the facility would be if it were determined without regard to section 168. If only a portion of a facility is certified under section 168(e), allowances for depreciation based on the rate and method properly used with respect to the uncertified part of the facility are used in determining what the adjusted basis of the facility would be if it were determined without regard to section 168. The principles of this paragraph may be illustrated by the following examples:

Example 1. On December 31, 1954, a taxpayer making his income tax returns on a calendar year basis acquires at a cost of $20,000 an emergency facility (used in his business) 50 percent of the adjusted basis of which has been certified under section 168(e). The facility would normally have a useful life of 20 years and a salvage value of $2,000 allocable equally between the certified and uncertified portions. Under section 168 the taxpayer elects to begin the 60-month amortization period on January 1, 1955. He takes amortization deductions with respect to the certified portion in the amount of $4,000 for the years 1955 and 1956 (24 months). On December 31, 1956, he sells the facility for a price of $19,000 which is allocable equally between the certified and uncertified portions. The adjusted basis of the certified portion on that date is $6,000 ($10,000 cost, less $4,000 amortization). With respect to the uncertified portion, the straight line method of depreciation is used and a deduction for depreciation in the amount of $450 is claimed and allowed for the year 1955. The adjusted basis of the uncertified portion on January 1, 1956, is $9,550 ($10,000 cost, less $450 depreciation). The depreciation allowance for the uncertified portion for the year 1956 would be limited to $50, the amount by which the adjusted basis of such portion at the beginning of the year exceeded its aliquot portion of the sales price. Thus, on December 31, 1956, the adjusted basis of the uncertified portion would be $9,500. Without regard to section 168, and using the rate and method the taxpayer properly applied to the uncertified portion of the facility, the adjusted basis of the certified portion on December 31, 1956, would be $9,500, computed in the same manner as the adjusted basis of the uncertified portion. The difference between the facility's actual adjusted basis ($15,500) and its adjusted basis determined without regard to section 168 ($19,000), is $3,500. Accordingly, the entire $3,500 gain on the sale of the facility ($19,000 sale price, less $15,500 adjusted basis) is treated as ordinary income.

Example 2. Assume that the entire facility in example (1) had been certified under section 168(e) and that, therefore, the adjusted basis of the facility on December 31, 1956, is $12,000. Assume further that the taxpayer adopts straight line depreciation as a proper method of depreciation for determining the adjusted basis of the facility without regard to section 168. Thus, the adjusted basis, without regard to section 168, would be $19,000. This amount is $7,000 more than the $12,000 adjusted basis under section 168. Hence, the entire $7,000 gain on the sale of the facility ($19,000 sale price less $12,000 adjusted basis) is treated as ordinary income.

(b) *Substituted basis.* If a taxpayer acquires other property in an exchange for an emergency facility with respect to which amortization deductions have been allowed or allowable, and if the basis in his hands of the other property is determined by reference to the basis of the emergency facility, then the basis of the other property is determined with regard to section 168, and therefore the provisions of section 1238 apply with respect to gain realized on a subsequent sale or exchange of the other property. The provisions of section 1238 also apply to gain realized on the sale or exchange of an emergency facility (or other property acquired, as described in the preceding sentence, in exchange for an emergency facility) by a taxpayer in whose hands the basis of the facility (or other property) is determined by reference to its basis in the hands of another person to whom deductions were allowable or allowed with respect to the facility under section 168.

[T.D. 6500, 25 FR 12020, Nov. 26, 1960, as amended by T.D. 6825, 30 FR 7281, June 2, 1965]

§ 1.1239–1 Gain from sale or exchange of depreciable property between certain related taxpayers after October 4, 1976.

(a) *In general.* In the case of a sale or exchange of property, directly or indirectly, between related persons after October 4, 1976 (other than a sale or exchange made under a binding contract entered into on or before that date), any gain recognized by the transferor shall be treated as ordinary income if such property is, in the hands of the transferee, subject to the allowance for depreciation provided in section 167. This rule also applies to property which would be subject to the allowance for depreciation provided in section 167 except that the purchaser has elected a different form of deduction, such as those allowed under sections 169, 188, and 191.

(b) *Related persons.* For purposes of paragraph (a) of this section, the term *related persons* means:

(1) A husband and wife,

(2) An individual and a corporation 80 percent or more in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual, or

(3) Two or more corporations 80 percent or more in value of the outstanding stock of each of which is owned, directly or indirectly, by or for the same individual.

(c) *Rules of construction*—(1) *Husband and wife.* For purposes of paragraph (b)(1) of this section, if on the date of the sale or exchange a taxpayer is legally separated from his spouse under an interlocutory decree of divorce, the taxpayer and his spouse shall not be treated as husband and wife, provided the sale or exchange is made pursuant to the decree and the decree subsequently becomes final. Thus, if pursuant to an interlocutory decree of divorce, an individual transfers depreciable property to his spouse and, because of this section, the gain recognized on the transfer of the property is treated as ordinary income, the individual may, if the interlocutory decree becomes final after his tax return has been filed, file a claim for a refund.

