1964

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GAIN FROM DISPOSITION OF CERTAIN DEPRECIABLE PROPERTY — SECTION 1245 OF THE INTERNAL REVENUE CODE OF 1954

Charles J. Kerester and Richard Katcher

LEGISLATIVE HISTORY

In his April 20, 1961 message on taxation, the late President Kennedy recommended to Congress that capital gains treatment be withdrawn from gain on the disposition of depreciable real and personal property to the extent that depreciation had been deducted for such property by the seller in previous years.

He pointed out that while depreciation is taken as a deduction from ordinary income, the gain upon the resale of the property where the amount of depreciation allowable exceeds the decline in actual value is taxed as a capital gain. He called attention to the fact that the advantages resulting from this practice were increased by the liberalization of depreciation rates.

He believed that the capital gains concept should not encompass this kind of income; that the “inequity” should be eliminated, especially in view of the proposed investment credit; and that the further acquisition of such property should not be encouraged through tax incentives as long as this “loophole” remains.\(^1\)

The President's recommendation was amplified by the Secretary of the Treasury in the latter’s May 3, 1961 statement filed with the House Ways and Means Committee.\(^2\)

In its report\(^3\) in connection with this provision, the Senate Finance Committee also considered the then existing law in this respect as permitting the conversion of ordinary income into capital gain. The Committee also believed that the problem was of major significance in connection with the depreciation liberalization announced by the Treasury Department, since under the new approach, many taxpayers would be permitted to depreciate assets faster for tax purposes than had previously been allowed. Therefore, additional ordinary income would be converted into capital gain.

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1. See Hearings Before the House Committee on Ways and Means, 87th Cong., 1st Sess. 3, 13 (1961) on the tax recommendations of the President contained in his message transmitted to the Congress.
2. Id. at 20, 44.
In its corresponding report, the House Ways and Means Committee gave similar reasons.

Neither the House nor the Senate version of the bill applied ordinary income treatment to buildings or structural components thereof. The Treasury Department, however, has had more success in connection with certain depreciable real property in the Revenue Act of 1964.

**Basic Pattern of Section 1245**

Except as otherwise provided, a disposition of "section 1245 property" generally results in ordinary income in an amount equal to the adjustments reflected in the adjusted basis of the property on account of the deductions allowed or allowable for depreciation, or amortization under section 168, for periods after December 31, 1961. But in no event will this ordinary income be greater than the excess of the amount realized or the fair market value of the property, as the case may be, over its adjusted basis. Stated differently, the amount of ordinary income which is to be taken into account under section 1245 is the smallest of the following:

(a) the amount of the adjustments reflected in the adjusted basis of the property as a result of depreciation, or amortization under section 168, allowed or allowable for periods after December 31, 1961 (the excess of "recomputed basis" over the adjusted basis);

(b) in the case of a sale, exchange or involuntary conversion, the excess of the amount realized over the adjusted basis; and

(c) in the case of any other disposition, the excess of the fair market value over the adjusted basis.

Both committee reports give the following examples of the operation of section 1245. If the section 1245 property has an adjusted basis of $2,000 and a recomputed basis of $3,300 and is sold for $2,900, the amount of the gain to which section 1245 applies is $900 ($2,900 minus $2,000). If the property is sold for $3,700, the gain is $1,700 of which $1,300 ($3,300 minus $2,000) is gain to which section 1245(a) applies. If, on the other hand, the property is distributed by a corporation to a stockholder in a distribution to which section 1245(a) applies and at a time when the fair market value of the property is $3,100, the gain recognized to the corporation upon such disposition is $1,100 ($3,100 minus $2,000). If the fair market value is $3,800 at the time of such disposition, the gain to which section 1245(a) applies is $1,300 ($3,300 minus $2,000).


6. CODE §§ 1245(a) (1), (2).

Broadly speaking, section 1245 accomplishes two things: (1) it recognizes ordinary income in transactions where no income or gain previously was recognized; and (2) it changes the character of gain otherwise treated as capital gain under section 1231 to ordinary income.\(^8\) It accomplishes the former by overriding many nonrecognition provisions of the Code. Section 1245 (a) (1) expressly states that the gain referred to therein shall be recognized notwithstanding any other provision of the subtitle. Further, section 1245 (d) states that section 1245 shall apply notwithstanding any other provision of the subtitle. (Section 1245 (b), however, contains its own exceptions and limitations which will be discussed below.) For example, section 1245 overrides the provisions of section 311, relating to the taxability of a corporation on distributions of property with respect to its stock; section 336, relating to the taxability of a corporation on the distribution of property in a partial or complete liquidation; and section 337, relating to the taxability of a corporation on sales or exchanges made by it within a twelve month period following the adoption of a plan of complete liquidation.

