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UNITED STATES CODE SERVICE  
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\*\*\* CURRENT THROUGH PL 110-460, APPROVED 12/23/2008 \*\*\*

TITLE 26. INTERNAL REVENUE CODE  
SUBTITLE A. INCOME TAXES  
CHAPTER 1. NORMAL TAXES AND SURTAXES  
SUBCHAPTER A. DETERMINATION OF TAX LIABILITY  
PART IV. CREDITS AGAINST TAX  
SUBPART E. RULES FOR COMPUTING INVESTMENT CREDIT

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*26 USCS § 47*

§ 47. Rehabilitation credit.

(a) General rule. For purposes of section 46 [26 USCS § 46], the rehabilitation credit for any taxable year is the sum of-

(1) 10 percent of the qualified rehabilitation expenditures with respect to any qualified rehabilitated building other than a certified historic structure, and

(2) 20 percent of the qualified rehabilitation expenditures with respect to any certified historic structure.

(b) When expenditures taken into account.

(1) In general. Qualified rehabilitation expenditures with respect to any qualified rehabilitated building shall be taken into account for the taxable year in which such qualified rehabilitated building is placed in service.

(2) Coordination with subsection (d). The amount which would (but for this paragraph) be taken into account under paragraph (1) with respect to any qualified rehabilitated building shall be reduced (but not below zero) by any amount of qualified rehabilitation expenditures taken into account under subsection (d) by the taxpayer or a predecessor of the taxpayer (or, in the case of a sale and leaseback described in section 50(a)(2)(C) [26 USCS § 50(a)(2)(C)], by the lessee), to the extent any amount so taken into account has not been required to be recaptured under section 50(a) [26 USCS § 50(a)].

(c) Definitions. For purposes of this section--

(1) Qualified rehabilitated building.

(A) In general. The term 'qualified rehabilitated building' means any building (and its structural components) if--

(i) such building has been substantially rehabilitated,

(ii) such building was placed in service before the beginning of the rehabilitation,

(iii) in the case of any building other than a certified historic structure, in the rehabilitation process--

(I) 50 percent or more of the existing external walls of such building are retained in place as external walls,

(II) 75 percent or more of the existing external walls of such building are retained in place as internal or external walls, and

(III) 75 percent or more of the existing internal structural framework of such building is retained in place, and

(iv) depreciation (or amortization in lieu of depreciation) is allowable with respect to such building.

(B) Building must be first placed in service before 1936. In the case of a building other than a certified historic structure, a building shall not be a qualified rehabilitated building unless the building was first placed in service before 1936.

(C) Substantially rehabilitated defined.

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(i) In general. For purposes of subparagraph (A)(i), a building shall be treated as having been substantially rehabilitated only if the qualified rehabilitation expenditures during the 24-month period selected by the taxpayer (at the time and in the manner prescribed by regulation) and ending with or within the taxable year exceed the greater of--

- (I) the adjusted basis of such building (and its structural components), or
- (II) \$ 5,000.

The adjusted basis of the building (and its structural components) shall be determined as of the beginning of the 1st day of such 24-month period, or of the holding period of the building, whichever is later. For purposes of the preceding sentence, the determination of the beginning of the holding period shall be made without regard to any reconstruction by the taxpayer in connection with the rehabilitation.

(ii) Special rule for phased rehabilitation. In the case of any rehabilitation which may reasonably be expected to be completed in phases set forth in architectural plans and specifications completed before the rehabilitation begins, clause (i) shall be applied by substituting '60-month period' for '24-month period'.

(iii) Lessees. The Secretary shall prescribe by regulation rules for applying this subparagraph to lessees.

(D) Reconstruction. Rehabilitation includes reconstruction.

(2) Qualified rehabilitation expenditure defined.

(A) In general. The term 'qualified rehabilitation expenditure' means any amount properly chargeable to capital account--

(i) for property for which depreciation is allowable under section 168 [26 USCS § 168] and which is--

- (I) nonresidential real property,
- (II) residential rental property,
- (III) real property which has a class life of more than 12.5 years, or
- (IV) an addition or improvement to property described in subclause (I), (II), or (III), and

(ii) in connection with the rehabilitation of a qualified rehabilitated building.

(B) Certain expenditures not included. The term 'qualified rehabilitation expenditure' does not include--

(i) Straight line depreciation must be used. Any expenditure with respect to which the taxpayer does not use the straight line method over a recovery period determined under subsection (c) or (g) of section 168 [26 USCS § 168]. The preceding sentence shall not apply to any expenditure to the extent the alternative depreciation system of section 168(g) [26 USCS § 168(g)] applies to such expenditure by reason of subparagraph (B) or (C) of section 168(g)(1) [26 USCS § 168(g)(1)].

(ii) Cost of acquisition. The cost of acquiring any building or interest therein.

(iii) Enlargements. Any expenditure attributable to the enlargement of an existing building.

(iv) Certified historic structure, etc. Any expenditure attributable to the rehabilitation of a certified historic structure or a building in a registered historic district, unless the rehabilitation is a certified rehabilitation (within the meaning of subparagraph (C)). The preceding sentence shall not apply to a building in a registered historic district if--

(I) such building was not a certified historic structure,

(II) the Secretary of the Interior certified to the Secretary that such building is not of historic significance to the district, and

(III) if the certification referred to in subclause (II) occurs after the beginning of the rehabilitation of such building, the taxpayer certifies to the Secretary that, at the beginning of such rehabilitation, he in good faith was not aware of the requirements of subclause (II).

(v) Tax-exempt use property.

(I) In general. Any expenditure in connection with the rehabilitation of a building which is allocable to the portion of such property which is (or may reasonably be expected to be) tax-exempt use property (within the meaning of section 168(h) [26 USCS § 168(h)], except that "50 percent" shall be substituted for "35 percent" in paragraph (1)(B)(iii) thereof).

(II) Clause not to apply for purposes of paragraph (1)(C). This clause shall not apply for purposes of determining under paragraph (1)(C) whether a building has been substantially rehabilitated.

