulations do not apply, however, to certain property acquired or leased pursuant to a binding contract in effect on June 18, 1984. The temporary regulations relating to substantiation requirements for the use of "listed property", §1.274-5T, are effective for taxable years beginning after December 31, 1984.

### **FOR FURTHER INFORMATION CONTACT:**

George T. Magnatta (with respect to cost recovery deduction questions) (202-566-6456), Michel A. Daze (with respect to investment tax credit or leasing questions) (202-566-3458), Cynthia E. Grigsby (with respect to definitional questions) (202-566-3935), of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, D.C. 20224 (Attention: CC:LR:T).

### **SUPPLEMENTARY INFORMATION:**

*Background*

This document adds new temporary regulations to the Income Tax Regulations (26 CFR Part 1) under sections 274 and 280F of the Internal Revenue Code of 1954, relating, respectively, to substantiation requirements and to the limitations on cost recovery deductions and the investment tax credit for certain property. Section 179 of the Tax Reform Act of 1984 (Pub. L. 98-369, 98 Stat. 494) amended Code section 274 and added new Code section 280F. The temporary regulations provided by this document will remain in effect until superseded by later temporary or final regulations on the subject.

### *Explanation of Provisions*

Generally, new section 280F limits the amount of cost recovery deductions under section 168 and the investment tax credit ("ITC") under section 46(a) that are allowable for a passenger automobile. With certain exceptions, the term "passenger automobile" includes generally any 4-wheeled vehicle for highway use with a gross weight of 6,000 pounds or less. Thus, a light-duty truck may be a "passenger automobile." Additionally, section 280F limits the method of cost recovery and the amount of the ITC allowable when "listed property" (including a passenger automobile) is used for other than certain qualified business purposes.

### *Special Limitations for "Passenger Automobiles"*

Section 280F(a) provides that the amount of the cost recovery deduction under section 168 for the year a passenger automobile (as defined in section 280F(d)(5)) is placed in service may not exceed \$4,000. Any cost recovery deduction claimed in a succeeding taxable year during the recovery period may not exceed \$6,000. Furthermore, the amount of the ITC claimed for the automobile may not exceed \$1,000 (2/3 of \$1,000 in the case of an election to take a reduced ITC under section 48(q)(4)). For automobiles placed in service after 1984, the allowable cost recovery deductions and investment tax credit amounts will be adjusted to reflect the automobile price inflation adjustment (see section 280F(d)(7)).

If, after the end of the recovery period, the taxpayer has any "unrecovered basis" (described below) in the passenger automobile, that amount is treated as an expense for the first taxable year and succeeding taxable years after the recovery period. However, the amount treated as an expense for any taxable year after the close of the recovery period shall not exceed \$6,000. In no event may any amount be expensed unless a cost recovery deduction under section 168 would have been allowable for the taxable year. For example, a taxpayer may not deduct any amount in a year during which a passenger automobile is disposed of or used exclusively for personal purposes.

The term "unrecovered basis" means the difference (if any) between the unadjusted basis (as defined in section 168(d) without any reduction for the amount (if any) the taxpayer elects to expense under section 179) of the passenger automobile and the amount of the cost recovery deductions (including any section 179 deduction) which would have been allowable for taxable years in the recovery period (determined after taking into account the limitations imposed on cost recovery deductions during the recovery period) if the passenger automobile was used exclusively in a trade or business or for use in the production of income.

Under section 280F, any amount allowable as a deduction under section 179 (relating to the election to expense certain depreciable business assets) is treated as a deduction allowable under section 168. The limitation on the amount of cost recovery deductions allowable for a passenger automobile may adversely affect a taxpayer who makes a section 179 election. The Internal Revenue Service is considering under what circumstances a taxpayer should be granted permission to revoke a section 179 election to avoid any unforeseen consequences of the interaction between sections 179 and 280F.

If the passenger automobile is also used for personal purposes, the limitations imposed on the cost recovery deductions and the ITC must be reduced in proportion to the personal use of the automobile. For example, if a passenger automobile is placed in service on July 1, 1984, and is used 20 percent for personal purposes (determined on an annual basis) during that year, the cost recovery deduction for that year may not exceed \$3,200 (i.e., 80 percent of \$4,000) and the ITC may not exceed \$800 (i.e., 80 percent of \$1,000) or \$533.33 (i.e., 80 percent of 2/3 of \$1,000 if section 48(q)(4) is elected). The limitations imposed on the cost recovery deductions and the ITC are also reduced if the taxpayer has a short taxable year.

The temporary regulations provide special rules for a passenger automobile that is acquired in a transaction to which section 1031 or section 1033 applies. The temporary regulations have reserved special rules for other nonrecognition transactions. These rules require taxpayers to take restrictions on potential recovery deductions with respect to an automobile into account when they acquire another automobile in a "like kind" exchange (including a "trade-in") or after an involuntary conversion. Additionally, these regulations provide special rules for an improvement made to a passenger automobile that qualifies as a capital expenditure under section 263.

#### *Limitations With Respect to "Listed Property" When "Qualified Business Use" Does Not Exceed 50 Percent*

Section 280F(b) provides limitations for "listed property" when the property is not "predominantly used in a qualified business use for any taxable year." The term "listed property" includes: (1) Any passenger automobile (2) any other property used as a means of transportation, (3) any property of a type generally used for purposes of entertainment, recreation, or amusement, and (4) any computer or peripheral equipment (unless the computer or equipment is used exclusively at a regular business establishment). The temporary regulations define "means of transportation" to include boats, airplanes, motorcycles, and any other vehicles for transporting persons or goods. The term does not include any vehicle or property that is of a type ordinarily not susceptible to personal use (e.g., cement mixers and forklifts). However, any vehicle used by an individual for commuting purposes does not meet that exception.

The ITC and use of the accelerated percentages under section 168 are permitted for listed property only if the property is used predominantly (that is, more than 50 percent, determined on an annual basis) in a qualified business use. The use of listed property for the production of income is not "qualified business use" (as explained below). However, if the "predominant use" test is otherwise met, use in an activity for the production of income is taken into account in determining the amount of the ITC and the cost recovery deduction that may be claimed. For example, if the

property is used 40 percent in a qualified business use and 20 percent for the production of income, no ITC may be claimed and the accelerated percentages under section 168 are unavailable. However, if the property is used 60 percent in a qualified business use and 20 percent for the production of income, an ITC may be claimed and the accelerated percentages under section 168 are available based on 80 percent business/investment use.

"Qualified business use" means generally use in a trade or business, but section 280F(d)(6)(C) provides certain exceptions. For example, the use of property provided as compensation to 5-percent owners and related taxpayers is generally not treated as qualified business use. Additionally, the leasing of property to any 5-percent owner or related party is not treated as qualified business use to the extent that an individual who is a 5-percent owner or related party with respect to the owner or the lessee of the property uses the property.

If listed property does not meet the "predominant use" test in the year it is placed in service, no ITC or section 179 deduction is available. Additionally, in these circumstances, the taxpayer must recover the cost of the property over its earnings and profits life (see section 312(k)(3)(A)) using the straight line method and the half-year convention for property other than 15-year or 18-year real property. For example, the cost of a passenger automobile that does not meet the "predominant use" test must be recovered over a 5-year recovery period using the straight line method. Once it is determined that the straight line method of cost recovery must be used, both the business and investment uses of the property are taken into account for purposes of computing the allowable cost recovery deduction.

If, however, listed property does meet the "predominant use" test in the year it is placed in service but in a succeeding taxable year does not meet the test, the property ceases to be section 38 property in its entirety as of the beginning of that later year and the ITC may be recaptured. Additionally, this event will cause a recapture of any "excess depreciation." "Excess depreciation" is the difference (if any) between the cost recovery deductions allowable (including any section 179 deduction) during the preceding recovery years and the amount that would have been allowable had the taxpayer computed his cost recovery deductions over the property's earnings and profits life using the straight line method. Any excess is included in gross income and is added to the property's adjusted basis for the taxable year in which the property is used 50 percent or less in a trade or business. The cost recovery deduction for the year in which the business use is 50 percent or less and for subsequent taxable years must be computed using the straight line method over the property's earnings and profits life.

#### *Special Rules With Respect to Leased Property*

Section 280F(c) provides that section 280F does not apply to listed property leased or held for leasing by a person regularly engaged in the business of leasing. The limitations on the investment tax credit for listed property will apply to a lessee who is treated by the lessor as having acquired the property under section 48(d). In addition, section 280F(c) requires the Secretary to impose limitations on lessees of luxury automobiles and other listed property which are "substantially equivalent" to the limitations imposed on similarly situated owners of such property. These temporary regulations require a lessee of a luxury automobile to include in gross income an amount based on the fair market value of the automobile (at the

beginning of the lease term) and the lessee's business/investment use. The inclusion approximates the present value of the limitations imposed on a similarly situated owner.

These temporary regulations require a lessee of listed property (including passenger automobiles) not used predominantly in a qualified business use to include in income in the first taxable year in which such listed property is not used predominantly in a qualified business use an amount based on the fair market value of the listed property (at the beginning of the lease term) and average business/investment use of such property. The amount which a lessee must include in income in such circumstances is generally limited to the deductible portion of the rent allocable to the taxable year and approximates the present value to a similarly situated owner of any recapture of investment tax credit and the denial of the use of the accelerated percentages under section 168.

#### *Miscellaneous Rules*

Two special rules under section 280F apply with respect to all listed property, whether the limitations described above affect the property or not.

Under section 280F(d)(2), if there is any use of listed property for business/investment purposes during a taxable year, then for purposes of determining recovery deductions in later years the property is treated as having been used solely for business/investment purposes during that year. Thus, the amount that the taxpayer may recover through later recovery deductions is reduced to the same extent that that amount would have been reduced if the taxpayer had used the property solely for business/investment purposes. However, the basis of property for purposes of determining gain or loss on the sale or other disposition of the property is not affected by this rule.

Section 280F(d)(3) limits the circumstances in which an employee may treat use of listed property in connection with employment as trade or business use for purposes of determining tax credits and recovery deductions. An employee who owns listed property and uses the property in connection with his employment may treat that use as business use only if the use of the property is required as a "condition of employment" and is for the "convenience of the employer."

In addition, temporary §1.280F-6T(d)(3)(iv) provides that use of the taxpayer's automobile by another person may not be treated as use of the automobile in a trade or business unless one of three conditions is met.

Finally, these temporary regulations contain a substantiation requirement for "listed property." For taxable years beginning after December 31, 1984, no deduction or credit is allowed with respect to the use of "listed property" unless the taxpayer substantiates such use by adequate contemporaneous records. This requirement is satisfied by keeping a log, journal, diary, or other similar record in the manner prescribed by these temporary regulations.

Because the recapture of "excess depreciation" may be triggered by a decline in the qualified business use of the property at any time during the earnings and profits life of the property, the temporary regulations require taxpayers to maintain contemporaneous records of the use of the listed property throughout that period.