Section 1245 is not limited to a disposition by way of a sale or an exchange. It may be triggered by other dispositions as well.\(^9\)

Section 1245 relates only to gains from the sale or other disposition of section 1245 property. It does not relate to losses.\(^10\) Where "loss" property and "gain" property are the subject of the same sale or other disposition, some unexpected results may occur if the losses on the sale of section 1245 property cannot be offset against the gains on the sale of the section 1245 property involved in the same sale. If, for example, in a transaction qualifying under section 337, a liquidating corporation sells all of its section 1245 property to one purchaser and the sale of some section 1245 property results in a gain while the sale of other section 1245 property results in a loss, and if the provisions of section 1245 exclude a netting concept, the corporation will find that although the losses will not be recognized by reason of section 337, the gain on the sale of section 1245 property will be subject to ordinary income treatment under section 1245 notwithstanding the provisions of section 337, even though the aggregate bases of the section 1245 property sold may have equaled or exceeded the aggregate amount realized upon the sale of all the section 1245 property. If netting of losses against gains is not permitted for purposes of section 1245, similar consequences might be expected in the case of distributions of section 1245 property in liquidation of a corporation where the liquidation is governed at the stock-

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8. Code §§ 1245 (a) (1), (b).
9. In this respect it is somewhat analogous to the provisions of § 453 (d), relating to dispositions of installment obligations.
10. Code § 1245 (a) (1).
holder level by section 331. If the netting of losses against gains is not permitted, then where the corporation makes a liquidating distribution of section 1245 property, some of which is gain property and the other of which is loss property, the nonrecognition provisions of section 336 apparently would continue to bar the recognition of any loss to the corporation on its distribution of any of the section 1245 property which constitutes loss property. The nonrecognition provisions of section 336 would be set aside by section 1245 for the section 1245 property which constitutes gain property. If netting is not permitted, similar tax consequences might be expected in a liquidation governed by section 333—the one month liquidation provisions—on liquidating distributions of section 1245 property. Could netting be accomplished where the facts lend themselves to the argument that, in effect, there was only one property, although it was made up of various parts, much as the bricks of a building are treated as parts of the building, and that the adjusted basis of such property is the aggregate of the adjusted bases of the various parts?11 If so, the next question is: When do the facts lend themselves to such an argument? Would they, for example, where a closely held corporation liquidates in order for its shareholders to own and operate the business as a partnership, or if the section 1245 property involved in a sale by a liquidating corporation consists of the various units of machinery in a plant, and all such machinery and the plant are sold to the purchaser as a going business?

In general, the netting of losses and gains has not been permitted in the cases applying the provisions corresponding to section 267 of the 1954 Code under which deductions are not allowed for losses in respect to sales or exchanges of property directly or indirectly between related persons.12

"RECOMPUTED BASIS"

As indicated earlier, "recomputed basis" is an element necessary to the determination of the amount of gain treated as ordinary income under section 1245. The recomputed basis of section 1245 property is the sum of (1) the adjusted basis of such property, and (2) the amount of the adjustments reflected in such adjusted basis as a result of deductions for depreciation, or amortization under section 168, allowed or allowable for periods after December 31, 1961. The adjustments referred to are not limited to the adjustments on account of such de-

11. See the comments in Lakeside Irrigation Co. v. Commissioner, 128 F.2d 418 (5th Cir.), cert. denied, 317 U.S. 666 (1942).
12. See, e.g., Morris Inv. Corp. v. Commissioner, 156 F.2d 748 (3d Cir.), cert. denied, 329 U.S. 788 (1946); Lakeside Irrigation Co. v. Commissioner, 131 F.2d 1014 (2d Cir. 1942); William F. Krah, 9 T.C. 862 (1947); B.O. Mahaffey, 1 T.C. 176 (1942); I.T. 3334, 1939-2 CUM. BULL. 180.
ductions which were allowed or allowable only to the taxpayer. They also include the adjustments on account of such deductions allowed or allowable to any other person if the adjustments attributable to such deductions are reflected in the taxpayer's adjusted basis of such property. Consequently, where a taxpayer's basis for section 1245 property is determined with reference to a prior holder's basis for such property, the taxpayer, in determining the amount of the adjustments in ascertaining his recomputed basis for such property, must take into account the adjustments on account of deductions for depreciation, or amortization under section 168, allowed or allowable for periods after December 31, 1961 to such prior holder. Examples include a corporate transferee in a section 351 transaction relating to transfers to a controlled corporation, a corporate transferee in a section 361 transaction relating to reorganizations, and a partnership in a section 721 transaction relating to contributions of property to a partnership.