(vi) Expenditures of lessee. Any expenditure of a lessee of a building if, on the date the rehabilitation is completed, the remaining term of the lease (determined without regard to any renewal periods) is less than the recovery period determined under section 168(c) [26 USCS § 168(c)].

(C) Certified rehabilitation. For purposes of subparagraph (B), the term 'certified rehabilitation' means any rehabilitation of a certified historic structure which the Secretary of the Interior has certified to the Secretary as being consistent with the historic character of such property or the district in which such property is located.

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(D) Nonresidential real property; residential rental property; class life. For purposes of subparagraph (A), the terms 'nonresidential real property,' 'residential rental property,' and 'class life' have the respective meanings given such terms by section 168 [26 USCS § 168].

(3) Certified historic structure defined.

(A) In general. The term 'certified historic structure' means any building (and its structural components) which--

(i) is listed in the National Register, or

(ii) is located in a registered historic district and is certified by the Secretary of the Interior to the Secretary as being of historic significance to the district.

(B) Registered historic district. The term 'registered historic district' means--

(i) any district listed in the National Register, and

(ii) any district--

(I) which is designated under a statute of the appropriate State or local government, if such statute is certified by the Secretary of the Interior to the Secretary as containing criteria which will substantially achieve the purpose of preserving and rehabilitating buildings of historic significance to the district, and

(II) which is certified by the Secretary of the Interior to the Secretary as meeting substantially all of the requirements for the listing of districts in the National Register.

(d) Progress expenditures.

(1) In general. In the case of any building to which this subsection applies, except as provided in paragraph (3)--

(A) if such building is self-rehabilitated property, any qualified rehabilitation expenditure with respect to such building shall be taken into account for the taxable year for which such expenditure is properly chargeable to capital account with respect to such building, and

(B) if such building is not self-rehabilitated property, any qualified rehabilitation expenditure with respect to such building shall be taken into account for the taxable year in which paid.

(2) Property to which subsection applies.

(A) In general. This subsection shall apply to any building which is being rehabilitated by or for the taxpayer if--

(i) the normal rehabilitation period for such building is 2 years or more, and

(ii) it is reasonable to expect that such building will be a qualified rehabilitated building in the hands of the taxpayer when it is placed in service.

Clauses (i) and (ii) shall be applied on the basis of facts known as of the close of the taxable year of the taxpayer in which the rehabilitation begins (or, if later, at the close of the first taxable year to which an election under this subsection applies).

(B) Normal rehabilitation period. For purposes of subparagraph (A), the term 'normal rehabilitation period' means the period reasonably expected to be required for the rehabilitation of the building--

(i) beginning with the date on which physical work on the rehabilitation begins (or, if later, the first day of the first taxable year to which an election under this subsection applies), and

(ii) ending on the date on which it is expected that the property will be available for placing in service.

(3) Special rules for applying paragraph (1). For purposes of paragraph (1)--

(A) Component parts, etc. Property which is to be a component part of, or is otherwise to be included in, any building to which this subsection applies shall be taken into account--

(i) at a time not earlier than the time at which it becomes irrevocably devoted to use in the building, and

(ii) as if (at the time referred to in clause (i)) the taxpayer had expended an amount equal to that portion of the cost to the taxpayer of such component or other property which, for purposes of this subpart [26 USCS §§ 46 et seq.], is properly chargeable (during such taxable year) to capital account with respect to such building.

(B) Certain borrowing disregarded. Any amount borrowed directly or indirectly by the taxpayer from the person rehabilitating the property for him shall not be treated as an amount expended for such rehabilitation.

(C) Limitation for buildings which are not self-rehabilitated.

(i) In general. In the case of a building which is not self-rehabilitated, the amount taken into account under paragraph (1)(B) for any taxable year shall not exceed the amount which represents the portion of the overall cost to the taxpayer of the rehabilitation which is properly attributable to the portion of the rehabilitation which is completed during such taxable year.

(ii) Carry-over of certain amounts. In the case of a building which is not a self-rehabilitated building, if for the taxable year--

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(I) the amount which (but for clause (i)) would have been taken into account under paragraph (1)(B) exceeds the limitation of clause (i), then the amount of such excess shall be taken into account under paragraph (1)(B) for the succeeding taxable year, or

(II) the limitation of clause (i) exceeds the amount taken into account under paragraph (1)(B), then the amount of such excess shall increase the limitation of clause (i) for the succeeding taxable year.

(D) Determination of percentage of completion. The determination under subparagraph (C)(i) of the portion of the overall cost to the taxpayer of the rehabilitation which is properly attributable to rehabilitation completed during any taxable year shall be made, under regulations prescribed by the Secretary, on the basis of engineering or architectural estimates or on the basis of cost accounting records. Unless the taxpayer establishes otherwise by clear and convincing evidence, the rehabilitation shall be deemed to be completed not more rapidly than ratably over the normal rehabilitation period.

(E) No progress expenditures for certain prior periods. No qualified rehabilitation expenditures shall be taken into account under this subsection for any period before the first day of the first taxable year to which an election under this subsection applies.

(F) No progress expenditures for property for year it is placed in service, etc. In the case of any building, no qualified rehabilitation expenditures shall be taken into account under this subsection for the earlier of--

(i) the taxable year in which the building is placed in service, or

(ii) the first taxable year for which recapture is required under section 50(a)(2) [26 USCS § 50(a)(2)] with respect to such property,

or for any taxable year thereafter.

(4) Self-rehabilitated building. For purposes of this subsection, the term 'self-rehabilitated building' means any building if it is reasonable to believe that more than half of the qualified rehabilitation expenditures for such building will be made directly by the taxpayer.

(5) Election. This subsection shall apply to any taxpayer only if such taxpayer has made an election under this paragraph. Such an election shall apply to the taxable year for which made and all subsequent taxable years. Such an election, once made, may be revoked only with the consent of the Secretary.