Thus, a taxpayer who has fully recovered the cost of 3-year listed property over the first three years by use of the accelerated recovery percentages must continue to maintain records on the use of the property for an additional three years (the "5-year" earnings and profits life actually extends into the sixth year because of the half-year convention).

#### *Non-Applicability of Executive Order 12291*

The Commissioner of Internal Revenue has determined that this temporary rule is not a major rule as defined in Executive Order 12291 and that a regulatory impact analysis is not required.

#### *Regulatory Flexibility Act*

A notice of proposed rulemaking is not required by 5 U.S.C. 553 for temporary regulations. Accordingly, the temporary regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. Chapter 6).

#### *Paperwork Reduction Act*

The collection of information requirements contained in these regulations have been submitted to the Office of Management and Budget in accordance with the requirements of the Paperwork Reduction Act of 1980. These requirements have been approved by OMB under control number 1545-0074.

#### *Drafting Information*

The principal authors of these temporary regulations are George T. Magnatta, Michel A. Daza and Donald W. Stevenson of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, on matters of both substance and style.

#### *List of Subjects in 26 CFR 1.61-1 through 1.281-4*

Income taxes, Taxable income, Deductions, Exemptions.

#### *Amendments to the Regulations*

Accordingly, the Income Tax Regulations (26 CFR Part 1) are amended as follows:

#### **PART 1-[AMENDED]**

Paragraph 1. A new §1.274-5T is added immediately before §1.274-6. New §1.274-5T reads as follows:

**§1.274-5T Substantiation with respect to listed property for taxable years beginning after 1984. (Temporary)**

(a) In general. For taxable years beginning after December 31, 1984, no deduction or credit shall be allowed with respect to the use of any listed property (as defined in section 280F(d)(4) and §1.280F-6T(b)) unless the taxpayer substantiates such use by adequate contemporaneous records. Note that this section applies with respect to all property that is listed property (as so defined), regardless of the date on which the property was placed in service or leased by the taxpayer.

(b) "Adequate contemporaneous record" requirement-(1) In general. The "adequate contemporaneous record" requirement shall be satisfied only by keeping a log, journal, diary, or other similar record in the manner prescribed in this paragraph.

(2) Content of log, etc.-(i) Separate entry. Except as otherwise provided in paragraph (b)(2)(ii) of this section, the taxpayer shall make a separate entry in the log, diary, journal, or other similar record for each use of the listed property. Uses which may be considered part of a single use, for example, a round trip, may be accounted for by a single entry. Each entry shall specify-

(A) The date of the use of the property,

(B) The name of the user of the property,

(C) The number of miles, in the case of a passenger automobile or in the case of any other means of transportation; or the amount of time that the property was used, in the case of any other listed property, and

(D) The purpose of the use of the property (e.g., "to make a sales presentation to a customer", "to devise a personal budget plan").

(ii) Entries with respect to non-business use not required in certain circumstances. The requirements of paragraph (b)(2)(i) of this section shall be satisfied by making an entry only with respect to a business or investment use of the property (and not with respect to other uses) if the overall use of the property for a taxable year can be definitely determined without entries for other uses. If the overall use of the property cannot be definitely determined without entries for each use, then the taxpayer must make an entry for each such use. For example, the overall use of a passenger automobile during a taxable year can be determined by comparing the odometer readings at the beginning and the end of the taxable year. Thus, the taxpayer is required to keep a log only with respect to business or investment uses of the automobile during the year.

(3) Time for making entry. Each entry in the log, journal, diary, or similar record shall be made at or near to the time the listed property is actually used.

**(Approved by the Office of Management and Budget under control number 1545-0074)**

Par. 2. New §1.208F-1T is added in the appropriate place and reads as follows:

**§1.280F-1T Limitations on investment tax credit and recovery deductions under section 168 for passenger automobiles and certain other listed property; overview of regulations (temporary).**

(a) In general. Section 280F(a) limits the amount of investment tax credit determined under section 46(a) and recovery deductions under section 168 for passenger automobiles. Section 280F(b) denies the investment tax credit and requires use of the straight line method of recovery for listed property that is not predominantly used in a qualified business use. In certain circumstances, section 280F(b) requires the recapture of an amount of cost recovery deductions previously claimed by the taxpayer. Section 280F(c) provides that lessees are to be subject to restrictions substantially equivalent to those imposed on owners of such property under section 280F (a) and (b). § 280F(d) provides definitions and special rules; note that section 280F(d) (2) and (3) apply with respect to all listed property, even if the other provisions of section 280F do not affect the treatment of the property.

(b) Key to Code provisions. The following table identifies the provisions of section 280F under which regulations are provided, and lists each provision below with its corresponding regulation section:

Section	Section	Section	Section	Section	1.280F-6T
1.280F-2T	1.280F-3T	1.280F-4T	1.280F-5T(a)	.....	(b) ..... (d)(2) ..... (c)
.....	(d)(3)	(d)(1)	.....	(d)(1)	.....
.....	.....	.....	.....	.....	..... (d)(4) (d)(8)
.....	.....	.....	.....	(d)(5)	(d)(10) ..... ..
.....	.....	(d)(6)	.....	.....	.....

**Sections 1.280F-2T(f) and 1.280F-4T(b) also provide special rules for improvements to passenger automobiles and other listed property that qualify as capital expenditures.**

(c) Effective dates-(1) In general. This section and §§1.280F-2T through 1.280F-6T apply to property placed in service or leased after June 18, 1984, in taxable years ending after that date.

(2) Exception. This section and §§1.280F-2T through 1.280F-6T shall not apply to any property-

(i) Acquired pursuant to a binding contract in effect on June 18, 1984, and at all times thereafter, or under construction by the taxpayer on that date, but only if the property is placed in service before January 1, 1985 (January 1, 1987, in the case of 15-year real property), or

(ii) Leased pursuant to a binding contract in effect on June 18, 1984, and at all times thereafter, but only if the lessee first uses such property under the lease before January 1, 1985 (January 1, 1987, in the case of 15-year real property).

Par. 3. New §1.280F-2T is added immediately after §1.280F-1T and reads as follows:

**§1.280F-25 Limitations on recovery deductions and the investment tax credit for certain passenger automobiles (Temporary).**

(a) Limitation on amount of investment tax credit-(1) General rule. The amount of the investment tax credit determined under section 46(a) for any passenger automobile shall not exceed \$1,000. For a passenger automobile placed in service after December 31, 1984, the \$1,000 amount shall be increased by the automobile price inflation adjustment (as defined in section 280F(d)(7)) for the calendar year in which the automobile is placed in service.

(2) Election of reduced investment tax credit. If the taxpayer elects under section 48(q)(4) to reduce the amount of the investment tax credit in lieu of adjusting the basis of the passenger automobile under section 48(q)(1), the amount of the investment tax credit for any passenger automobile shall not exceed two-thirds of the amount determined under paragraph (a)(1) of this section.

(b) Limitations on allowable recovery deductions-(1) Recovery deduction for year passenger automobile is placed in service. For the taxable year that a taxpayer places a passenger automobile in service, the allowable recovery deduction under section 168(a) shall not exceed \$4,000. See paragraph (b)(3) of this section for the adjustment to this limitation.

(2) Recovery deduction for remaining taxable years during the recovery period. For any taxable year during the recovery period remaining after the year that the property is placed in service, the allowable recovery deduction under section 168(a) shall not exceed \$6,000. See paragraph (b)(3) of this section for the adjustment to this limitation.

(3) Adjustment to limitation by reason of automobile price inflation adjustment. The limitations on the allowable recovery deductions prescribed in paragraph (b) (1) and (2) of this section are increased by the automobile price inflation adjustment (as defined in section 280F(d)(7)) for the calendar year in which the automobile is placed in service.

(4) Coordination with section 179. For purposes of section 280F(a) and this section, any deduction allowable under section 179 (relating to the election to expense certain depreciable trade or business assets) is treated as if that deduction were a recovery deduction under section 168. Thus, the amount of the section 179 deduction is subject to the limitations described in paragraph (b) (1) and (2) of this section.

(c) Disallowed recovery deductions allowed for years subsequent to the recovery period-(1) In general. (i) Except as otherwise provided in this paragraph (c), the "unrecovered basis" (as defined in paragraph (c)(1)(ii) of this section) of any passenger automobile is treated as a deductible expense in the first taxable year succeeding the end of the recovery period.

(ii) The term "unrecovered basis" means the excess (if any) of-

(A) The unadjusted basis (as defined in section 168(d)(1)(A), except that there is no reduction by reason of an election to expense a portion of the basis under section 179) of the passenger automobile, over

(B) The amount of the recovery deductions (including any section 179 deduction elected by the taxpayer) which would have been allowable for taxable years in the recovery period (determined after the application of section 280F (a) and paragraph (b) of this section and as if all use during the recovery period were used described in section 168(c)(1)).

(2) Special rule when taxpayer elects to use the section 168(b)(3) optional recovery percentages. If the taxpayer elects to use the optional recovery percentages under

section 168(b)(3) or must use the straight line method over the earnings and profits life (as defined and described in §1.280F-3T(f)), the second succeeding taxable year after the end of the recovery period is treated as the first succeeding taxable year after the end of the recovery period for purposes of this paragraph (c) because of the half-year convention. For example, assume a calendar-year taxpayer places in service on July 1, 1984, a passenger automobile (i.e., 3-year recovery property) and elects under section 168(b)(3) to recover its cost over 5 years using the straight line optional percentages. Based on these facts, calendar year 1990 is treated as the first succeeding taxable year after the end of the recovery period.

(3) Deduction limited to \$6,000 for any taxable year. The amount that may be treated as a deductible expense under this paragraph (c) in the first taxable year succeeding the recovery period shall not exceed \$6,000. Any excess shall be treated as an expense for the succeeding taxable years. However, in no event may any deduction in a succeeding taxable year exceed \$6,000. The limitation on amounts deductible as an expense under this paragraph (c) with respect to any passenger automobile is increased by the automobile price inflation adjustment (as defined in section 280F(d)(7)) for the calendar year in which such automobile is placed in service.

(4) Deduction treated as a section 168 recovery deduction. Any amount allowable as an expense in a taxable year after the recovery period by reason of this paragraph (c) shall be treated as a recovery deduction allowable under section 168. However, a deduction is allowable by reason of this paragraph (c) with respect to any passenger automobile for a taxable year only to the extent that a deduction under section 168 would be allowable with respect to the automobile for that year. For example, no recovery deduction is allowable for a year during which a passenger automobile is disposed of or is used exclusively for personal purposes.

(d) Additional reduction in limitations by reason of personal use of passenger automobile or by reason of a short taxable year. See paragraph (i) of this section for rules regarding the additional reduction in the limitations prescribed by paragraphs (a) through (c) of this section by reason of the personal use of a passenger automobile or by reason of a short taxable year.

(e) Examples. The provisions of paragraphs (a) through (c) of this section may be illustrated by the following examples. For purposes of these examples, assume that all taxpayers use the calendar year and that no short taxable years are involved.