(2) *Sales between commonly controlled corporations.* In general, in the case of a sale or exchange of depreciable property between related corporations (within the meaning of paragraph (b)(3) of this section), gain which is treated as ordinary income by reason of this section shall be taxable to the transferor corporation rather than to a controlling shareholder. However, such gain shall be treated as ordinary income taxable to a controlling shareholder rather than the transferor corporation if the transferor corporation is used by a controlling shareholder as a mere conduit to make a sale to another controlled corporation, or the entity of the corporate transferor is otherwise properly disregarded for tax purposes. Sales between two or more corporations that are related within the meaning of paragraph (b)(3) of this section may also be subject to the rules of section 482 (relating to allocation of income between or among organizations, trades, or businesses which are commonly owned or controlled), and to rules requiring constructive dividend treatment to the controlling shareholder in appropriate circumstances.

(3) *Relationship determination for transfers made after January 6, 1983—taxpayer and an 80-percent owned entity.* For purposes of paragraph (b)(2) of this section with respect to transfers made after January 6, 1983—

(i) If the transferor is an entity, the transferee and such entity are related if the entity is an 80-percent owned entity with respect to such transferee either immediately before or immediately after the sale or exchange of depreciable property, and

(ii) If the transferor is not an entity, the transferee and such transferor are related if the transferee is an 80-percent owned entity with respect to such transferor immediately after the sale or exchange of depreciable property.

(4) *Relationship determination for transfers made after January 6, 1983—two 80-percent owned entities.* For purposes of paragraph (b)(3) of this section, with respect to transfers made after January 6, 1983, two entities are related if the same shareholder both owns 80 percent or more in value of the stock of the transferor before the sale or exchange of depreciable property and owns 80 percent or more in value of the stock of the transferee immediately after the sale or exchange of depreciable property.

(5) *Ownership of stock.* For purposes of determining the ownership of stock under this section, the constructive ownership rules of section 318 shall be applied, except that section 318(a)(2)(C) (relating to attribution of stock ownership from a corporation) and section 318(a)(3)(C) (relating to attribution of stock ownership to a corporation) shall be applied without regard to the 50-percent limitation contained therein. The application of the constructive ownership rules of section 318 to section 1239 is illustrated by the following examples:

Example 1. A, an individual, owns 79 percent of the stock (by value) of Corporation X, and a trust for A's children owns the remaining 21 percent of the stock. A's children are deemed to own the stock owned for their benefit by the trust in proportion to their actuarial interests in the trust (section 318(a)(2)(B)). A, in turn, constructively owns the stock so deemed to be owned by his children (section 318(a)(1)(A)(ii)). Thus, A is treated as owning all the stock of Corporation X, and any gain A recognizes from the sale of depreciable property to Corporation X is treated under section 1239 as ordinary income.

Example 2. Y Corporation owns 100 percent in value of the stock of Z Corporation. Y Corporation sells depreciable property at a gain to Z Corporation. P and his daughter, D, own 80 percent in value of the Y Corporation stock. Under the constructive ownership rules of section 318, as applied to section 1239, P and D are each considered to own the stock in Z Corporation owned by Y Corporation. Also, P and D are each considered to own the stock in Y Corporation owned by the other. As a result, both P and D constructively own 80 percent or more in value of the stock of both Y and Z Corporations. Thus, the sale between Y and Z is governed by section 1239 and produces ordinary income to Y.

[T.D. 7569, 43 FR 51388, Nov. 3, 1978, as amended by T.D. 8106, 51 FR 42835, Nov. 26, 1986]

§ 1.1239–2 Gain from sale or exchange of depreciable property between certain related taxpayers on or before October 4, 1976.

Section 1239 provides in general that any gain from the sale or exchange of depreciable property between a husband and wife or between an individual and a controlled corporation on or before October 4, 1976 (and in the case of a sale or exchange occurring after that date if made under a binding contract entered into on or before that date), shall be treated as ordinary income. Thus, any gain recognized to the transferor from a sale or exchange after May 3, 1951, and on or before October 4, 1976 (or thereafter if pursuant to a binding contract entered into on or before that date), directly or indirectly, between a husband and wife or between an individual and a controlled corporation, of property which, in the hands of the transferee, is property of a character subject to an allowance for depreciation provided in section 167 (including such property on which a deduction for amortization is allowable under sections 168 and 169) shall be considered as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231. For the purpose of section 1239, a corporation is controlled when more than 80 percent in value of all outstanding stock of the corporation is beneficially owned by the taxpayer, his spouse, and his minor children and minor grandchildren. For the purpose of this section, the terms *children* and *grandchildren* include legally adopted children and their children. The provisions of section 1239(a)(2) are applicable whether property is transferred from a corporation to a shareholder or from a shareholder to a corporation.

[T.D. 6500, 25 FR 12021, Nov. 26, 1960, as amended by T.D. 7569, 43 FR 51388, Nov. 3, 1978]

§ 1.1240–1 Capital gains treatment of certain termination payments.

Any amounts received by an employee for the assignment or release of all his rights to receive, after termination of his employment and for a period of not less than five years or for a period ending with his death, a percentage of the profits or receipts of his employer attributable to a time subsequent to such termination, are considered received from the sale or exchange of a capital asset held for more than six months if the following requirements are met:

(a) The employee was employed by the employer, in whose future profits or receipts the employee had an interest, for a period of more than 20 years before the assignment or release by the employee of his rights in such future profits or receipts,

(b) The full rights of the employee to the percentage of the future profits or receipts on such employer, which rights are the subject of the assignment or release, were incorporated in the terms of the contract of employment between the employee and the employer for a period of at least 12 years, and were so incorporated before August 16, 1954,

(c) The assignment or release was made after the termination of the employee's employment with such employer,

(d) The assignment or release conveyed all the rights of the employee in