**HISTORY:**

(Added Oct. 16, 1962, P.L. 87-834, § 2(b), 76 Stat. 966; Dec. 30, 1969, P.L. 91-172, Title VII, § 703(c), 83 Stat. 666; Jan. 12, 1971, P.L. 91-676, § 1, 84 Stat. 2060; Dec. 10, 1971, P.L. 92-178, Title I, §§ 102(c), 107(a)(1), (b)(1), 85 Stat. 500, 507; March 29, 1975, P.L. 94-12, Title III, § 302(b)(2)(A), (c)(1), (2), 89 Stat. 43, 44; Oct. 4, 1976, P.L. 94-455, Title VIII, § 804(b), Title XIX, § 1906(b)(13)(A), 90 Stat. 1594, 1834; Nov. 6, 1978, P.L. 95-600, Title III, § 317(a), 92 Stat. 2830; Nov. 9, 1978, P.L. 95-618, Title II, § 241(b), 92 Stat. 3193; Aug. 13, 1981, P.L. 97-34, Title II, § 211(f)(2), (g), 95 Stat. 231, 233; Sept. 3, 1982, P.L. 97-248, Title II, § 208(a)(2)(B), 96 Stat. 435; Jan. 12, 1983, P.L. 97-448, Title I, § 102(e)(3), 96 Stat. 2371; July 18, 1984, P.L. 98-369, Div A, Title IV, §§ 421(b)(7), 431(b)(2), (d)(4), (5), 474(o)(8), (9), 98 Stat. 794, 807, 810, 836; Oct. 4, 1984, P.L. 98-443, § 9(p), 98 Stat. 1708; Oct. 11, 1985, P.L. 99-121, Title I, § 103(b)(6), 99 Stat. 510; Oct. 22, 1986, P.L. 99-514, Title XV, § 1511(c)(2), Title XVIII, §§ 1802(a)(5)(A), 1844(b)(1), (2), (4), 100 Stat. 2744, 2788, 2855; Nov. 10, 1988, P.L. 100-647, Title I, §§ 1002(a)(18), (26)-(28), 1007(g)(3)(A), 102 Stat. 3356, 3357, 3435; Nov. 5, 1990, P.L. 101-508, Title XI, §§ 11801(c)(8)(A), 11813(a), 104 Stat. 1388-524, 1388-536.)

(As amended July 30, 2008, P.L. 110-289, Div C, Title I, Subtitle C, § 3025(a), 122 Stat. 2897.)

**HISTORY; ANCILLARY LAWS AND DIRECTIVES**

Amendments:

In 2008, P.L. 110-289, Sec. 3025(a) (applicable to expenditures properly taken into account for periods after 12/31/2007, as provided by Sec. 3025(b) of P.L. 110-289, which appears as a note to this section), amended subsec. (c)(2)(B)(v)(I) by substituting "section 168(h), except that '50 percent' shall be substituted for '35 percent' in paragraph (1)(B)(iii) thereof" for "section 168(h)".

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In 1990, P.L. 101-508, Sec. 11813(a), amended Code Sec. 47 as part of the amendment to subpart E, of part IV of subchapter A of chapter 1, effective for property placed in service after 12/31/90 except as provided in Sec. 11813(c)(2) of this Act, reproduced in note following Code Sec. 29.

Prior to amendment, Code Sec. 47 read as follows:

"Sec. 47. Certain dispositions, etc., of section 38 property.

"(a) *General rule.*

"Under regulations prescribed by the Secretary--

"(1) Early disposition, etc. If during any taxable year any property is disposed of, or otherwise ceases to be section 38 property with respect to the taxpayer, before the close of the useful life which was taken into account in computing the credit under section 38, then the tax under this chapter for such taxable year shall be increased by an amount equal to the aggregate decrease in the credits allowed under section 38 for all prior taxable years which would have resulted solely from substituting, in determining qualified investment, for such useful life the period beginning with the time such property was placed in service by the taxpayer and ending with the time such property ceased to be section 38 property.

"(2) Property becomes public utility property. If during any taxable year any property taken into account in determining qualified investment becomes public utility property (within the meaning of section 46(c)(3)(B)), then the tax under this chapter for such taxable year shall be increased by an amount equal to the aggregate decrease in the credits allowed under section 38 for all prior taxable years which would have resulted solely from treating the property, for purposes of determining qualified investment, as public utility property (after giving due regard to the period before such change in use). If the application of this paragraph to any property is followed by the application of paragraph (1) to such property, proper adjustment shall be made in applying paragraph (1).

"(3) Property ceases to be progress expenditure property.

"(A) In general. If during any taxable year any property taken into account in determining qualified investment under section 46(d) ceases (by reason of sale or other disposition, cancellation or abandonment of contract, or otherwise) to be, with respect to the taxpayer, property which, when placed in service, will be new section 38 property, then the tax under this chapter for such taxable year shall be increased by an amount equal to the aggregate decrease in the credits allowed under section 38 for all prior taxable years which would have resulted solely from reducing to zero the qualified investment taken into account with respect to such property.

"(B) Certain excess credit recaptured. Any amount which would have been applied as a reduction of the qualified investment in property by reason of paragraph (4) of section 46(c) but for the fact that a reduction under such paragraph cannot reduce qualified investment below zero shall be treated as an amount required to be recaptured under subparagraph (A) for the taxable year in which the property is placed in service.

"(C) Certain sales and leasebacks. Under regulations prescribed by the Secretary a sale by, and leaseback to, a taxpayer who, when the property is placed in service, will be a lessee to whom section 48(d) applies shall not be treated as a cessation described in subparagraph (A) to the extent that the qualified investment which will be passed through to the lessee under section 48(d) with respect to such property is not less than the qualified progress expenditures properly taken into account by the lessee with respect to such property.

"(D) Coordination with paragraphs (1) and (5). If, after property is placed in service, there is a disposition or other cessation described in paragraph (1), or a disposition, cessation, or change in expected use described in paragraph (5), then paragraph (1) or (5), as the case may be, shall be applied as if any credit, which was allowable by reason of section 46(d) and which has not been required to be recaptured before such disposition, cessation, or change in use were allowable for the taxable year the property was placed in service.