The Senate Finance Committee report gives the following example of a situation in which adjustments for depreciation of a prior holder of the property are taken into account by a taxpayer in determining the recomputed basis of the property for purposes of section 1245. If a taxpayer who reports his income on the basis of a fiscal year ending November 30 purchases section 1245 property on January 1, 1962 at a cost of $10,000, and the taxpayer takes depreciation deductions of $2,000 (the amount allowable) before making a gift of the property to his son on October 31, 1962, the son's adjusted basis in the property for purposes of determining gain would be the same as his father's adjusted basis ($8,000). The recomputed basis of the property in the son's hands would be $10,000, since the $2,000 of depreciation deductions taken by the father are reflected in the son's basis in the property. If the son later sells the property for $10,000 during his own taxable year beginning after December 31, 1962, he would have $2,000 of gain to which section 1245 (a) would apply. Moreover, if the son himself takes $1,000 in depreciation deductions (the amount allowable) with respect to the property and then sells it for $10,000, he would have $3,000 of gain to which section 1245 applies.4

The adjustments for deductions on account of depreciation, or amortization under section 168, are not limited merely to those attributable to the particular section 1245 property which was the subject of the disposition. The adjustments taken into account for this purpose also include similar adjustments made in respect to other property, provided such adjustments are reflected in the taxpayer's adjusted basis for the

section 1245 property which was the subject of disposition. An example is section 1245 property acquired as the result of a tax-free exchange of property for like property under section 1031.

The statutory reference is to the amount of such deductions "allowed or allowable." However, if the taxpayer can establish, "by adequate records or other sufficient evidence," that the amount allowed for depreciation, or for amortization under section 168, for any period was less than the amount allowable, the amount taken into account for this purpose for such period will be the amount "allowed." The statutory provisions and the committee reports are silent on the effect of the absence of any tax benefit from the amount of depreciation or amortization deductions "allowed or allowable."

The adjustments referred to in determining the recomputed basis of property are the adjustments for the deduction on account of "depreciation, or for amortization under section 168." The reference to the adjustments for a deduction on account of depreciation are not limited to the depreciation deduction allowed or allowable under any particular section of the Code. Hence, if the deduction was for depreciation, it would seem immaterial whether the deduction for depreciation was under section 167 or some other section. According to the committee reports\textsuperscript{15} the deductions, for purposes of determining the recomputed basis of section 1245 property, include not only regular depreciation deductions but also the special initial allowance deduction and any deduction for the amortization of emergency facilities. However, according to such reports, the special reduction in the basis of property provided in connection with the investment credit, section 38 of the Code, is not treated as a deduction for depreciation, or amortization under section 168, for this purpose.

Section 1.167(a)-4 of the Treasury Regulations, relating to leased property, provides that capital expenditures made by a lessee for the erection of buildings or for the construction of other permanent improvements on leased property are recoverable through allowances for depreciation or amortization. It provides that if the useful life of such improvements in the hands of the taxpayer is equal to or shorter than the remaining period of the lease, the allowances shall take the form of depreciation under section 167. Such regulations, however, also provide that if the estimated useful life of such property in the hands of the taxpayer, determined without regard to the terms of the lease, would be longer than the remaining period of the lease, the allowances shall take the form of annual deductions from gross income in an amount equal to the unrecovered costs of such capital expenditures divided by

\textsuperscript{15} S. REP. No. 97; H.R. REP. No. 68.
the number of years remaining in the term of the lease, and that “such
deductions shall be in lieu of allowances for depreciation.” 16

Code section 48(a), defining “section 38 property” for purposes of
the investment credit, uses both terms—“depreciation” and “amortization
in lieu of depreciation.” The committee reports 17 with respect to the in-
vestment credit provisions state that property may qualify as section 38
property if amortization is allowable with respect to such property in
lieu of depreciation.

Does the use of both terms — “depreciation” and “amortization in
lieu of depreciation” — in section 48(a) create any inference that the
reference in section 1245 only to depreciation, and amortization under
section 168, and the omission of any reference to “amortization in lieu
of depreciation,” imply that an adjustment to basis on account of a
deduction for amortization under section 162 in lieu of depreciation
under section 167 is not an adjustment which may be taken into account
in determining the recomputed basis of section 1245 property? More
specifically, if under the above regulations, the annual allowance with
respect to a particular leasehold improvement is not treated as an allow-
ance for depreciation, but is treated as an allowance for amortization
deductible under section 162, would the adjustments as a result of such
allowance be treated as an adjustment on account of a deduction for
depreciation for purposes of computing the recomputed basis of such
property if such improvement qualifies as section 1245 property? Could
such improvement constitute section 1245 property? Under these cir-
cumstances, is it property which is or has been property of a character
subject to the allowance for depreciation provided in section 167, a neces-
sary characteristic of section 1245 property?