Example (1). (i) On July 1, 1984, B purchases for \$45,000 and places in service a passenger automobile which is 3-year recovery property under section 168. In 1984, B does not elect under section 179 to expense a portion of the cost of the automobile. The automobile is used exclusively in B's business during taxable years 1984 through 1990.

(ii) The maximum amount of B's investment tax credit is \$1,000 (i.e., the lesser of \$1,000 or  $.06 \times \$45,000$ ). B's unadjusted basis for purposes of section 168 is \$44,500 (i.e., \$45,000 reduced under section 48(q)(1) by \$500). B selects the use of the accelerated recovery percentages under section 168(b)(1).

(iii) The maximum amount of B's recovery deduction for 1984 is \$4,000 (i.e., the lesser of \$4,000 or  $.25 \times \$44,500$ ); for 1985, \$6,000 (i.e., the lesser of \$6,000 or  $.38 \times \$44,500$ ); and for 1986, \$6,000 (i.e., the lesser of \$6,000 or  $.37 \times \$44,500$ ).

(iv) At the beginning of taxable year 1987, B's unrecovered basis in the automobile is \$28,500 (i.e.,  $\$44,500 - \$16,000$ ). Under paragraph (c) of this section, B may expense \$6,000 of the unrecovered basis in the automobile in 1987. This expense is treated as a recovery deduction under section 168. For taxable years 1988 through 1990, B may deduct \$6,000 of the unrecovered basis per year. At the beginning of 1991, B's unrecovered basis in the automobile is \$4,500. During that year, B disposes of the automobile. B is not allowed a deduction for 1991 because no deduction would be allowable under section 168 based on these facts.

Example (2). (i) On July 1, 1984, C purchases for \$50,000 and places in service a passenger automobile which is 3-year recovery property under section 168. The automobile is used exclusively in C's business during taxable years 1984 through 1992. In 1984, C does not elect under section 179 to expense a portion of the automobile's cost. C elects under section 48(q)(4) to take a reduced investment tax credit in lieu of the section 48(q)(1) basis adjustment.

(ii) The maximum amount of C's investment tax credit is \$666.67 (i.e., the lesser of  $2/3$  of \$1,000 or  $.04 \times \$50,000$ ). C's unadjusted basis for purposes of section 168 is \$50,000. C elects to use the optional recovery percentages under section 168(b)(3) based on a 5-year recovery period.

(iii) The maximum amount of C's recovery deduction for 1984 is \$4,000 (i.e., the lesser of \$4,000 or  $.10 \times \$50,000$ ); for taxable years 1985 through 1988, \$6,000 per year (i.e., the lesser of \$6,000 or  $.20$  of \$50,000). C's recovery deduction for 1989 is \$5,000 (i.e., the lesser of  $.10 \times \$50,000$  or \$6,000).

(iv) At the beginning of taxable year 1990, C's unrecovered basis in the automobile is \$17,000. Under paragraph (c) of this section, C may expense \$6,000 of the unrecovered basis in the automobile in 1990. This expense is treated as a recovery deduction under section 168. For taxable years 1991 and 1992, C may deduct \$6,000, and \$5,000, respectively of the unrecovered basis per year.

Example (3). Assume the same facts as in example (2), except that C disposes of the passenger automobile on July 1, 1990. Under paragraph (c) of this section, C is not allowed a deduction for 1990 or for any succeeding taxable year because no deduction would be allowable under section 168 based on these facts.

Example (4). (i) On July 1, 1984, G purchases for \$15,000 and places in service a passenger automobile which is 3-year recovery property under section 168. The automobile is used exclusively in G's business during taxable years 1984 through 1987. In 1984, G elects under section 179 to expense \$5,000 of the cost of the property.

(ii) The maximum amount of G's investment tax credit is \$600 (i.e., the lesser of  $.06 \times \$10,000$  or \$1,000).

(iii) G's unadjusted basis for purposes of section 168 is \$9,700 (i.e., \$15,000 minus the sum of \$5,000 (the amount of the expense elected under section 179) and \$300 (one-half of the investment tax credit under section 48(q)(1))). Under paragraph (b)(4) of this section, the allowable deduction under section 179 is treated as a recovery deduction under section 168 for purposes of this section. Thus, the maximum amount of G's section 179 deduction is \$4,000 (i.e., the lesser of \$4,000 or  $\$5,000 + .25 \times \$9,700$ ). G is entitled to no further recovery deduction under section 168 for 1984. The amount of G's 1985 and 1986 recovery deductions are \$3,686 (i.e., the lesser of  $.38 \times \$9,700$  or \$6,000) and \$3,589 (i.e., the lesser of  $.37 \times \$9,700$  or \$6,000), respectively. At the beginning of 1987, G's unrecovered basis in the automobile is \$3,425 (i.e.,  $\$14,700 - \$11,275$ ). Under paragraph (c) of this section, G may expense the remaining \$3,425 in 1987.

Example (5). (i) On July 1, 1984, D purchases for \$55,000 and places in service a passenger automobile which is 3-year recovery property under section 168. The automobile is used exclusively in D's business during taxable years 1984 through 1993. In 1984, D elects under section 179 to expense \$5,000 of the cost of the property.

(ii) The maximum amount of D's investment tax credit is \$1,000 (i.e., the lesser of \$1,000 or  $.06 \times \$50,000$ ).

(iii) D's unadjusted basis for purposes of section 168 is \$49,500 (i.e., \$55,000 minus the sum of \$5,000 (the amount of the expense elected under section 179) and \$500 (one-half of the investment tax credit under section 48 (q)(1))). Under paragraph (b)(4) of this section, the allowable deduction under section 179 is treated as a recovery deduction under section 168 for purposes of this section. Thus, the maximum amount of D's section 179 deduction is \$4,000 (i.e., the lesser of \$4,000 or  $\$5,000 + .25 \times \$49,500$ ). D is entitled to no further recovery deduction under section 168 for 1984. The maximum amount of D's 1985 recovery deduction is \$6,000 (i.e., the lesser of \$6,000 or  $.38 \times \$49,500$ ); and for 1986, \$6,000 (i.e., the lesser of \$6,000 or  $.37$  of \$49,500).

(iv) At the beginning of 1987, D's unrecovered basis is \$38,500. D may expense the remaining unrecovered basis at the rate of \$6,000 per year through 1992 and \$2,500 in 1993.

Example (6). Assume the same facts as in example (5), except that in 1993, D uses the automobile only 60 percent in his business. Under paragraph (c)(4) of this section for 1993, D may expense \$1,500 (i.e.,  $.60 \times \$2,500$ ). D is entitled to no further deductions with respect to the automobile in any later year.

Example (7). (i) On July 1, 1984, F purchases for \$44,500 and places in service a passenger automobile which is 3-year recovery property under section 168. The automobile is used exclusively in F's business during taxable years 1984 through 1992. In 1984, F elects under section 179 to expense \$5,000 of the cost of the property.

(ii) F elects under section 48(q)(4) to take a reduced investment tax credit in lieu of the section 48(q)(1) basis adjustment. The maximum amount of F's investment tax credit is \$666.67 (i.e., the lesser of  $2/3$  of \$1,000 or  $.04 \times \$39,500$ ).

(iii) F's unadjusted basis for purposes of section 168 is \$39,500 (i.e., \$44,500-\$5,000 (the amount of the expense elected under section 179)). F elects to use the optional recovery percentage under section 168(b)(3) based on a 5-year recovery period. Under paragraph (b)(4) of this section, the allowable section 179 deduction is treated as a recovery deduction under section 168 for purposes of this section. Thus, the maximum amount of F's section 179 deduction is \$4,000 (i.e., the lesser of \$4,000 or  $\$5,000 + .10 \times \$39,500$ ). F is entitled to no further recovery deduction under section 168 for 1984. The maximum amounts of F's recovery deductions for 1985 through 1988 are \$6,000 per year (i.e., the lesser of \$6,000 or  $.20 \times \$39,500$ ). F's recovery deduction for 1989 (the first taxable year after the 5-year recovery period but the sixth recovery year for purposes of section 168) is \$3,950 (i.e., the lesser of  $.10 \times \$39,500$  or \$6,000).

(iv) Under paragraph (c), taxable year 1990 is considered to be the first taxable year succeeding the end of the recovery period. At the beginning of taxable year 1990, F's unrecovered basis in the automobile is \$12,550 (i.e., \$44,500-\$31,950). Under paragraph (c), F may expense \$6,000 of his unrecovered basis in the automobile in 1990 and in 1991. This expense is treated as a recovery deduction under section 168. For taxable year 1992, F may expense the remaining \$550 of his unrecovered basis in the automobile.

(f) Treatment of improvements that qualify as capital expenditures. An improvement to a passenger automobile that qualifies as a capital expenditure under section 263 is treated as a new item of recovery property placed in service in the year the improvement is made. However, the limitations in paragraph (b) of this section on the amount of recovery deductions allowable are determined by taking into account as a whole both the improvement and the property of which the improvement is a part. If that improvement also qualifies as an investment in new section 38 property under section 48(b) and §1.48-2(b)(2), the limitation in paragraph (a)(1) of this section on the amount of the investment tax credit for that improvement is determined by taking into account any investment tax credit previously allowed for the passenger automobile (including any prior improvement considered part of the passenger automobile). Thus, the maximum credit allowable for the automobile (including the improvement) will be \$1,000 (or 2/3 of \$1,000, in the case of an election to take a reduced credit under section 48(q)(4)) (adjusted under section 280F(d)(7) to reflect the automobile price inflation adjustment for the year the property of which the improvement is a part is placed in service).

(g) Treatment of section 1031 or section 1033 transactions-(1) Treatment of exchanged passenger automobile. For a taxable year in which a transaction described in section 1031 or section 1033 occurs, the unadjusted basis of an exchanged or converted passenger automobile shall cease to be taken into account in determining any recovery deductions allowable under section 168 as of the beginning of the taxable year in which the exchange or conversion occurs. Thus, no recovery deduction is allowable for the exchanged or converted automobile in the year of the exchange or conversion.

(2) Treatment of acquired passenger automobile-(i) In general. The acquired automobile is treated as new property placed in service in the year of the exchange (or in the replacement year) and that year is its first recovery year.

(ii) Limitations on recovery deductions. If the exchanged (or converted) automobile was acquired after the effective date of section 280F (as set out in §1.280F-1(c)), the basis of that automobile as determined under section 1031(d) or section 1033(b) (whichever is applicable) must be reduced for purposes of computing recovery deductions with respect to the acquired automobile (but not for purposes of determining the amount of the investment tax credit and gain or loss on the sale or other disposition of the property) by the excess (if any) of-

(A) The sum of the amounts that would have been allowable as recovery deductions with respect to the exchanged (or converted) automobile during taxable years preceding the year of the exchange (or conversion) if all of the use of the automobile during those years was use described in section 168(c), over

(B) The sum of the amounts allowable as recovery deductions during those years.

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

Example (1). (i) In 1982, F purchases and places in service a passenger automobile which is 3-year recovery property under section 168. The automobile is used exclusively in F's business.