"(4) Special rules for commuter highway vehicles.

"(A) Useful life. For purposes of this subsection, 3 years shall be treated as the useful life which was taken into account in computing the credit under section 38 with respect to any commuter highway vehicle (as defined in section 46(c)(6)(B)).

"(B) Change in use. If less than 80 percent of the mileage use of any commuter highway vehicle by the taxpayer during that portion of any taxable year which is within the first 36 months of the operation of such vehicle by the taxpayer meets the requirements of section 46(c)(6)(B), then the tax under this chapter for such taxable year shall be increased by an amount equal to the aggregate decrease in the credits allowed under section 38 for all prior taxable years which would have resulted solely from treating such vehicle, for purposes of determining qualified investment, as not being a commuter highway vehicle. If the application of this subparagraph to any property is followed by the application of paragraph (1) to such property, proper adjustment shall be made in applying paragraph (1).

"(5) Special rules for recovery property.

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"(A) General rule. If, during any taxable year, section 38 recovery property is disposed of, or otherwise ceases to be section 38 property with respect to the taxpayer before the close of the recapture period, then, except as provided in subparagraph (D), the tax under this chapter for such taxable year shall be increased by the recapture percentage of the aggregate decrease in the credits allowed under section 38 for all prior taxable years which would have resulted solely from reducing to zero the qualified investment taken into account with respect to such property.

"(B) Recapture percentage. For purposes of subparagraph (A), the recapture percentage shall be determined in accordance with the following table:

| If the recovery<br>property ceases to<br>be section 38<br>property within--      | The recapture percentage is:               |                        |
|--|--|------------------------|
|  | For property other than<br>3-year property | For 3-year<br>property |
| One full year after place in<br>service.....                                     | 100  | 100                    |
| One full year after the close of<br>the period described in clause<br>(i).....   | 80   | 66                     |
| One full year after the close of<br>the period described in clause<br>(ii).....  | 60   | 33                     |
| One full year after the close of<br>the period described in clause<br>(iii)..... | 40   | 0                      |
| One full year after the close of<br>the period described in clause<br>(iv).....  | 20   | 0                      |

"(C) Property ceases to be progress expenditure property. If, during any taxable year, any recovery property taken into account in determining qualified investment under section 46(d)(1) ceases to be progress expenditure property (as determined under paragraph (3)) or becomes, with respect to the taxpayer, recovery property of a character other than that expected in determining the applicable percentage under section 46(d)(1)(B)(i), then the tax under this chapter for such taxable year shall be adjusted in accordance with regulations prescribed by the Secretary.

"(D) Limitation. The tax for the taxable year shall be increased under subparagraph (A) only with respect to the credits allowed under section 38 which were used to reduce tax liability. In the case of credits not so used to reduce tax liability, the carrybacks and carryovers under section 39 shall be appropriately adjusted.

"(E) Definitions and special rules.

"(i) Section 38 recovery property. For purposes of this paragraph, the term "section 38 recovery property" means any section 38 property which is recovery property (within the meaning of section 168).

"(ii) Recapture period. For purposes of this paragraph, the term "recapture period" means, with respect to any recovery property, the period consisting of the first full year after the property is placed in service and the 4 succeeding full years (the 2 succeeding full years in the case of 3-year property).

"(iii) Classification of property. For purposes of this paragraph, property shall be classified as provided in section 168(e).

"(iv) Paragraph (1) not to apply. Paragraph (1) shall not apply with respect to any recovery property.

"(v) Treatment as recovery property. Any reference in this paragraph to recovery property shall be treated as including a reference to any property to which section 168 (as amended by the Tax Reform Act of 1986) applies.

"(6) Carrybacks and carryovers adjusted. In the case of any cessation described in paragraph (1), (3), or (5) or any change in use described in paragraph (2) or (4), the carrybacks and carryovers under section 39 shall be adjusted by reason of such cessation (or change in use).

"(7) Aircraft used outside the United States after April 18, 1969.

"(A) General rule. Any aircraft which was new section 38 property for the taxable year in which it was placed in service and which is used outside the United States under a qualifying lease or leases shall be treated as not ceasing to be section 38 property by reason of such use until such aircraft has been so used for a period or periods exceeding 3 1/2

years in total. For purposes of the preceding sentence, the registration of such aircraft under the laws of a foreign country shall be treated as use outside the United States.

"(B) Computation of qualified investment. If an aircraft described in subparagraph (A) is disposed of or otherwise ceases to be section 38 property, the increase under paragraph (1) and the adjustment under paragraph (6) shall not be greater than the increase or adjustment which would result if the qualified investment of such aircraft were based upon a useful life equal to the lesser of (i) the actual useful life of such aircraft with respect to the taxpayer, or, (ii) twice the number of full calendar months during which such aircraft was registered by the Administrator of the Federal Aviation Agency and was used in the United States, operated to and from the United States, or operated under contract with the United States. For purposes of the preceding sentence, an aircraft shall be treated as used in the United States for any calendar month beginning after such aircraft was placed in service, if such month is included in a taxable year ending before January 1, 1971, for which such aircraft was section 38 property (determined without regard to this paragraph).

"(C) Qualifying lease defined. For purposes of subparagraph (A), the term "qualifying lease" means a lease from an air carrier (as defined in section 101 of the Federal Aviation Act of 1958, as amended (*49 U.S.C. 1301*)) which complies with the provisions of the Federal Aviation Act of 1958, as amended, and the rules and regulations promulgated by the Secretary of Transportation thereunder, but only if such lease was executed after April 18, 1969.

"(8) Motion picture films and video tapes.

"(A) Disposition where depreciation exceeds 90 percent of basis or cost. A qualified film (within the meaning of section 48(k)(1)(B)) which has an applicable percentage determined under section 48(k)(3) shall cease to be section 38 property with respect to the taxpayer at the close of the first day on which the aggregate amount allowable as a deduction under section 167 equals or exceeds 90 percent of the basis or cost of such film (adjusted for any partial dispositions).

