

*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.,  $.70 \times \frac{1}{12} \times \$4,000$ ).

(98 Stat. 494, 26 U.S.C. 280F; 68A Stat. 917, 26 U.S.C. 7805)

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**§ 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-6(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-6(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-6(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-6(d)(3)) of that property is qualified business use (as defined in § 1.280F-6(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-6(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-6(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-6(b)) is not predominantly used in a qualified business use (as defined in § 1.280F-6(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-6(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

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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-6(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.* A taxpayer must be able to substantiate the use of any listed property, as prescribed in section 274(d)(4) and § 1.274-5T or § 1.274-6T, for any taxable year for which recapture under section 280F(b)(3) and paragraph (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:

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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
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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 recap-

ture 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  $.80\% \times \$1,000$  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×\$6,000 or .45×.20×\$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×\$6,000 or .55×.20×\$60,000). For taxable year 1989 (the last recovery year), G's recovery deduction is \$3,300 (*i.e.*, .55×.10×\$60,000 or .55×\$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×\$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×\$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.

(98 Stat. 494, 26 U.S.C. 280F; 68A Stat. 917, 26 U.S.C. 7805)

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#### § 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-6(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-