(ii) On July 1, 1984, F exchanges the passenger automobile and \$1,000 cash for a new passenger automobile ("like kind" property). Under paragraph (g)(1) of this section, no recovery deduction is allowed in 1984 for the exchanged automobile. Any investment tax credit claimed with respect to that automobile is subject to recapture under section 47.

(iii) F's basis in the acquired property (as determined under section 1031(d) and F's qualified investment are \$20,000. Under the provisions of paragraph (g)(2)(i) of this section, the acquired property is treated as new recovery property placed in service in 1984 to the extent of the full \$20,000 of basis. The maximum amount of F's investment tax credit is limited to \$1,000 (i.e., the lesser of \$1,000 or  $.06 \times \$20,000$ ). Cost recovery deductions are computed pursuant to paragraph (b) of this section.

Example (2). (i) On July 1, 1984, E purchases for \$30,000 and places in service a passenger automobile which is 3-year recovery property under section 168. In 1984, E's business use percentage is 80 percent and such use constitutes his total business/investment use.

(ii) E elects under section 48(q)(4) to take a reduced investment tax credit in lieu of the section 48 (q)(1) basis adjustment. The maximum amount of E's investment tax credit is \$533.33 (i.e., the lesser of  $\frac{2}{3}$  of  $\$1,000 \times .80$  or  $.80 \times .04 \times \$30,000$ ).

(iii) E's unadjusted basis for purposes of section 168 is \$30,000. E selects the use of the accelerated recovery percentages under section 168(b)(1). The maximum amount of E's recovery deduction for 1984 is \$3,200 (i.e., the lesser of  $.80 \times \$4,000$  or  $.80 \times .25 \times \$30,000$ ).

(iv) On June 10, 1985, E exchanges the passenger automobile and \$1,000 cash for a new passenger automobile ("like kind" property). Under paragraph (g)(1) of this section, no recovery deduction is allowable in 1985 for the exchanged automobile. The investment tax credit claimed is subject to recapture under section 47. Under paragraph (g)(2)(ii) of this section, E's basis in the acquired property for purposes of computing recovery deductions under section 280F is \$27,000 (i.e., \$27,800 (section 1031(d) basis)-\$800). The acquired automobile is used exclusively in F's business during taxable years 1985 through 1988. Under paragraph (g)(2) of this section, the acquired property is treated as new recovery property placed in service in 1985. Assume that the automobile price inflation adjustment (as described under section 280F(d)(7)) is zero. E's qualified investment in the property, as determined under §1.46-3(c)(1), is \$27,800. The maximum amount of E's investment tax credit is \$1,000 (i.e., the lesser of \$1,000 or  $.06 \times \$27,800$ ). E's unadjusted basis for purposes of section 168 is \$26,500 (i.e., \$27,000 reduced under section 48(q)(1) by \$500). Cost recovery deductions are computed pursuant to paragraph (b) of this section.

(h) Other nonrecognition transactions. [Reserved]

(i) Limitation under this section applies before other limitations-

- (1) Personal use. The limitations imposed upon the maximum amount of the allowable investment tax credit and the allowable recovery deductions (as described in paragraphs (a) through (c) of this section) must be adjusted during any taxable year in which a taxpayer makes any use of a passenger automobile other than for business/investment use (as defined in §1.280F-6T(d)(3)). The limitations on the amount of the allowable investment tax credit (as described in paragraph (a) of this section) and the allowable cost recovery deductions (as described in paragraphs (b) and (c) of this section) are redetermined by multiplying the limitations by the percentage of business/investment use (determined on an annual basis) during the taxable year.

- (2) Short taxable year. The limitations imposed upon the maximum amount of the allowable recovery deductions (as described in paragraphs (a) through (c) of this section) must be adjusted during any taxable year in which a taxpayer has a short taxable year. In this case, the limitation is adjusted by multiplying the limitation that would have been applied if the taxable year were not a short taxable year by a fraction, the numerator of which is the number of months and part-months in the short taxable year and the denominator of which is 12.

- (3) Examples. The provisions of this paragraph (i) may be illustrated by the following examples:

Example (1). On July 1, 1984, A purchases and places in service a passenger automobile and uses it 80 percent for business/investment use during 1984. Under paragraph (i)(1) of this section, the maximum amount of the investment tax credit that A may claim for the automobile is \$800 (i.e.,  $.80 \times \$1,000$ ).

Example (2). Assume the same facts as in example (1), except that A elects under section 48(q)(4) to take a reduced investment tax credit in lieu of the section 48(q)(1) basis adjustment. Under paragraph (i)(1) of this section, the maximum amount of the investment tax credit that A may claim for the automobile is \$533.33 (i.e.,  $.80 \times \frac{2}{3} \times \$1,000$ ).

Example (3). On July 1, 1984, B purchases and places in service a passenger automobile and uses it 60 percent for business/investment use during 1984. Under paragraph (i)(1) of this section, the maximum amount of the investment tax credit that B may claim for the automobile is \$600 (i.e.,  $.60 \times \$1,000$ ). B uses the car 70 percent for business/investment use during 1985 and 80 percent during 1986. Under paragraph (i)(1) of this section, the maximum amount of recovery deductions that B may claim for 1984, 1985, and 1986 are \$2,400 (i.e.,  $.60 \times \$4,000$ ), \$4,200 (i.e.,  $.70 \times \$6,000$ ), and \$4,800 (i.e.,  $.80 \times \$6,000$ ), respectively.

Example (4). Assume the same facts as in example (3) with the added facts that B's unrecovered basis at the beginning of 1987 is \$6,000 and that B uses the automobile 85 percent for business/investment use during 1987. Under paragraph (i)(1) of this section, the maximum amount that B may claim as an expense for 1987 is \$5,000 (i.e.,  $.85 \times \$6,000$ ).

Example (5). On August 1, 1984, C purchases and places in service a passenger automobile and uses it exclusively for business. Taxable year 1984 for C is a short taxable year which consists of 6 months. Under paragraph (i)(2) of this section, the maximum amount that C may claim as a recovery deduction for 1984 is \$2,000 (i.e.,  $6/12 \times \$4,000$ ).

Example (6). Assume the same facts as in example (5), except that C uses the passenger automobile 70 percent for business/investment use during 1984. Under paragraph (i) (1) and (2) of this section, the maximum amount that C may claim as a recovery deduction for 1984 is \$1,400 (i.e.,  $.70 \times 6/12 \times \$4,000$ ).

Par. 4. New §1.280F-3T is added immediately after §1.280F-2T and reads as follows:

**§1.280F-3T Limitations on recovery deductions and the investment tax credit when the business use percentage of listed property is not greater than 50 percent. (Temporary).**

(a) In general. Section 280F(b), generally, imposes limitations with respect to the amount allowable as an investment tax credit under section 46(a) and the amount allowable as a recovery deduction under section 168 in the case of listed property (as defined in §1.280F-6T(b)) if certain business use of the property (referred to as "qualified business use") does not exceed 50 percent during a taxable year. "Qualified business use" generally means use in a trade or business, rather than use in an investment or other activity conducted for the production of income within the meaning of section 212. See §1.280F-6T(d) for the distinction between "business/investment use" and "qualified business use."

(b) Limitation on the amount of investment tax credit-(1) Denial of investment tax credit when business use percentage not greater than 50 percent. Listed property is not treated as section 38 property to any extent unless the business use percentage (as defined in section 280F(d)(6) and §1.280F-6T(d)(1)) is greater than 50 percent. For example, if a taxpayer uses listed property in a trade or business in the taxable year in which it is placed in service, but the business use percentage is not greater than 50 percent, no investment tax credit is allowed for that listed property. If, in the taxable year in which listed property is placed in service, the only business/investment use (as defined in §1.280F-6T(d)(3)) of that property is qualified business use (as defined in §1.280F-6T(d)(2)(i)), and the business use

percentage is 55 percent, the investment tax credit is allowed for the 55 percent of the listed property that is treated as section 38 property. The credit allowed is unaffected by any increase in the business use percentage in a subsequent taxable year.

(2) Recapture of investment tax credit. Listed property ceases to be section 38 property to the extent that the business/investment use (as defined in §1.280F-6T(d)(3)) for any taxable year is less than the business/investment use for the taxable year in which the property is placed in service. See §1.47-2(c). If the business use percentage (as defined in §1.280F-6T(d)(1)) of listed property is greater than 50 percent for the taxable year in which the property is placed in service, and less than or equal to 50 percent for any subsequent taxable year, that property ceases to be section 38 property in its entirety in that subsequent taxable year. Under §1.47-1(c)(1)(ii)(b), the property (or a portion thereof) is treated as ceasing to be section 38 property on the first day of the taxable year in which the cessation occurs.

(c) Limitation on the method of cost recovery under section 168 when business use of property not greater than 50 percent-

(1) Year of acquisition. If any listed property (as defined in §1.280F-6T(b)) is not predominantly used in a qualified business use (as defined in §1.280F-6T(d)(4)) in the year it is acquired, the recovery deductions allowed under section 168 for the property for that taxable year and for succeeding taxable years are to be determined using the straight line method over its earnings and profits life (as defined in paragraph (f) of this section). Additionally, the taxpayer is not entitled to make any election under section 179 with respect to the property for that year.

(2) Subsequent years. If any listed property is not subject to paragraph (c)(1) of this section because such property is predominantly used in a qualified business use (as defined in §1.280F-6T(d)(4)) during the year it is acquired but is not predominantly used in a qualified business use during a subsequent taxable year, the rules of this paragraph (c)(2) apply. In such a case, the taxpayer must determine the recovery deductions allowed under section 168 for the taxable year that the listed property is not predominantly used in a qualified business use and for any subsequent taxable year as if such property was not predominantly used in a qualified business use in the year in which it was acquired and there had been no section 179 election with respect to the property. Thus, the recovery deductions allowable under section 168 for the remaining taxable years are computed by determining the applicable recovery percentage that would apply if the taxpayer had used the straight line method over the property's earnings and profits life beginning with the year the property was placed in service.

(3) Effect of rule on recovery property that is not listed property. The mandatory use of the straight line method over the property's earnings and profits life under paragraphs (d) (1) and (2) of this section does not have any effect on the proper method of cost recovery for other recovery property of that same class placed in service in the same taxable year by the taxpayer and does not constitute an election to use an optional recovery period under section 168(b)(3).

(d) Recapture of excess recovery deductions claimed-

(1) In general. If paragraph (c)(2) of this section is applicable, any excess depreciation (as defined in paragraph (d)(2) of this section) must be included in the taxpayer's gross income and added to

the property's adjusted basis for the first taxable year in which the property is not predominantly used in a qualified business use (as defined in §1.280F-6T(d)(4)).

(2) Definition of "excess depreciation". For purposes of this section, the term "excess depreciation" means the excess (if any) of-

(i) The amount of the recovery deductions allowable with respect to the property for taxable years before the first taxable year in which the property was not predominantly used in a qualified business use, over

(ii) The amount of the recovery deductions which would have been allowable for those years if the property had not been predominantly used in a qualified business use for the year it was acquired and there had been no section 179 election with respect to the property.