"(B) Other dispositions. In the case of a disposition of the exclusive right to display a qualified film which has an applicable percentage determined under section 48(k)(3) in one or more mediums of publication or exhibition in one or more specifically defined geographical areas over the remaining initial period of commercial exploitation of the film or tape in such geographical areas, the taxpayer shall be considered to have disposed of all or part of such film or tape and shall recompute the credit earned on all of his basis or cost or on that part of the basis or cost properly allocable to that part of the film or tape disposed of. In the case of an affiliated group of corporations, a transfer within the affiliated group shall not be treated as a disposition until there is a transfer outside the group. For purposes of the preceding sentence, the term "affiliated group" has the meaning given to such term by section 1504 (determined as if section 1504(b) did not include paragraph (3) thereof). For purposes of this paragraph, section 1504(a) shall be applied by substituting "50 percent" for "80 percent" each place it appears.

"(9) Aircraft leased to foreign persons or entities.

"(A) In general. Any aircraft which was new section 38 property for the taxable year in which it was placed in service and which is used by any foreign person or entity (as defined in section 168(h)(2)) under a qualified lease (as defined in paragraph (7)(C)) entered into before January 1, 1990, shall not be treated as ceasing to be section 38 property by reason of such use until such aircraft has been so used for a period or periods exceeding 3 years in total.

"(B) Recapture period extended. For purposes of paragraphs (1) and (5)(B) of this subsection, any period during which there was use described in subparagraph (A) of an aircraft shall be disregarded.

"(b) *Section not to apply in certain cases.*

"Subsection (a) shall not apply to--

"(1) a transfer by reason of death, or

"(2) a transaction to which section 381(a) applies.

For purposes of subsection (a), property shall not be treated as ceasing to be section 38 property with respect to the taxpayer by reason of a mere change in the form of conducting the trade or business so long as the property is retained in such trade or business as section 38 property and the taxpayer retains a substantial interest in such trade or business.

"(c) *Special rule.*

"Any increase in tax under subsection (a) shall not be treated as tax imposed by this chapter for purposes of determining the amount of any credit allowable under subpart A, B, D, or G.

"(d) *Increases in nonqualified nonrecourse financing.*

"(1) In general. If, as of the close of the taxable year, there is a net increase with respect to the taxpayer in the amount of nonqualified nonrecourse financing (within the meaning of section 46(c)(8)) with respect to any property to which section 46(c)(8) applied, then the tax under this chapter for such taxable year shall be increased by an amount equal to the aggregate decrease in credits allowed under section 38 for all prior taxable years which would have resulted from reducing the credit base (as defined in section 46(c)(8)(C)) taken into account with respect to such property by the amount of such net increase. For purposes of determining the amount of credit subject to the early disposition or cessa-

tion rules of subsection (a), the net increase in the amount of the nonqualified nonrecourse financing with respect to the property shall be treated as reducing the property's credit base (and correspondingly reducing the qualified investment in the property) in the year in which the property was first placed in service.

"(2) Transfers of debt more than 1 year after initial borrowing not treated as increasing nonqualified nonrecourse financing. For purposes of paragraph (1), the amount of nonqualified nonrecourse financing (within the meaning of section 46(c)(8)(D)) with respect to the taxpayer shall not be treated as increased by reason of a transfer of (or agreement to transfer) any evidence of an indebtedness if such transfer occurs (or such agreement is entered into) more than 1 year after the date such indebtedness was incurred.

"(3) Special rules for certain energy property.

"(A) In general. In the case of the second taxable year following the taxable year in which any qualified energy property (within the meaning of section 46(c)(8)(F)) is placed in service by the taxpayer and any succeeding taxable year, the taxpayer, for purposes of paragraph (1), shall be treated as increasing the amount of nonqualified nonrecourse financing (within the meaning of section 46(c)(8)) with respect to such property for such taxable year in an amount equal to the credit recapture amount (if any).

"(B) Credit recapture amount. For purposes of this paragraph, the term "credit recapture amount" means an amount equal to the excess (if any) of--

"(i) the total amount of principal to be paid as of the close of any taxable year under a nonrecourse level payment loan (as defined in section 46(c)(8)(F)(iv)) with respect to such property, over

"(ii) the sum of --

"(I) the amount of principal actually paid as of the close of such taxable year, plus

"(II) the sum of the credit recapture amounts with respect to such property for all preceding taxable years.

"(C) Special rules for determining principal to be paid. For purposes of subparagraph (B)(i), in determining the amount of the principal to be paid under a level payment loan, such determination shall be made as if such loan was to be fully repaid by the end of a period equal to the earlier of--

"(i) the class life (as defined in section 168(i)(1)) of the property or, if the property has no class life, a similar period determined by the Secretary, or

"(ii) the period at the end of which full repayment is to occur under the terms of the loan.

"(D) Special rule for certain cumulative deficiencies. If the excess of--

"(i) the amount of the total scheduled principal payments under a loan described in subparagraph (B)(i) as of the close of the taxable year, over

"(ii) the total principal actually paid under such loan as of the close of such taxable year,

is equal to or greater than the amount of such total scheduled payments for the 5-taxable year period ending with such taxable year, then, notwithstanding subparagraph (B), the credit recapture amount for such taxable year shall be equal to the principal remaining to be paid as of the close of such taxable year over the sum of the credit recapture amounts with respect to such property for all preceding taxable years.

"(E) Special rule for certain dispositions.

"(i) In general. If any property which is held by the taxpayer and to which this paragraph applies is disposed of by the taxpayer, then for purposes of paragraph (1) and notwithstanding subparagraph (B), the credit recapture amount for the taxpayer shall be an amount equal to the unpaid principal on the loan described in subparagraph (B)(i) as of the date of disposition reduced by the sum of the credit recapture amounts with respect to such property for all preceding taxable years;

"(ii) Assumptions, etc. Any amount of the loan described in subparagraph (B)(i) which is assumed or taken subject to by any person shall be treated for purposes of clause (i) as not reducing unpaid principal with respect to such loan.