In view of the fact that adjustments on account of deductions for
depreciation must be taken into account in determining the recomputed
basis of section 1245 property and may thus increase the amount sub-
ject to ordinary income treatment under section 1245, many taxpayers
probably will give increased attention to leasing property rather than
purchasing it, since rent deductions are not taken into account in a sub-
sequent sale of the leasehold.

SECTION 1245 PROPERTY

In General

A disposition of property can result in ordinary income under section
1245 only if the property is “section 1245 property.” Section 1245
property in turn, as defined by that section, is any property (other than

16. See CODE § 162 and the Regulations thereunder.
livestock) which is or has been property of a character subject to the allowance for depreciation provided in section 167 and is either:

(a) personal property; or
(b) other property (not including a building or its structural components), but only if such other property is tangible and has an adjusted basis in which there are reflected adjustments described in the statutory paragraph relating to recomputed basis (described above), for a period in which such property (or other property)

(i) was used as an integral part of certain specified activities, or
(ii) constituted research or storage facilities used in connection with any of the specified activities. 18

The specified activities are manufacturing, production or extraction, furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services. 19

Section 1245 (a) (3) provides in part that section 1245 property means any property (other than livestock) which is or has been property of a character subject to the allowance for depreciation provided in section 167 and meets certain other tests. There is no requirement in section 1245 (a) (3), which defines section 1245 property, limiting it to property which has that character in the hands of the taxpayer. It is evident from the committee reports that even though property may not be subject to the allowance for depreciation in the hands of the taxpayer, such property is subject nevertheless to provisions of section 1245 (a) if (1) the property was subject to the allowance for depreciation in the hands of any prior holder, and (2) such depreciation is taken into account in determining the adjusted basis of the property in the hands of the taxpayer. 20

**Personal Property**

Section 1245 does not define the term "personal property" as used therein. Both committee reports, however, state that the definition of "section 1245 property" is similar in certain respects to the definition of "section 38 property" contained in section 48(a) relating to the investment credit, but that section 1245 property is a broader concept than section 38 property. For example, the definition of section 1245 property is not subject to the minimum useful life provision of section 48(a) (1) or to the other limitation and exclusion provisions in paragraphs (2) through (5) of section 48(a). The Senate Finance Com-

18. **Code** § 1245 (a) (3).
19. **Code** § 1245 (a) (3) (B) (i).
mittee report states that the term “personal property” in subparagraph (A) of section 1245(a)(3) is intended to include not only “tangible personal property” referred to in section 48(a)(1)(A), but also intangible personal property. The corresponding sentence in the House Ways and Means Committee report provides that the term personal property in subparagraph (A) of section 1245(a)(3) is intended to include not only “tangible personal property” as defined in section 48(a)(1)(A), but also intangible personal property. In view of these statements in the committee reports, the definition of “tangible personal property” as used in section 48(a)(1)(A) and set forth in such committee reports is relevant to the meaning of the term “personal property” as used in section 1245(a)(3)(A).

Both committee reports with respect to section 48 provide that “tangible personal property” is not intended to be defined narrowly. Nor is it necessarily to follow the rules of state law. Rather, it is intended that assets accessory to a business, such as grocery store counters, printing presses, individual air-conditioning units, etc., are to qualify for the investment credit even though they are fixtures under local law. Similarly, assets of a mechanical nature, such as gasoline pumps, even though located outside a building, are to qualify for the investment credit. The Senate Finance Committee report with reference to section 48 also provides in part as follows:

For purposes of section 48, the term “tangible personal property” includes any tangible property except land and improvements thereto, such as buildings or other inherently permanent structures thereon (including items which are structural components of such buildings or structures).

A similar statement appears in the House Committee report.

The Proposed Regulations with respect to section 48 reflect the above statements that are contained in the committee reports. Thus, under such Proposed Regulations, property which is contained in or attached to a building, such as production machinery, printing presses, and neon and other signs, as well as all property which is in the nature of machinery (other than structural components of a building or other inherently permanent structures), even though located outside a building, such as a gasoline pump, hydraulic car lift, or automatic vending machine, constitutes tangible personal property for purposes of the credit allowed by section 38. Land and improvements thereto, such as buildings or other inherently permanent structures (including items which

are structural components of such buildings or structures), for example, swimming pools, paved parking areas, wharves, docks, and bridges do not constitute tangible personal property.