**For purposes of paragraph (d)(2)(i), any deduction allowable under section 179 (relating to the election to expense certain depreciable trade or business assets) is treated as if that deduction was a recovery deduction under section 168.**

(3) Recordkeeping requirement. The taxpayer shall maintain adequate contemporaneous records (within the meaning of §1.274-5T) of the use of any listed property for any taxable year for which recapture under section 280F(b)(3) and paragraphs (d) (1) and (2) of this section may occur even if the taxpayer has fully depreciated (or expensed) the listed property in a prior year. For example, in the case of 3-year recovery property, the taxpayer shall maintain a log, journal, etc. for six years even though the taxpayer fully depreciated the property in the first three years.

(e) Earnings and profits life-(1) Definition. The earnings and profits life with respect to any listed property is generally the following:

In the case of--	The applicable recovery period is--
3-year property .....	5 years.
5-year property .....	12 years.
10-year property .....	25 years.
18-year real property and low-income housing	40 years.
15-year public utility property .....	35 years.

**However, if the recovery period applicable to any recovery property under section 168 is longer than the above assigned recovery period, such longer recovery period shall be used. For example, generally, the recovery period for recovery property used predominantly outside the United States is the property's present class life (as defined in section 168(g)(2)). In many cases, a property's present class life is longer than the recovery period assigned to the property under the above table. Pursuant to this paragraph (e)(1), the property's recovery period is its present class life.**

(2) Applicable recovery percentages. If the applicable recovery period is determined pursuant to the table prescribed in paragraph (e)(1) of this section, the applicable recovery percentage is:

(i) For property other than 18-year real property or low-income housing:

If the recovery year is-- And the recovery period is-- -----  
----- 5 12 25 35 -----  
----- 1 ..... 10 4 2 1 2 .....  
20 9 4 3 3 ..... 20 9 4 3 4 ..... 20 9 4 3 5  
..... 10 8 4 3 7 ..... ----- 8 4 3 8  
..... ----- 8 4 3 9 ..... ----- 8 4 3 10  
..... ----- 8 4 3 11 ..... ----- 8 4 3 12  
..... ----- 8 4 3 13 ..... ----- 4 4 3 14  
..... ----- 4 3 15 ..... ----- 4 3  
16 ..... ----- 4 3 17 ..... ----- 4  
3 18 ..... ----- 4 3 19 ..... -----  
4 3 20 ..... ----- 4 3 21 ..... -----  
- 4 3 22 ..... ----- 4 3 23 ..... -----  
--- 4 3 24 ..... ----- 4 3 25 ..... -----  
---- 4 3 26 ..... ----- 2 3 27 ..... -----  
----- 3 28 ..... ----- 3 29  
..... ----- 3 30 ..... -----  
----- 3 31 ..... ----- 3 32 ..... -----  
----- 2 33 ..... ----- 2 34  
..... ----- 2 35 ..... -----  
----- 2 36 ..... ----- 1 -----  
-----

(ii) For 18-year real property: [Reserved]

(iii) For low-income housing: [Reserved]

(f) Examples. The provisions of this section may be illustrated by the following examples. For purposes of these examples, assume that all taxpayers use the calendar year and that no short taxable years are involved.

Example (1). On July 1, 1984, B purchases for \$50,000 and places in service an item of listed property (other than a passenger automobile) which is 3-year recovery property under section 168. For the first taxable year that the property is in service, B used the property 40 percent in a trade or business, 40 percent for the production of income, and 20 percent for personal purposes. Although B's total business/investment use is greater than 50 percent, the business use percentage for that taxable year is only 40 percent. Under paragraph (b)(1) of this section, no investment tax credit is allowed for the property.

Example (2). (i) On January 1, 1985, C purchases for \$40,000 and places in service an item of listed property (other than a passenger automobile) that is 3-year recovery property under section 168. Seventy percent of the use of the property is in C's trade or business and 30 percent of the use is for personal purposes. C does not elect a reduced investment tax credit under section 48(q)(4). The amount of C's investment tax credit is \$1,680 (i.e.,  $\$40,000 \times .60 \times .10 \times .70$ ).

(ii) In addition, in 1986, only 55 percent of the use of the property is in C's trade or business and 45 percent of the use is for personal purposes. Under paragraph (b)(2) of this section, the property ceases to be section 38 property to the extent that the

use in a trade or business decreased below 70 percent. As a result, a portion of the investment tax credit must be recaptured as an increase in tax liability for 1986 under the rules of section 47 (relating to the recapture of investment tax credit). See section 47(a)(5) and §1.47-2(e) for rules relating to the computation of the recapture amount.

Example (3). On July 1, 1984, B purchases and places in service an item of listed property (other than a passenger automobile) that is 3-year recovery property. B elects to take a reduced investment tax credit under section 48(q)(4). In 1984, B uses the property exclusively in his business. Assume that B's 1984 allowable recovery deduction is \$12,500. In 1985 and 1986, the property is not predominantly used in a qualified business use. The investment tax credit claimed is subject to recapture in full under section 47 in 1985 since the property ceases to be section 38 property in its entirety on January 1, 1985. Under paragraph (c)(2) of this section, B must treat the property for 1985 and subsequent taxable years as if he recovered its cost over a 5-year recovery period (i.e., its earnings and profits life) using the straight line method (with the half-year convention) from the time it was placed in service. Therefore, taxable year 1985 is treated as the property's second recovery year (of its 5-year recovery period) and the applicable recovery deduction using the straight line method must be used to determine the recovery deduction. Under paragraph (d) of this section, B must recapture any excess depreciation claimed for taxable year 1984. If B had used the straight line method over a 5-year recovery period his recovery deduction for 1984 would have been \$5,000. Under paragraph (d)(2) of this section, B's excess depreciation is \$7,500 (i.e., \$12,500 - \$5,000) and that amount must be included in B's 1985 gross income and added to the property's basis. The taxable years 1986 through 1989 are the property's second through sixth recovery years, respectively, of such property's 5-year recovery period.

Example (4). Assume the same facts as in example (3), except that in 1986 B used the property exclusively in his business. B is entitled to no investment tax credit with respect to the property in 1986 and must continue to recover the property's cost over a 5-year recovery period using the straight line method.

Example (5). On July 1, 1984, H purchases and places in service listed property (other than a passenger automobile) which is 3-year recovery property under section 168. H selects the use of the accelerated recovery percentages under section 168. In 1984 through 1986, H uses the property exclusively for business. In 1987, the property is not predominantly used in a qualified business use. Under paragraph (c)(2) of this section, H must compute his 1987 and subsequent taxable year's recovery deductions using the straight line method over a 5-year recovery period with 1987 treated as the fourth recovery year. Under paragraph (d) of this section, H must recapture any excess depreciation claimed for taxable years 1984 through 1986 even though by 1987 the full cost of the property had already been recovered.

Example (6). Assume the same facts as in example (5), except that H uses the property exclusively for personal purposes in 1987. Under paragraph (d) of this section, H must recapture any excess depreciation claimed for taxable years 1984 through 1986. H is entitled to no cost recovery deduction under the 5-year straight line method for 1987. Assume further that in 1988 H uses the property 70 percent in his business. Thus, H's business use percentage for that year is 70 percent. Under paragraph (c)(2) of this section, H must compute his 1988 cost recovery deduction

using the straight line method over a 5-year recovery period with 1988 treated as the fifth recovery year.

Example (7). (i) On July 1, 1984, F purchases for \$70,000 and places in service listed property (other than a passenger automobile) which is 3-year recovery property under section 168. F's business use percentage for 1984 through 1986 is 60 percent. F elects under section 179 to expense \$5,000 of the cost of the property.

(ii) F elects a reduced investment tax credit under section 48(q)(4). The maximum amount of F's investment tax credit is \$1,560 (i.e.,  $\$65,000 \times .04 \times .60$ ).

(iii) F's unadjusted basis for purposes of section 168 is \$65,000 (i.e., \$70,000 reduced by the \$5,000 section 179 expense). F selects the use of the accelerated recovery percentages under section 168(b)(1). F's recovery deduction for 1984 is \$9,750 (i.e.,  $\$65,000 \times .25 \times .60$ ).

(iv) In 1985, the property is not predominantly used in a qualified business use. The investment tax credit claimed is subject to recapture in full under section 47 in 1985 since the property ceases to be section 38 property in its entirety on January 1, 1985. Under paragraph (c)(2) of this section, F must treat the property for 1985 and subsequent taxable years as if he recovered its cost over a 5-year recovery period (i.e., its earnings and profits life) using the straight line method (with the half year convention) from the time it was placed in service. Under paragraph (d) of this section, F must recapture any excess depreciation claimed for taxable year 1984. F's excess depreciation is \$10,550 [i.e.,  $(\$65,000 \times .25 \times .60 + \$5,000) - (\$70,000 \times .10 \times .60)$ ]. This amount must be included in F's 1985 gross income and added to the property's adjusted basis.

Example (8). (i) On July 1, 1984, G purchases for \$60,000 and places in service a passenger automobile which is 3-year recovery property under section 168.

(ii) In 1984, G's business use percentage is 80 percent and such use constitutes his total business/investment use. G elects under section 48(q)(4) to take a reduced investment tax credit in lieu of the basis adjustment under section 48(q)(1). The maximum amount of G's investment tax credit is \$533.33 (i.e., the lesser of  $.80 \times 2/3 \times \$1,000$  or  $\$60,000 \times .80 \times .04$ ).

(iii) In 1984, G does not elect under section 179 to expense a portion of the automobile's cost. G selects the use of the accelerated recovery percentages under section 168. G's unadjusted basis for purposes of section 168 is \$60,000. The maximum amount of G's 1984 recovery deduction is \$3,200 (i.e., the lesser of  $.80 \times \$4,000$  or  $.80 \times .25 \times \$60,000$ ).

(iv) In 1985, G's business use percentage is 80 percent and such use constitutes his total business/investment use. The maximum amount of G's 1985 recovery deduction is \$4,800 (i.e., the lesser of  $.80 \times \$6,000$  or  $.80 \times .38 \times \$60,000$ ).

(v) In 1986, G's business use percentage is 45 percent and such use constitutes his total business/investment use. Under paragraph (b)(2) of this section, as a result of the decline in the business use percentage to 50 percent or less, the automobile ceases to be section 38 property in its entirety and G must recapture (pursuant to

§§1.47-1(c) and 1.47-2(e)) the investment tax credit previously claimed. Since G's business use percentage in 1986 is not greater than 50 percent, under the provisions of paragraph (d) of this section, G must recompute (for recapture purposes) his recovery deductions for 1984 and 1985 using the straight line method over a 5-year recovery period (i.e., earnings and profits life for 3-year recovery property using the half-year convention) to determine if any excess depreciation must be included in his 1986 taxable income. G's recomputed recovery deductions for 1984 and 1985 are \$3,200 (i.e., the lesser of  $.80 \times \$4,000$  or  $.80 \times .10 \times \$60,000$ ), and \$4,800 (i.e., the lesser of  $.80 \times \$6,000$  or  $.80 \times .20 \times \$60,000$ ), respectively. G does not have to recapture any excess depreciation since his recovery deductions for 1984 and 1985 computed using the straight line method over a 5-year recovery period are the same as the amounts actually claimed during those years.