"(F) Deleted

"(G) Additional interest. In the case of any increase in tax under paragraph (1) by reason of the application of this paragraph, there shall be added to such tax interest on such tax (determined at the underpayment rate established under section 6621) as if the increase in tax under paragraph (1) was for the taxable year in which the property was placed in service.

*"(e) Transfers between spouses or incident to divorce.*

" In the case of any transfer described in subsection (a) of section 1041

"(1) subsection (a) of this section shall not apply, and

"(2) the same tax treatment under this section with respect to the transferred property shall apply to the transferee as would have applied to the transferor."

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--P.L. 101-508, Sec. 11801(c)(8)(A), substituted ", or" for the comma at the end of para. (b)(1), substituted a period for ", or" at the end of para. (b)(2), and deleted para. (b)(3), effective 11/5/90, except as provided in Sec. 11821(b) of this Act, which appears as a note to Code Sec. 29.

Prior to amendment, para. (b)(3) read as follows:

"(3) a transfer to which subsection (c) of section 374 (relating to exchanges under the final system plan of ConRail) applies."

In 1988, P.L. 100-647, Sec. 1002(a)(18), substituted "46(c)(8)(C)" for "48(c)(8)(C)" in para. (d)(1) . . . Sec. 1002(a)(26)(A), added clause (a)(5)(E)(v) . . . Sec. 1002(a)(26)(B), deleted the last sentence of subpara. (a)(5)(D) . . . Sec. 1002(a)(26)(C), substituted "168(e)" for "168(c)" in clause (a)(5)(E)(iii) . . . Sec. 1002(a)(27), substituted "section 168(h)(2)" for "section 168(j)(4)(C)" in subpara. (a)(9)(A) . . . Sec. 1002(a)(28), substituted "class life (as defined in section 168(i)(1))" for "present class life (as defined in section 168(g)(2))" and substituted "no class life (as defined in section 168(i)(1))" for "no present class life (as defined in section 168(g)(2))" in clause (d)(3)(C)(i), effective for property placed in service after 12/31/86, in tax. yrs. end. after 12/31/86.

Prior to deletion the last sentence of subpara. (d)(5)(D) read as follows: "If, prior to a disposition to which this subsection applies, any portion of any credit is not allowable with respect to any property by reason of section 168(i)(3), such portion shall be treated (for purposes of this subparagraph) as not having been used to reduce tax liability."

--P.L. 100-647, Sec. 1007(g)(3)(A), substituted "D, or G" for "or D" in subsec. (c), effective for tax. yrs. begin. after 12/31/86.

In 1986, P.L. 99-514, Sec. 1511(c)(2), substituted "determined at the underpayment rate established under section 6621" for "determined under section 6621" in subpara. (d)(3)(G), effective for purposes of determining interest for periods after 12/31/86.

--P.L. 99-514, Sec. 1802(a)(5)(A), added para. (a)(9), effective as if included in the provisions of P.L. 98-369 to which the amendment relates, as provided by Sec. 1881 of P.L. 99-514, which appears as a note to Code Sec. 48.

--P.L. 99-514, Sec. 1844(b)(1), substituted "reducing the credit base (as defined in section 48(c)(8)(C))" for "reducing the qualified investment" in, and added the last sentence to, para. (d)(1) . . . Sec. 1844(b)(2), deleted subpara. (d)(3)(F) . . . Sec. 1844(d)(4), added "reduced by the sum of the credit recapture amounts with respect to such property for all preceding taxable years" before the semicolon in clause (d)(3)(E)(i), effective as if included in the provisions of P.L. 98-369 to which the amendment relates, as provided by Sec. 1881 of P.L. 99-514, which appears as a note to Code Sec. 48.

Prior to deletion, subpara. (d)(3)(F) read as follows:

"(F) Application with subsection (a). The amount of any increase in tax under subsection (a) with respect to any property to which this paragraph applies shall be determined by reducing the qualified investment with respect to such property by the aggregate credit recapture amounts for all taxable years under this paragraph."

In 1985, P.L. 99-121, Sec. 103(b)(6), substituted "For property other than 3-year property" for "For 15-year, 10-year, and 5-year property" in the table in subpara. (a)(5)(B), effective for property placed in service by the taxpayer after 3/15/84. For exceptions and special rules, see Sec. 111(g)(2)-(4) of P.L. 98-369, reproduced in note following Code Sec. 168.

In 1984, P.L. 98-443, Sec. 9(p), substituted "Secretary of Transportation" for "Civil Aeronautics Board" in subpara. (a)(7)(C), effective 1/1/85.

--P.L. 98-369, Sec. 421(b)(7), added subsec. (e), applicable as provided by Sec. 421(d) of such Act, which appears as a note to Code Sec. 1041.

--P.L. 98-369, Sec. 431(b)(2), amended the heading of subsec. (d) and paras. (d)(1) and (2) . . . Sec. 431(d)(4), substituted "increasing the amount of nonqualified nonrecourse financing (within the meaning of section 46(c)(8))" for "ceasing to be at risk" in subpara. (d)(3)(A) . . . Sec. 431(d)(5), deleted "other than a loan described in section 46(c)(8)(B)(ii)" in clause (d)(3)(B)(i), applicable as provided by Sec. 431(e) of such Act, which appears as a note to Code Sec. 46.

Prior to amendment, the heading of subsec. (d) and paras. (d)(1) and (2) read as follows:

"(d) *Property ceasing to be at risk.*

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"(1) In general. If the taxpayer ceases to any extent to be at risk (within the meaning of section 46(c)(8)(B)) with respect to any amount in connection with section 38 property, then the tax under this chapter for such taxable year shall be increased by an amount equal to the aggregate decrease in credits allowed under section 38 for all prior taxable years which would have resulted from substituting, in determining qualified investment, the amount determined under section 46(c)(8) with respect to such property if, on the date the property was placed in service, the taxpayer had not been at risk with respect to the amount he ceased to be at risk to.