The term "tangible personal property" also is used in section 179 relating to the additional first year depreciation allowance.\(^{26}\) Section 1.179-3(b) of the Treasury Regulations, with respect to the latter section, also provides that local law definitions will not be controlling for purposes of determining the meaning of the term "tangible personal property" as it is used in section 179 and the Regulations thereunder.

At the date of this writing the Treasury Department has not issued proposed regulations with respect to section 1245.

Unlike sections 48(a) and 179, section 1245(a)(3) does not limit the definition to tangible personal property. Intangible personal property also may constitute section 1245 property. Personal property which otherwise qualifies as section 1245 property will still remain section 1245 property even though it was never used as an integral part of the specified activities referred to in section 1245(a)(3)(B) or constituted research or storage facilities used in connection with any of such specified activities.

**Property Other than Personal Property**

In addition to personal property, section 1245 property includes certain other property (other than a building or its structural components) but only if, among other things, it has been used as an integral part of specified activities or has constituted research or storage facilities used in connection with any of the specified activities.

Even though particular property in this second category has not been used by the taxpayer as an integral part of one of the specified activities or has not constituted the required research or storage facilities for the taxpayer, such property in certain circumstances nevertheless may be section 1245 property. According to the committee reports,\(^{27}\) an illustration of such a circumstance occurs when the adjusted basis of such property in the hands of the taxpayer reflects adjustments for depreciation with respect to such property for periods after December 31, 1961, when such property was used as an integral part of manufacturing by another taxpayer. Another illustration occurs when the adjusted basis of such property in the hands of the taxpayer reflects the adjustments for depreciation with respect to other property (as, for example, in the case of a like kind exchange under section 1031) for periods after December 31, 1961, when such other property was used as an integral part of one of the specified activities by the taxpayer.

\(^{26}\) Code § 179(d)(1).

Miscellaneous

The committee reports\(^{28}\) state that the language in clauses (i) and (ii) in section 1245 (a) (3) (B) is intended to have the same meaning as when used in clauses (i) and (ii) in section 48 (a) (1) (B), relating to the definition of section 38 property subject to the investment credit. Hence, reference should be made to the comments of the committee reports\(^{29}\) with respect to "section 38 property."

Integral Part

The committee reports\(^{30}\) with reference to "section 38 property" state that property is to be considered as being used as an integral part of a system of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services only if such property is used by one engaged in the trade or business of furnishing such services. Thus, if a manufacturing firm constructs an airstrip for use by airplanes operated for the convenience of its officers and employees, such airstrip would not qualify as section 38 property since the manufacturing firm is not engaged in the transportation business. Such reports\(^{31}\) further provide that to qualify for the investment credit, property (other than tangible personal property and research or storage facilities used in connection with the specified activities) must be used as an integral part of one or more of the specified activities; that, for example, section 38 property ordinarily would not include such assets as pavements, parking areas, advertising displays, outdoor lighting facilities, or swimming pools which, although used as a part of the overall business operation, are not used directly in the specified activities; that specific examples of qualifying property which normally would be used as an integral part of one of the specified activities are blast furnaces, oil and gas pipelines, and railroad track and signals; and that fences will qualify as section 38 property where used as an integral part of a specified activity as, for example, where used in connection with the raising of livestock.

Research or Storage Facilities

Research or storage facilities (other than buildings and structural components thereof) may constitute section 1245 property if used in connection with any of the specified activities, although such property is not an integral part of the activity. Such property also may qualify

\(^{28}\) Ibid.
\(^{29}\) S. REP. No. 16; H.R. REP. No. 12.
\(^{30}\) S. REP. No. 155; H.R. REP. No. A18.
\(^{31}\) S. REP. No. 155; H.R. REP. NOS. A18-19.
for the investment credit. Examples of such facilities given in the Senate Finance Committee report with respect to the latter include wind tunnels and test stands.\(^\text{32}\)

**EFFECT OF TAXPAYER’S METHOD OF ACCOUNTING**

Section 1245 may be affected by the taxpayer’s method of accounting. According to the committee reports,\(^\text{33}\) a gain from a disposition to which section 1245 applies may be reported by the taxpayer under the installment method if such method is otherwise available under section 453. Since depreciation deductions are allowed or allowable over a period of years, the installment method of reporting the gain from a disposition to which section 1245 applies gives the taxpayer the opportunity to spread over a period of years the ordinary income resulting from such disposition and thereby avoid a bunching of ordinary income in the single year in which the disposition occurs.