(vi) Under paragraph (c)(2) of this section, for 1986 and succeeding taxable years G must compute his remaining recovery deductions using the straight line method over a 5-year recovery period beginning with the third recovery year. The maximum amount of G's 1986 recovery deduction is \$2,700 (i.e., the lesser of  $.45 \times \$6,000$  or  $.45 \times .20 \times \$60,000$ ). For taxable years 1987 through 1993, G's business use percentage is 55 percent and such use constitutes his total business/investment use. G's 1987 and 1988 recovery deductions are \$3,300 per year (i.e., the lesser of  $.55 \times \$6,000$  or  $.55 \times .20 \times \$60,000$ ). For taxable year 1989 (the last recovery year), G's recovery deduction is \$3,300 (i.e.,  $.55 \times .10 \times \$60,000$  or  $.55 \times \$6,000$ ).

(vii) As of the beginning of 1990, G will have claimed a total of \$20,600 of recovery deductions. Under §1.280F-2T(c), G may expense his remaining unrecovered basis (up to a certain amount per year) in the first succeeding taxable year after the end of the recovery period and in taxable years thereafter. If G had used his automobile for 100 percent business use in taxable years 1984 through 1989, G could have claimed a recovery deduction of \$4,000 in 1984 and a recovery deduction of \$6,000 in each of those remaining years. At the beginning of 1990, therefore, G's unrecovered basis (as defined in section 280F(d)(8)) is \$26,000 (i.e.,  $\$60,000 - \$34,000$ ). The maximum amount of G's 1990 recovery deduction is \$3,300 (i.e.,  $.55 \times \$6,000$ ). At the beginning of 1991, G's unrecovered basis is \$20,000 (i.e.,  $\$26,000$  adjusted under section 280F(d)(2) and §1.280F-4T(a) to account for the amount that would have been claimed in 1990 for 100 percent business/investment use during that year). The maximum amount of G's 1991 recovery deduction is \$3,300 (i.e.,  $.55 \times \$6,000$ ) and his unrecovered basis as of the beginning of 1992 is \$14,000 (i.e.,  $\$20,000 - \$6,000$ ). In 1992, G disposes of the automobile. G is not allowed a recovery deduction for 1992.

Par. 5. New §1.280F-4T is added immediately after §1.280F-3T and reads as follows:

**§1.280F-4T Special rules for listed property (temporary).**

(a) Limitations on allowable recovery deductions in subsequent taxable years-(1) Subsequent taxable years affected by reason of personal use in prior years. For purposes of computing the amount of the recovery deduction for "listed property" for a subsequent taxable year, the amount that would have been allowable as a recovery deduction during an earlier taxable year if all of the use of the property was use described in section 168(c) is treated as the amount of the recovery deduction allowable during that earlier taxable year. The preceding sentence applies with respect to all earlier taxable years, beginning with the first taxable year in which

some or all use of the "listed property" is use described in section 168(c). For example, on July 1, 1984, B purchases and places in service listed property (other than a passenger automobile) which is 5-year recovery property under section 168. B selects the use of the accelerated percentages under section 168. B's business/investment use of the property (all of which is qualified business use as defined in section 280F(d)(6)(B) and §1.280F-6T(d)(2)) in 1984 through 1988 is 80 percent, 70 percent, 60 percent, and 55 percent, respectively, and B claims recovery deductions for those years based on those percentages. B's qualified business use for the property for 1989 and taxable years thereafter increases to 100 percent. Pursuant to this rule, B may not claim a recovery deduction in 1989 (or for any subsequent taxable year) for the increase in business use because there is no adjusted basis remaining to be recovered for cost recovery purposes after 1988.

(2) Special rule for passenger automobiles. In the case of a passenger automobile that is subject to the limitations of §1.280F-2T, the amount treated as the amount that would have been allowable as a recovery deduction if all of the use of the automobile was use described in section 168(c) shall not exceed \$4,000 for the year the passenger automobile is placed in service and \$6,000 for each succeeding taxable year (adjusted to account for the automobile price inflation adjustment, if any, under section 280F(d)(7) and for short taxable year under §1.280F-2T(i)(2)). See. §1.280F-3T(g). Example (8).

(b) Treatment of improvements that qualify as capital expenditures-(1) In general. In the case of any improvement that qualifies as a capital expenditure under section 263 made to any listed property other than a passenger automobile, the rules of this paragraph (b) apply. See §1.280F-2T(f) for the treatment of an improvement made to a passenger automobile.

(2) Investment tax credit allowed for the improvement. If the improvement qualifies as an investment in new section 38 property under section 48(b) and §1.48-2(b), the investment tax credit for that improvement is limited by paragraph (b)(1) of §1.280F-3T, as applied to the item of listed property as a whole.

(3) Cost recovery of the improvement. The improvement is treated as a new item of recovery property. The method of cost recovery with respect to that improvement is limited by §1.280F-3T(c), as applied to the item of listed property as a whole.

Par. 6. New §1.280F-5T is added immediately after §1.280F-4T and reads as follows:

**§1.280F-5T Leased property (temporary).**

(a) In general. Except as otherwise provided in this section, the limitation on cost recovery deductions and the investment tax credit provided in section 280F (a) and (b) and §§1.280F-2T and 1.280F-3T do not apply to any listed property leased or held for leasing by any person regularly engaged in the business of leasing listed property. If a person is not regularly engaged in the business of leasing listed property, the limitations on cost recovery deductions and the investment tax credit provided in section 280F and §§1.280F-2T and 1.280F-3T apply to such property leased or held for leasing by such person. The special rules for lessees set out in this section apply with respect to all lessees of listed property, even those whose lessors are not regularly engaged in the business of leasing listed property.

(b) Section 48(d) election. If a lessor elects under section 48(d) with respect to any listed property to treat the lessee as having acquired such property, the amount of the investment tax credit allowed to the lessee is subject to the limitation prescribed in §1.280F-3T(b) (1) and (2). If a lessor elects under section 48(d) with respect to any passenger automobile to treat the lessee as having acquired such automobile, the amount of the investment tax credit allowed to the lessee is also subject to the limitations prescribed in §1.280F-2T (a) and (i).

(c) Regularly engaged in the business of leasing. For purposes of paragraph (a) of this section, a person shall be considered regularly engaged in the business of leasing listed property only if contracts to lease such property are entered into with some frequency over a continuous period of time. The determination shall be made on the basis of the facts and circumstances in each case, taking into account the nature of the person's business in its entirety. Occasional or incidental leasing activity is insufficient. For example, a person leasing only one passenger automobile during a taxable year is not regularly engaged in the business of leasing automobiles. In addition, an employer that allows an employee to use the employer's property for personal purposes and charges such employee for the use of the property is not regularly engaged in the business of leasing with respect to the property used by the employee.

(d) Inclusions in income of lessees of passenger automobiles-(1) In general. For each taxable year during which a taxpayer leases a passenger automobile, the taxpayer must include in gross income an inclusion amount (prorated for the number of days of the lease term included in that taxable year) which is determined under this paragraph (d)(1) and multiplied by the business/investment use (as defined in §1.280F-6T(d)(3)(i)) for the particular taxable year. The inclusion amount-

(i) Is 7.5 percent of the excess (if any) of the automobile's fair market value over \$16,500 for each of the first three taxable years during which a passenger automobile is leased.

(ii) Is 6 percent of the excess (if any) of the automobile's fair market value over \$22,500 for the fourth taxable year during which a passenger automobile is leased.

(iii) Is 6 percent of the excess (if any) of the automobile's fair market value over \$28,500 for the fifth taxable year during which a passenger automobile is leased.

(iv) Is 6 percent of the excess (if any) of the automobile's fair market value over \$34,500 for the sixth taxable year during which a passenger automobile is leased.

**For the seventh and subsequent taxable years during which a passenger automobile is leased, the inclusion amount is 6 percent of the excess (if any) of the automobile's fair market value over the sum of (A) \$16,500 and (B) \$6,000 multiplied by the number of such taxable years in excess of three years. See paragraph (g)(2) of this section for the definition of fair market value.**

(2) Additional inclusion amount when less than predominant use in a qualified business use. (i) If a passenger automobile is not used predominantly in a qualified business use during a taxable year, the lessee must add to gross income in the first taxable year that the automobile is not so used (and only in that year) an inclusion

amount determined under this paragraph (d)(2). This inclusion amount is in addition to the amount required to be included in gross income under paragraph (d)(1) of this section.

(ii) If the fair market value (as defined in paragraph (g)(2) of this section) of the automobile is greater than \$16,500, the inclusion amount is determined by multiplying the average of the business/investment use (as defined in paragraph (g)(3) of this section) by the appropriate dollar amount from the table in paragraph (d)(3)(iii) of this section. If the fair market value (as defined in paragraph (g)(2) of this section) of the automobile is \$16,500 or less, the inclusion amount is the product of the fair market value of the automobile, the average business/investment use, and the applicable percentage from the table in paragraph (d)(3)(iv) of this section.

(iii) The dollar amount is determined under the following table: -----  
 ----- If a passenger automobile is not  
 The dollar amount: predominantly used in a qualified business use during-- -----  
 ----- Lease term (years) ---  
 ----- 1 2 3 4 or more  
 ----- The first  
 taxable year of the lease term ..... \$350 \$700 \$1,350 \$1,850  
 The second taxable year of the lease term ..... ----- 650  
 1,250 The third taxable year of the lease term ..... -----  
 ----- 650 -----

(iv) The applicable percentage is determined under the following table: -----  
 ----- If a passenger automobile  
 is not The applicable percentage: predominantly used in a qualified business use  
 during-- -----  
 Lease term (years) -----  
 ----- 1 2 3 4 or more -----  
 ----- The first taxable year of the lease term ..... 3.0 6.0  
 10.2 13.2 The second taxable year of the lease term ..... -----  
 1.25 6.2 10.4 The third taxable year of the lease term ..... -----  
 -- ----- 2.25 6.5 The fourth taxable year of the lease term .....  
 ----- ----- 1.7 The fifth taxable year of the lease term  
 ..... ----- 0.5 -----  
 -----

(e) Inclusions in income of lessees of listed property other than passenger automobiles- (1) In general. If listed property other than a passenger automobile is not used predominantly in a qualified business use in any taxable year in which such property is leased, the lessee must add to gross income in the first taxable year in which such property is not so predominantly used (and only in that year) an inclusion amount determined under this paragraph (e).

(2) Inclusion amount. The inclusion amount is the product of the following amounts:

(i) The fair market value (as defined in paragraph (g)(2) of this section) of the property,

(ii) The average business/investment use (as defined in paragraph (g)(3) of this section), and

(iii) The applicable percentage (as determined under paragraph (e)(3) of this section).