"(2) Certain transfers not treated as ceasing to be at risk. If, after the 12-month period after the date on which a taxpayer borrows an amount from a qualified person (within the meaning of section 46(c)(8)(D)) with respect to which such taxpayer is considered at risk under section 46(c)(8)(B), the qualified person transfers or agrees to transfer any evidence of such indebtedness to a person who is not a qualified person, then, for purposes of paragraph (1), the taxpayer shall not be treated as ceasing to be at risk with respect to such amount."

--P.L. 98-369, Sec. 474(o)(8), substituted "under section 39" for "under section 46(b)" in paras. (a)(5) and (6) . . . Sec. 474(o)(9), substituted "subpart A, B, or D" for "subpart A" in subsec. (c), effective for tax. yrs. begin. after 12/31/83 and for carrybacks from tax. yrs. begin. after 12/31/83.

In 1983, P.L. 97-448, Sec. 102(e)(3)(A), substituted "section 46(c)(8)(D)" for "section 48(c)(8)(D)" and substituted "section 46(c)(8)(B)" for "section 48(c)(8)(B)" in para. (d)(2) . . . Sec. 102(c)(3)(B), substituted "section 46(c)(8)(F)" for "section 46(c)(8)(E)" in subpara. (d)(3)(A), for property placed in service after 12/31/80 in tax. yrs. end. after 12/31/80.

In 1982, P.L. 97-248, Sec. 208(a)(2)(B), added the last sentence at end of subpara. (a)(5)(D), effective for agreements entered into after 7/1/82, or to property placed in service after 7/1/82. For transitional rules see Sec. 208(d)(2)-(6) of this Act reproduced in note following Code Sec. 168.

In 1981, P.L. 97-34, Sec. 211(f)(2), added subsec. (d), applicable as provided by Sec. 211(i)(5) of such Act, which appears as a note to Code Sec. 46.

--P.L. 97-34, Sec. 211(g)(1), redesignated paras. (a)(5), (6) and (7) as paras. (a)(6), (7) and (8) and added new para. (a)(5) . . . Sec. 211(g)(2)(A), amended subpara. (a)(3)(D) . . . Sec. 211(g)(2)(B), substituted "paragraph (1), (3), or (5)" for "paragraph (1) or (3)" in para. (a)(6) as redesignated by Sec. 211(g)(1) of this Act . . . Sec. 211(g)(2)(C), substituted "paragraph (6)" for "paragraph (5)" in subpara. (a)(7)(B) as redesignated by Sec. 211(g)(1) of this Act, effective for property placed in service after 12/31/80.

Prior to amendment, subpara. (a)(3)(D) read as follows:

"(D) Coordination with paragraph (1). If, after property is placed in service, there is a disposition or other cessation described in paragraph (1), paragraph (1) shall be applied as if any credit which was allowable by reason of section 46(d) and which has not been required to be recaptured before such cessation were allowable for the taxable year the property was placed in service."

In 1978, P.L. 95-618, Sec. 241(b), redesignated para. (a)(4) as para. (a)(5) . . . added new para. (a)(4) . . . substituted "paragraph (2) or (4)" for "paragraph (2)" in para. (a)(5) as redesignated . . . substituted "paragraph (5)" for "paragraph (4)" in subpara. (a)(6)(B), effective 11/9/78.

--P.L. 95-600, Sec. 317(a), deleted "or" at the end of para. (b)(1) . . . substituted ", or" for the period at the end of para. (b)(2) . . . added para. (b)(3), for tax. yrs. end. after 3/31/76.

In 1976, P.L. 94-455, Sec. 804(b), added para. (a)(7), for tax. yrs. begin. after '74.

--P.L. 94-455, Sec. 1906(b)(13)(A), substituted "Secretary" for "Secretary or his delegate" each place it appeared in subsec (a), for tax. yrs. begin. after '76.

In 1975, P.L. 94-12, Sec. 302(b)(2), redesignated former para. (3) as (4) and added new para. (3), effective for tax. yrs. end. after 12/31/74.

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--P.L. 94-12, Sec. 302(c)(1), substituted "paragraph (1) or (3)" for "paragraph (1)" in para. (a)(4), as redesignated by Sec. 302(b)(2) of the Act, effective for tax. yrs. end. after 12/31/74.

--P.L. 94-12, Sec. 302(c)(2), substituted "paragraph (4)" for "paragraph (3)" in para. (a)(5) and subpara. (a)(6)(B), effective for tax. yrs. end. after 12/31/74.

In 1971, P.L. 92-178, Sec. 102(c), substituted "3 1/2 years" for "4 years" in subsec. (a)(6)(A), applicable as provided by Sec. 102(d)(2) of such Act, which appears as a note to Code Sec. 46, and by Sec. 102(d)(3) of such Act, which appears as a note to this section.

--P.L. 92-178, Sec. 107(a), repealed para. (a)(4), for casualties and thefts occurring after 8/15/71.

Prior to repeal para. (a)(4) read as follows:

"(4) Property destroyed by casualty, etc. No increase shall be made under paragraph (1) and no adjustment shall be made under paragraph (3) in any case in which--

"(A) any property is disposed of, or otherwise ceases to be section 38 property with respect to the taxpayer, on account of its destruction or damage by fire, storm, shipwreck, or other casualty, or by reason of its theft,

"(B) section 38 property is placed in service by the taxpayer to replace the property described in subparagraph (A), and

"(C) the reduction in basis or cost of such section 38 property described in the first sentence of section 46(c)(4) is equal to or greater than the reduction in qualified investment which (but for this paragraph) would be made by reason of the substitution required by paragraph (1) with respect to the property described in subparagraph (A).

Subparagraphs (B) and (C) shall not apply with respect to any casualty or theft occurring after April 18, 1969."

--P.L. 92-178, Sec. 107(b), repealed para. (a)(5), except if replacement property described in subpara. 47(a)(5)(B) is not property described in Code Sec. 50.