**EXCEPTIONS WITHIN SECTION 1245**

It has been indicated that the general rule of section 1245 is that a disposition of section 1245 property results in the imposition of ordinary income to the extent provided in the section. Congress, however, felt that it would not be justified in imposing a tax at ordinary income rates upon every disposition of section 1245 property. Accordingly, the section contains a number of specific exceptions to the general rule.\(^\text{34}\) These exceptions occur, other than in one instance, in situations where the transferor is not subject to any tax by reason of the disposition and the basis of section 1245 property in the hands of the transferee is the same as it was in the hands of the transferor.

By carving out these exceptions, the purpose of section 1245 is not violated, because recomputed basis, the touchstone in the computation of section 1245 income, is so defined as to include the depreciation deductions allowed to the transferor.\(^\text{35}\) When the transferee, therefore, disposes of the section 1245 property, the prior depreciation deductions will be taken into account in computing the amount taxed as ordinary income. Thus, there is merely a postponement of the tax, not an exemption.

*Dispositions by Gift*

The first of these exceptions relates to a disposition by gift.\(^\text{36}\) Although the donee, upon his disposition of the section 1245 property,

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32. S. REP. NO. 156.
34. Code \$ 1245(b).
35. Code \$ 1245(a)(2).
36. Code \$ 1245(b)(1).
must take into account as ordinary income the depreciation deductions taken by his donor, this particular exception permits a high tax bracket donor to shift the ordinary income element inherent in the property to a lower tax bracket donee. This shift of income subject to tax at ordinary income rates is to be compared with the situation that existed prior to the enactment of section 1245 when the potential income that was shifted to the donee by reason of the gift of depreciable personal property generally would have been subject to capital gains tax in the donor's hands. Thus, the gift exception under section 1245 effects in this regard a rather anomalous result.

Where the donee of the section 1245 property is a charitable organization, the gift exception applies, and no ordinary income will be recognized by the donor at the time of the gift. However, the amount of his charitable deduction is affected by the gift; it will equal the fair market value of the property minus the section 1245 income that would have been generated if the property were then sold for its fair market value. For example, assume A owns section 1245 property with an adjusted basis of $1,000, a recomputed basis of $1,500, and a fair market value of $2,000. If the property were sold for its then fair market value, the section 1245 income would be $500 (recomputed basis of $1,500 minus adjusted basis of $1,000). If A contributes that property to a charitable organization, his charitable contribution deduction would be $1,500 (fair market value of $2,000 minus the then potential section 1245 income of $500).

A conflict between the general rule of section 1245 that ordinary income results on the disposition of section 1245 property and the gift exception to that rule may be inherent in a charitable gift of property which is subject to a liability. For example, A owns section 1245 property with a zero basis, a recomputed basis of $1,000, and a fair market value of $10,000. The taxpayer borrows $8,000 on that property and then contributes the property, subject to the indebtedness, to a charitable organization. If the borrowing of $8,000 has no tax consequences to A, he has achieved the enviable position of realizing on a substantial portion of the appreciation of the property without paying any tax on that appreciation.

It appears evident, however, that to the extent that the proceeds of the loan exceed the taxpayer's basis, gain will be recognized. While it may be uncertain whether that gain will be construed as ordinary or

37. Code § 170(e).
capital,\textsuperscript{39} from the section 1245 standpoint the important thing is that if the two steps — the borrowing and the gift — are regarded as a single, integrated transaction and therefore a sale or other disposition, the general rule of section 1245 will apply. Presumably, then, the taxpayer would have recognized gain of $8,000, of which $1,000 would be ordinary income under section 1245.\textsuperscript{40}

This transaction raises the question of whether the charitable contribution deduction would be $2,000, the equity of the contributed property, or $1,000. The latter result would follow if section 170(e) controls. It provides that the charitable contribution deduction must be reduced by the section 1245 gain that would have been generated if the property had been sold at its "fair market value." Since the contributed property had been disposed of for $8,000 rather than its fair market value of $10,000, a literal reading of section 170(e) would require a reduction of the $2,000 net contribution to $1,000, the amount of the section 1245 gain. This result is patently unfair because, in effect, it would be subjecting the section 1245 gain to taxation twice. A taxpayer in A's position should not be penalized because the borrowing and contribution are telescoped into a single transaction. If A had sold the property for $8,000, the maximum section 1245 gain would be $1,000. In other words, section 170(e) should not operate to cut down the amount of the deduction since the section 1245 gain has already been charged to A at the point of the borrowing.