(3) Applicable percentages. The applicable percentages for 3-, 5-, and 10-year recovery property are determined according to the following tables:

(i) In the case of 3-year recovery property: -----  
----- Taxable year For the first taxable year in which the  
business use during lease percentage is 50 percent or less, the applicable term  
percentage for such taxable year is-- -----  
----- 1 2 3 4 5 6 and later -----  
----- For a lease term of: 1 year ..... 3.0 -----  
----- 2 years ..... 6.0 1.25 -----  
----- 3 years ..... 10.2 6.2 2.25 ----- 4 or more years  
..... 13.2 10.4 6.5 1.7 0.5 0 -----  
-----

(ii) In the case of 5-year recovery property: [Note: The following TABLE/FORM is too wide to be displayed on one screen. You must print it for a meaningful review of its contents. The table has been divided into multiple pieces with each piece containing information to help you assemble a printout of the table. The information for each piece includes: (1) a three line message preceding the tabular data showing by line # and character # the position of the upper left-hand corner of the piece and the position of the piece within the entire table; and (2) a numeric scale following the tabular data displaying the character positions.]

\*\*\*\*\*  
\*\*\*\*\* This is piece 1. -- It begins at character 1 of table line 1.  
\*\*\*\*\*  
\*\*\*\*\*  
\*\*\*\*\* Taxable year For the first  
taxable year during lease term ----- 1 2 3 -----  
----- For a lease term of: 1 year ..... 2.7 ----- 2  
years ..... 5.3 1.2 ----- 3 years ..... 9.9 6.1 1.6 4 years ..... 14.4 11.1 7.3 5  
years ..... 18.4 15.7 12.4 6 or more years ..... 21.8 19.6 16.7 -----  
-----  
1...+...10....+...20....+...30....+...40

\*\*\*\*\*  
\*\*\*\*\* This is piece 2. -- It begins at character 41 of table line 1.  
\*\*\*\*\*  
\*\*\*\*\*  
\*\*\*\*\*

in which the business use percentage is 50 percent or less, the applicable percentage  
for such taxable year is-- -----  
----- 4 5 6 7 8 9 10 11 12 -----  
-----  
-----  
----- 2.3 ----- ----- 8.2  
3.0 ----- ----- 13.5 9.6 5.25 4.4 3.6 2.8 1.8 1.0 0  
-----  
41..+...50....+...60....+...70....+...80....+...90....+...0....+...10....+.

(iii) In the case of 10-year recovery property: [Note: The following TABLE/FORM is too wide to be displayed on one screen. You must print it for a meaningful review of its contents. The table has been divided into multiple pieces with each piece containing information to help you assemble a printout of the table. The information for each piece includes: (1) a three line message preceding the tabular data showing by line # and character # the position of the upper left-hand corner of the piece and the position of the piece within the entire table; and (2) a numeric scale following the tabular data displaying the character positions.]

\*\*\*\*\*  
 \*\*\*\*\* This is piece 1. -- It begins at character 1 of table line 1.  
 \*\*\*\*\*  
 \*\*\*\*\*  
 \*\*\*\*\* Taxable  
 year For the first taxable year in which the business use during lease term -----  
 ----- 1 2 3 4 5 6 -----  
 ----- For a lease term of: 1 year ..... 2.5 ----- --  
 ----- 2 years ..... 5.1 .6 ----- 3 years  
 ..... 9.8 5.6 1.0 ----- 4 years ..... 14.0 10.3 6.2 1.4 -----  
 - 5 years ..... 17.9 14.5 10.9 6.7 1.8 ----- 6 years ..... 21.3 18.3 15.1 11.4 7.1  
 2.1 7 years ..... 21.9 19.0 15.9 12.4 8.4 3.9 8 years ..... 22.4 19.6 16.7 13.4  
 9.7 5.5 9 years ..... 22.9 20.2 17.4 14.3 10.9 7.0 10 years ..... 23.5 20.9 18.2  
 15.2 11.9 8.3 11 years ..... 23.9 21.4 18.8 16.0 12.8 9.3 12 years ..... 24.3 21.9  
 19.3 16.5 13.4 10.1 13 years ..... 24.7 22.2 19.7 16.9 14.0 10.7 14 years .....  
 25.0 22.5 20.1 17.3 14.4 11.1 15 or more years ..... 25.3 22.8 20.3 17.5 14.7  
 11.5  
 -----  
 1...+...10...+...20...+...30...+...40...+...50...+...60...+.

\*\*\*\*\*  
 \*\*\*\*\* This is piece 2. -- It begins at character 67 of table line 1.  
 \*\*\*\*\*  
 \*\*\*\*\*  
 -----  
 percentage is 50 pct or less, the applicable percentage for such -----  
 ----- 7 8 9 10 11 12 13 -----  
 -----  
 -----  
 ----- 2.4  
 ----- 4.5 2.7 -----  
 --- 6.4 5.1 3.0 ----- 8.1 7.2 5.7 3.3 ----- 9.4  
 8.9 7.7 5.9 3.1 ----- 10.3 10.0 9.3 7.8 5.5 2.9 ----- 11.1 11.0 10.4 9.2  
 7.4 5.2 2.7 11.6 11.7 11.3 10.3 8.8 6.9 4.8 12.0 12.2 11.9 11.1 9.8 8.2 6.5 -----  
 -----  
 67.....+...80...+...90...+...0...+...10...+...20...+...30.

\*\*\*\*\*  
 \*\*\*\*\* This is piece 3. -- It begins at character 132 of table line 1.  
 \*\*\*\*\*  
 \*\*\*\*\*  
 \*\*\*\*\* taxable year is-- ----- 14 15 -----  
 -----  
 -----  
 --- ----- 2.5 ----- 4.5 2.3 ----- 132....40...+...5

(f) Special rules applicable to inclusions in income of lessees. This paragraph (f) applies to the inclusions in gross income of lessees prescribed under paragraphs (d)(2) or (e) of this section.

(1) Lease term commences within 9 months of the end of lessee's taxable year. If-

(i) The lease term commences within 9 months before the close of the lessee's taxable year,

(ii) The property is not predominantly used in a qualified business use during that portion of the taxable year, and

(iii) The lease term continues into the lessee's subsequent taxable year,

**then the inclusion amount is added to gross income in the lessee's subsequent taxable year and the amount is determined by taking into account the average of the business/investment use for both taxable years and the applicable percentage for the taxable year in which the lease term begins (or, in the case of a passenger automobile with a fair market value greater than \$16,500, the appropriate dollar amount for the taxable year in which the lease term begins).**

(2) Lease term less than one year. If the lease term is less than one year, the amount which must be added to gross income is an amount that bears the same ratio to the inclusion amount determined before the application of this paragraph (f)(2) as the number of days in the lease term bears to 365.

(3) Maximum inclusion amount. The inclusion amount shall not exceed the sum of all deductible amounts in connection with the use of the listed property properly allocable to the lessee's taxable year in which the inclusion amount must be added to gross income.

(g) Definitions-(1) Lease term. In determining the term of any lease for purposes of this section, the rules of section 168(j)(6)(B) shall apply.

(2) Fair market value. For purposes of this section, the fair market value of listed property is such value on the first day of the lease term. If the capitalized cost of listed property is specified in the lease agreement, the lessee shall treat such amount as the fair market value of the property.

(3) Average business/investment use. For purposes of this section, the average business/investment use of any listed property is the average of the business/investment use for the first taxable year in which the business use percentage is 50 percent or less and all preceding taxable years in which such property is leased. See paragraph (f)(1) of this section for special rule when lease term commences within 9 months before the end of the lessee's taxable year.

(h) Examples. This section may be illustrated by the following examples.

Example (1). On January 1, 1985, A, a calendar year taxpayer, leases and places in service a passenger automobile with a fair market value of \$55,000. The lease is to

be for a period of four years. During taxable years 1985 and 1986, A uses the automobile exclusively in a trade or business. Under paragraph (d)(1) of this section, A must include in gross income in both 1985 and 1986, \$2,887.50 (i.e.,  $(\$55,000 - \$16,500) \times 7.5\%$ ).

Example (2). The facts are the same as in example (1), and in addition, A uses the automobile only 45 percent in a trade or business during 1987. Under paragraph (d)(1) of this section for 1987, A must include in gross income \$1,299.38 (i.e.,  $(\$55,000 - \$16,500) \times 7.5\% \times 45\%$ ). In addition, under paragraph (d)(2) of this section, A must also include in gross income in 1987, \$530.85 (i.e.,  $\$650 \times 81.67\%$ , average business/investment use).

Example (3). On August 1, 1985, B, a calendar year taxpayer, leases and places in service an item of listed property which is 5-year recovery property, with a fair market value of \$10,000. The lease is to be for a period of 5 years. B's qualified business use of the property is 40 percent in 1985, 100 percent in 1986, and 90 percent in 1987. Under paragraphs (e)(1) and (f)(1) of this section, before the application of paragraph (f)(3) of this section, B must include in gross income in 1986, \$1,288.00 (i.e.,  $\$10,000 \times 70\% \times 18.4\%$ , the product of the fair market value, the average business use for both taxable years, and the applicable percentage for year one from the table in paragraph (e)(3)(ii) of this section).

Example (4). On October 1, 1985, C, a calendar year taxpayer, leases and places in service an item of listed property which is 3-year recovery property with a fair market value of \$15,000. The lease term is 6 months (ending March 31, 1986) during which C uses the property 45 percent in a trade or business, the only business/investment use. Under paragraphs (e)(1) and (f)(1) and (2) of this section, before the application of paragraph (f)(3) of this section, C must include in gross income in 1986, \$100.97 (i.e.,  $\$15,000 \times 45\% \times 3\% \times 182/365$ , the product of the fair market value, the average business use for both taxable years, and the applicable percentage for year one from the table in paragraph (e)(3)(i) of this section, prorated for the length of the lease term).

Par. 7. New §1.280F-6T is added immediately after §1.280F-5T and reads as follows:

**§1.280F-6T Special rules and definitions (temporary).**

(a) Deductions of employee-(1) In general. Employee use of listed property shall not be treated as business/investment use (as defined in paragraph (d)(3) of this section) for purposes of determining the amount of any credit allowable under section 38 to the employee or the amount of any recovery deduction allowable (including any deduction under section 179) to the employee unless that use is for the convenience of the employer and required as a condition of employment.

(2) "Convenience of the employer" and "condition of employment" requirements-(i) In general. The terms "convenience of the employer" and "condition of employment" generally have the same meaning for purposes of section 280F as they have for purposes of section 119 (relating to the exclusion from gross income for meals or lodging furnished for the convenience of the employer).

(ii) "Condition of employment. In order to satisfy the "condition of employment" requirement, the use of the property must be required in order for the employee to

perform the duties of his or her employment properly. Whether the use of the property is so required depends on all the facts and circumstances. Thus, the employer need not explicitly require the employee to use the property. Similarly, a mere statement by the employer that the use of the property is a condition of employment is not sufficient.