Prior to repeal, para. (a)(5) read as follows:

"(5) Certain property replaced after April 18, 1969. In any case in which--

"(A) section 38 property is disposed of, and

"(B) property which would be section 38 property but for section 49 is placed in service by the taxpayer to replace the property disposed of,

the increase under paragraph (1) and the adjustment under paragraph (4) shall not be greater than the increase or adjustment which would result if the qualified investment of the property described in subparagraph (B) (determined as if such property were section 38 property) were substituted for the qualified investment of the property disposed of (as determined under paragraph (1)). Except in the case of a disposition by reason of a casualty or theft occurring before April 19, 1969, the preceding sentence shall apply only if the section 38 property disposed of is replaced within 6 months after the date of such disposition."

--P.L. 91-676, added para. (a)(6), effective for tax. yrs. end. after 4/18/69.

In 1969, P.L. 91-172, Sec. 703(c), added the last sentence of subsec. (a)(4) and added par. (5) of subsec. (a).

In 1962, P.L. 87-834, Sec. 2, added Code Sec. 47, for tax. yrs. end. after '61.

Other provisions:

**Application of amendment made by § 102(c) of Act Dec. 10, 1971.** Act Dec. 10, 1971, P.L. 92-178, Title I, § 102(d)(3), 85 Stat. 500, provides: "The amendment made by subsection (c) [amending this section] shall apply to leases executed after April 18, 1969."

**Clarification of effect of 1984 amendment on investment tax credit.** For provision that nothing in the amendments made by § 474(o) of P.L. 98-369, which amended this section, be construed as reducing the investment tax credit in taxable years beginning before Jan. 1, 1984, see § 475(c) of P.L. 98-369, which appears as 26 USCS § 46 note.

**Application of July 30, 2008 amendments.** Act July 30, 2008, P.L. 110-289, Div C, Title I, Subtitle C, § 3025(b), 122 Stat. 2897, provides: "The amendments made by this section [amending subsec. (c)(2)(B)(v)(I) of this section] shall apply to expenditures properly taken into account for periods after December 31, 2007."

**NOTES:**

## Code of Federal Regulations:

Internal Revenue Service, Department of the Treasury--Income taxes, 26 CFR Part 1.

## Related Statutes &amp; Rules:

This section is referred to in *26 USCS §§ 49, 50, 145, 170, 469, 470, 772, 1400I*.

## Research Guide:

## Am Jur:

*33A Am Jur 2d, Federal Taxation (2008) §§ 14802, 14851-14857, 14859-14861, 14909*.

## Forms:

*26 Rabkin & Johnson, Current Legal Forms, § 22.16*, Real Estate Development and Subdivision.

*31 Rabkin & Johnson, Current Legal Forms, Form 23.02*, Real Estate Leases.

## Federal Taxation:

1 Federal Income Taxation of Corporations Filing Consolidated Returns (Matthew Bender 2nd ed.), ch 31, Intercompany Transactions § 31.03.

1 Federal Income Taxation of Corporations Filing Consolidated Returns (Matthew Bender 2nd ed.), ch 34, Prior Period Intercompany Transactions § 34.11.

2 Federal Income Taxation of Corporations Filing Consolidated Returns (Matthew Bender 2nd ed.), ch 43, Consolidated Tax Credits § 43.01.

## Texts:

1 Environmental Law Practice Guide (Matthew Bender), ch 2, Historic Preservation § 2.06.

## Law Review Articles:

McCobb. Planning for Investment Tax Credit Recapture. *5 J Agr Tax & L* 363, Winter, 1984.

Dorr. Working with the Investment Credit Recapture Rules: A Blend of the Old and the New. *56 J Tax* 354, June, 1982.

Partner's ITC Recapture May Not Be Ordinary Income. *60 J Tax* 165, March, 1984.

Emory, Swenson, Lerner, and Fuller, Exception to ITC Recapture on Transfer, Leaseback. *60 J Tax* 378, June 1984.

Samuels. Equipment Leasing Under the Economic Recovery Tax Act of 1981. *2 Legal Notes & Viewpoints* 61, May, 1982.

Kelman. Time Preference and Tax Equity. *35 Stan L Rev* 649, April, 1983.

## Interpretive Notes and Decisions:

1. When fees or expenses incurred  
2. Expenses not exceeding adjusted basis in particular year  
3. Substantial rehabilitation  
4. Retention of existing exterior walls

### **1. When fees or expenses incurred**

General partner's development fee does not accrue upon execution of partnership agreement but only later, when partnership has actual obligation to pay fee; where, under partnership agreement, fee was payable to general partner only to extent of available cash, development fee was not accrued, and accordingly was not incurred for purposes of rehabilitation credit, until partnership actually had available cash. *Brassard v United States* (1999, CA8 Minn) 183 F3d 909, 99-2 USTC P 50752, 84 AFTR 2d 5386.

### **2. Expenses not exceeding adjusted basis in particular year**

Taxpayer is not entitled to credit for rehabilitation of historic building in year when qualified rehabilitation expenses do not exceed building's adjusted basis, even though projected qualified rehabilitation expenses for 60-month period after beginning of phased rehabilitation would exceed building's adjusted basis in later year. *Ford v United States* (1993, CA11 Ga) 989 F2d 450, 93-1 USTC P 50268, 71 AFTR 2d 1592, 7 FLW Fed C 259, substituted op, in part, reh, en banc, den (1993, CA11 Ga) 93 TNT 145-5, 7 FLW Fed C 550.

### **3. Substantial rehabilitation**

Test for substantial rehabilitation is applied with respect to entire building, and credit cannot be claimed for portion of building if building as whole does not satisfy test. *Alexander v Commissioner* (1991) 97 TC 244, affd (1992, CA3) 968 F2d 12, 70 AFTR 2d 5104.

### **4. Retention of existing exterior walls**

Requirement that at least 75 percent of building's existing external walls be retained in place as external or internal walls in rehabilitation process is to be construed in common sense fashion, and there is no foundation in legislative history to support argument that roof area is included in determining whether 75 percent of existing external walls are retained in place. *Depot Investors, Ltd. v Commissioner* (1992) TC Memo 1992-145, RIA TC Memo P 92145, 63 CCH TCM 2344.