The Part-Sale, Part-Gift Situation

The gift exception under section 1245 raises other interesting problems in the so-called part-sale, part-gift situation. Assume that A is the owner of section 1245 property with a $2,500 adjusted basis and a fair market value of $10,000. He sells it to his son for $5,000. Under such circumstances A's gain is $2,500, the difference between the amount realized, $5,000, and his adjusted basis of $2,500.\textsuperscript{41} He has made a gift of $5,000 (the excess of the $10,000 fair market value over the amount realized, $5,000). If that property had a recomputed basis of $5,000, the probability is that the entire $2,500 gain would be section 1245 income. This result would follow from the theory that if the entire basis

\textsuperscript{39} See Private Ruling dated November 26, 1954, bearing symbols T:R:1 R F.W-3, wherein the Service ruled that the donor realizes ordinary income in such a situation. However, in the Simon and Magnolia cases, the Commissioner took the position that the transaction constituted a sale from which the taxpayer realized long-term capital gain. Apparently the Service has abandoned its ordinary income approach to the problem.

\textsuperscript{40} Since the recomputed basis of $1,000 is lower than the amount realized of $8,000, $1245 income is the difference between $1,000 and the zero basis.

is applied against the sale price of $5,000, then the depreciation de-
ductions are to be attributed to the sale portion of the transaction.

If the recomputed basis was $6,000, the part-sale, part-gift transaction
would again result in section 1245 gain of $2,500 (the lower of gain
realized, $5,000, and recomputed basis, $6,000, minus adjusted basis,
$2,500). The basis of the donated portion of the property in the
hands of the son is zero. If A had sold the property for its fair market
value of $10,000, the section 1245 income would have been $3,500
(recomputed basis, $6,000, minus adjusted basis, $2,500). It could be
contended, therefore, that to the extent $1,000 of section 1245 income
was not taxed to A in the part-sale, part-gift transaction it carries over
into the hands of the son. Thus, upon the son's subsequent disposition
of the property for $10,000, out of his over-all gain of $5,000,42 he
is to be charged with section 1245 income in the amount of $1,000.

Transfers at Death

The second exception to the rule that a disposition of section 1245
property triggers the tax relates to transfers at death.43 This exception
violates the theory that permeates all the other statutory exceptions;
namely, that the ordinary income potential will be recaptured upon the
transferee's disposition of the property. Obviously, in the death situa-
tion, because of the step-up in basis provided for by section 1014, the in-
come potential in the depreciation deductions taken by the decedent is
never subjected to ordinary income taxation. However, if the section
1245 property is sold prior to the decedent's death, the section 1245 gain
is treated as income in respect of a decedent.44

Tax-Free Transfers

Section 1245(b)(3) excepts from the application of the general
rule certain specified tax-free transactions where the property in the
transferee's hands has a carryover basis from the hands of the transferor.

The first of these exceptions involves a complete liquidation of an
80% or more controlled subsidiary under the provisions of section 332.
This exception, however, applies only if the basis carryover rule of
section 334(b)(1) governs. Accordingly, if the liquidation of the
controlled subsidiary occurs under circumstances which require the basis
of the property acquired by the parent corporation in a section 332
liquidation to be the cost to it of the stock rather than the controlled

42. Where a transfer is part-sale and part-gift, the basis of the property in the hands of the
transferee is the greater of the amount he paid for the property or the transferor's adjusted
basis at the time of the transfer. Treas. Reg. § 1.1015-4(a) (1957).
43. Code § 1245(b)(2).
44. Code §§ 691, 1245(b)(2).
subsidiary's basis for its property, a substituted basis rule governs. Such a result will obtain when the parent corporation purchased during a period of not more than twelve months 80% or more of the voting stock of the subsidiary corporation and then adopted a plan of liquidation not more than two years after the date on which the stock requirement was met. Thus, at the point of liquidation, the subsidiary will have ordinary income to the extent that the fair market value or the recomputed basis of the property, whichever is lower, exceeds the adjusted basis of the section 1245 property.46

This particular exception to section 1245 has significance in connection with the acquisition of a corporate business. Previous to the enactment of section 1245, generally speaking, it made little difference taxwise to the seller or buyer whether the corporate buyer of the business bought assets or stock. If assets were purchased, to avoid the double tax on the sale and subsequent liquidation, the seller would plan its transaction so as to meet the requirements of section 337. No gain or loss would be recognized to the selling corporation upon the sale of its property within a twelve-month period commencing on the date it adopted a plan of complete liquidation if within that time it effected a complete liquidation. The buyer would acquire the assets at a basis equal to their cost. On the other hand, if the bargaining position of the seller and buyer dictated that the buyer purchase stock, the same general tax results would obtain. The selling shareholders would incur a tax on the sale of their stock. By fitting its purchase within the provisions of sections 332 and 334(b)(2), the assets received by the corporate buyer upon complete liquidation of the acquired corporation would have a basis equal to the cost to the buyer of the stock.