(iii) "Convenience of employer". [Reserved]

(3) Employee use. For purposes of this section, the term "employee use" means any use in connection with the performance of services by the employee as an employee.

(4) Examples. The principles of this paragraph are illustrated in the following examples:

Example (1). A is employed as a courier with W, which provides local courier services. A owns and uses a motorcycle to deliver packages to downtown offices for W. W does not provide delivery vehicles and explicitly requires all of its couriers to own a car or motorcycle for use in their employment with the company. A's use of the motorcycle for delivery purposes is for the convenience of W and is required as a condition of employment.

Example (2). B is an inspector for X, a construction company with many construction sites in the local area. B is required to travel to the various construction sites on a regular basis; B uses her automobile to make these trips. Although X does not furnish B an automobile, X does not explicitly require B to use her own automobile. However, X reimburses B for any costs she incurs in traveling to the various job sites. B's use of her own automobile in her employment is for the convenience of X and is required as a condition of employment.

Example (3). Assume the same facts as in example (2), except that X makes an automobile available to B who chooses to use her own automobile and receive reimbursement. B's use of her own automobile is not for the convenience of X and is not required as a condition of employment.

Example (4). C is a pilot for Y, a small charter airline. Y requires its pilots to obtain x hours of flight time annually in addition to the number of hours of flight time spent with the airline. Pilots can usually obtain these hours by flying with a military reserve unit or by flying part-time with another airline. C owns his own airplane. C's use of his airplane to obtain the required flight hours is not for the convenience of the employer and is not required as a condition of employment.

Example (5). D is employed as an engineer with Z, an engineering contracting firm. D occasionally takes work home at night rather than working late in the office. D owns and uses a computer which is virtually identical to the one she uses at the office to complete her work at home. D's use of the computer is not for the convenience of her employer and is not required as a condition of employment.

(b) Listed property-(1) In general. Except as otherwise provided in paragraph (b)(5) of this section, the term "listed property" means-

(i) Any passenger automobile (as defined in paragraph (c) of this section),

(ii) Any other property used as a means of transportation (as defined in paragraph (b)(2) of this section),

(iii) Any property of a type generally used for purposes of entertainment, recreation, or amusement, and

(iv) Any computer or peripheral equipment (as defined in section 168(j)(5)(D)), and

(v) Any other property specified in paragraph (b)(4) of this section.

(2) "Means of transportation"-(i) In general. Except as otherwise provided in paragraph (b)(2)(ii) of this section, property used as a "means of transportation" includes trucks, buses, trains, boats, airplanes, motorcycles, and any other vehicles for transporting persons or goods.

(ii) Exception. The term "means of transportation" does not include any vehicle or property that is of a type ordinarily not susceptible to personal use. Examples of such property are forklifts, cement mixers, and trucks specially designed for specific business purposes, such as refrigerated delivery trucks. This paragraph (b)(2)(ii) does not apply with respect to any vehicle used by any individual for commuting purposes.

(3) Property used for entertainment, etc. Property of a type generally used for purposes of entertainment, recreation, or amusement includes property such as photographic, phonographic, communication, and video recording equipment.

(4) Other property. [Reserved]

(5) Exception for computers. The term "listed property" shall not include any computer (including peripheral equipment) used exclusively at a regular business establishment. For purposes of the preceding sentence, a portion of a dwelling unit shall be treated as a regular business establishment if (and only if) the requirements of section 280A(c)(1) are met with respect to that portion.

(c) Passenger automobile-(1) In general. Except as provided in paragraph (c)(3) of this section, the term "passenger automobile" means any 4-wheeled vehicle which is-

(i) Manufactured primarily for use on public streets, roads, and highways, and

(ii) Rated at 6,000 pounds gross vehicle weight or less.

(2) Parts, etc. of automobile. The term "passenger automobile" includes any part, component, or other item that is physically attached to the automobile or is traditionally included in the purchase price of an automobile. The term does not include repairs that are not capital expenditures within the meaning of section 263.

(3) Exception for certain vehicles. The term "passenger automobile" shall not include any-

(i) Ambulance, hearse, or combination ambulance-hearse used by the taxpayer directly in a trade or business,

(ii) Vehicle used by the taxpayer directly in the trade or business of transporting persons or property for compensation or hire, or

(iii) Commuter highway vehicle as defined in section 46(c)(6)(B).

(d) Business use percentage-(1) In general. The term "business use percentage" means the percentage of the use of any listed property which is qualified business use as described in paragraph (d)(2) of this section.

(2) Qualified business use-(i) In general. Except as provided in paragraph (d)(2)(ii) of this section, the term "qualified business use" means any use in a trade or business of the taxpayer. The term "qualified business use" does not include use for which a deduction is allowable under section 212. Whether the amount of qualified business use exceeds 50 percent is determinative of whether the investment tax credit and the accelerated percentages under section 168 are available for listed property (or must be recaptured). See §1.280F-3T.

(ii) Exception for certain use by 5-percent owners and related persons) (A) In general. The term "qualified business use" shall not include-

(1) Leasing property to any 5-percent owner or related person,

(2) Use of property provided as compensation for the performance of services by a 5-percent owner or related person, or

(3) Use of property provided as compensation for the performance of services by any person not described in paragraph (d)(2)(ii)(A)(2) of this section unless an amount is properly reported by the taxpayer as income to such person and, where required, there was withholding under chapter 24.

**Paragraph (d)(2)(ii)(A)(1) of this section shall apply only to the extent that the use of the listed property is by an individual who is a related party or a 5-percent owner with respect to the owner or lessee of the property.**

(B) Special rule for aircraft. Paragraph (d)(2)(ii)(A) of this section shall not apply with respect to any aircraft if at least 25 percent of the total use of the aircraft during the taxable year consists of qualified business use not described in paragraph (d)(2)(ii)(A).

(C) Definitions. For purposes of this paragraph-

(1) 5-percent owner. The term "5-percent owner" means any person who is a 5-percent owner with respect to the taxpayer (as defined in section 416 (i)(1)(B)(i)).

(2) Related person. The term "related person" means any person related to the taxpayer (within the meaning of section 267(b)).

(3) Business/investment use-(i) In general. The term "business/investment use" means the total business or investment use of listed property that may be taken into account for purposes of computing (without regard to section 280F(b)) the percentage of investment tax credit or cost recovery deduction for a passenger automobile or other listed property for the taxable year. Whether the investment tax credit and the accelerated percentages under section 168 (as opposed to use of the straight line method of cost recovery) are available with respect to listed property or must be recaptured is determined, however, by reference to qualified business use (as defined in paragraph (d)(2) of this section) rather than by reference to business/investment use. Whether a particular use of property is a business or investment use shall generally be determined under the rules of section 162 or 212.

(ii) Entertainment use. The use of listed property for entertainment, recreation, or amusement purposes shall be treated as business use to the extent that expenses (other than interest and property tax expenses) attributable to that use are deductible after application of section 274.

(iii) Employee use. See paragraph (a) of this section for requirements to be satisfied for employee use of listed property to be considered business/investment use of the property.

(iv) Use of taxpayer's automobile by another person. Any use of the taxpayer's automobile by another person shall not be treated, for purposes of section 280F, as use in a trade or business under section 162 unless that use-

(A) Is directly connected with the business of the taxpayer,

(B) Is properly reported by the taxpayer as income to the other person and, where required, there was withholding under chapter 24, or

(C) Results in a payment of fair market rent.

**For purposes of this paragraph (d)(4)(iv)(C), payment to the owner of the automobile in connection with such use is treated as the payment of rent.**

(4) Predominantly used in qualified business use-(i) Definition. Property is predominantly used in a qualified business use for any taxable year if the business use percentage (as defined in paragraph (d)(1) of this section) is greater than 50 percent.

(ii) Special rule for transfers at death. Property does not cease to be used predominantly in a qualified business use by reason of a transfer at death.

(iii) Other dispositions of property. [Reserved]

(5) Examples. The following examples illustrate the principles set forth in this paragraph.

Example (1). E uses a home computer 50 percent of the time to manage her investments. The computer is listed property within the meaning of section 280F(d)(4). E also uses the computer 40 percent of the time in her part-time

consumer research business. Because E's business use percentage for the computer does not exceed 50 percent, the computer is not predominantly used in a qualified business use for the taxable year. Her aggregate business/investment use for purposes of determining the percent of the total allowable straight line depreciation that she can claim is 90 percent.

Example (2). Assume that E in example (1) uses the computer 30 percent of the time to manage her investments and 60 percent of the time in her consumer research business. E's business use percentage exceeds 50 percent. Her aggregate business/investment use for purposes of determining her allowable investment tax credit and cost recovery deductions is 90 percent.

Example (3). F is the proprietor of a plumbing contracting business. F's brother is employed with F's company. As part of his compensation, F's brother is allowed to use one of the company automobiles for personal use. The use of the company automobiles by F's brother is not a qualified business use because F and F's brother are related parties within the meaning of section 267(b).

Example (4). F, in example (3), allows employees unrelated to him to use company automobiles as part of their compensation. F, however, does not include the value of these automobiles in the employees' gross income and F does not withhold with respect to the use of these automobiles. The use of the company automobiles by the employees in this case is not business/investment use.

Example (5). X Corporation owns several automobiles which its employees use for business purposes. The employees are also allowed to take the automobiles home at night. However, the fair market value of the use of the automobile for any personal purpose, e.g., commuting to work, is reported by X as income to the employee and is withheld upon by X. The use of the automobile by the employee, even for personal purposes, is a qualified business use with respect to X.

(e) Method of allocating use of property-(1) In general. For purposes of section 280F, the taxpayer shall allocate the use of any listed property that is used for more than one purpose during the taxable year to the various uses in the manner prescribed in paragraph (e) (2) and (3) of this section.

(2) Passenger automobiles and other means of transportation. In the case of a passenger automobile or any other means of transportation, the taxpayer shall allocate the use of the property on the basis of mileage. Thus, the percentage of use in a trade or business for the year shall be determined by dividing the number of miles the vehicle is driven for purposes of that trade or business during the year by the total number of miles the vehicle is driven during the year for any purpose.

(3) Other listed property. In the case of other listed property, the taxpayer shall allocate the use of that property on the basis of the most appropriate unit of time the property is actually used (rather than merely being available for use). For example, the percentage of use of a computer in a trade or business for a taxable year is determined by dividing the number of hours the computer is used for business purposes during the year by the total number of hours the computer is used for any purpose during the year.

There is need for immediate guidance with respect to the subject matter of this Treasury decision. For this reason, it is found impracticable to issue this Treasury decision with notice and public hearing procedures under subsection (b) of section 553 of title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in sections 280F and 7805 of the Internal Revenue Code of 1954 (98 Stat. 494, 26 U.S.C. 280F; 68A Stat. 917, 26 U.S.C. 7805).

Roscoe L. Egger, Jr.,

Commissioner of Internal Revenue.

Approved: October 15, 1984.

Ronald A. Pearlman,

Acting Assistant Secretary of Treasury.