Presently, however, if section 1245 property is among the assets of the corporate business being purchased, a difference in the tax burden resulting from section 1245 gain will follow, dependent upon whether assets or stock is purchased. If the sale is effected through a section 337 transaction, the section 1245 income generated by the sale will be the tax responsibility of the selling corporation.46 If the assets are acquired through a purchase of stock and liquidation of the controlled corporation so as to result in a substituted basis for the property, the purchaser will discover that its subsidiary will have section 1245 income when it is liquidated.

It is apparent, therefore, that both the seller and the buyer must negotiate the sale with section 1245 in mind. Whether the ultimate form of the transaction will be that of an asset or stock purchase will

45. The substituted basis for the assets should be increased by the amount of the recognized § 1245 gain.
46. Code § 1245(b)(3).
depend in large measure on which party is in the stronger bargaining position. If, however, both parties are cognizant of the application of section 1245, the purchase price can be adjusted to reflect which is to bear the burden of the tax on section 1245 income.\footnote{To avoid § 1245 gain, it is expected that the instances in which § 1245 property will be leased rather than sold will increase.}

Exchanges Pursuant to Corporate Reorganizations

A Subchapter C exception to the general rule of section 1245 relates to a transfer of property to a controlled corporation in exchange for stock, and exchanges pursuant to certain corporate reorganizations.\footnote{Code § 1245 (b) (3). Additional exchanges which are excepted from § 1245 treatment are those relating to certain receivership and bankruptcy proceedings (§ 371(a)) and to certain railroad reorganizations (§ 374(a)).} Accordingly, if a taxpayer transfers section 1245 property to a corporation of which he is the sole shareholder in exchange for stock, the transferor is not taxed on the section 1245 income. The corporation, however, takes the transferred property with the transferor’s basis, so that the ordinary income potential inherent in that property will be recouped on the corporation’s subsequent disposition of it. By reason of this exception, the transferor could sell his stock after making the transfer of section 1245 property, and the character of any gain realized on that sale would be ascertained wholly apart from section 1245. To this extent, therefore, the transferor may be in a position to avoid the ordinary income tax potential built into the property from the depreciation deductions taken while he was the owner of the property.\footnote{There is no certainty of recapture at the corporate level because the asset involved may never be disposed of. Furthermore, even if there is a disposition by the corporate transferee, the likelihood is that the corporate tax rate will be lower than that which would have applied to the noncorporate transferor.}

It is important to note that no specific exemption is found in section 1245 for a contribution to the capital of a corporation.\footnote{From the corporation’s standpoint, it has no recognized gain when the contribution is made. Code § 118.} Such a contribution of section 1245 property is clearly a disposition of that property. Accordingly, unless that disposition falls within one of the enumerated exceptions, the contribution will give rise to section 1245 income. If the contribution to the corporation can be classified as a gift, it will fall within the gift exception to section 1245.

At first blush, it would appear that where a shareholder contributes property to a corporation without any consideration or compensation, it constitutes a gift. In income tax cases where the facts reflected such a lack of consideration, the courts have held that there was a gift and that the basis of the contributed property in the hands of the trans-
feree-corporation was that of the donor-shareholder. If, however, the corporation has more than one shareholder, there is a gift to the corporation.

Keeping in mind the theory of the exceptions to section 1245, the capital contribution transaction should fall within the gift exception. The corporation is required to pick up the transferor's basis for the property, and, therefore, on subsequent disposition of it, the Treasury would recoup the depreciation deductions. There appears to be no justification for a different section 1245 treatment for a contribution to the capital of a corporation and for a transfer to a controlled corporation in exchange for stock. In each instance, the property in the corporation's hands takes the transferor's basis. Accordingly, the purpose of section 1245 is not thwarted by postponing section 1245 treatment until the transferee-corporation makes a disposition. However, pending clarification of this point, if the contributing shareholders are in control of the corporation within the meaning of section 351, they should take additional stock for their contribution. In situations where control is lacking, it must be recognized that the contribution might result in section 1245 income to the transferor.

Where A and B, unrelated taxpayers, own other than in corporate form depreciable personal property which has appreciated in value, it has been a common occurrence for them to organize a corporation and "sell" that property to the corporation. The purpose of such a transaction is to step up the basis of the property in the hands of the corporation and thus increase its depreciation deductions at a capital gains cost to the selling shareholders. Section 1245 will now operate as an effective harness to such a transaction. A sizable portion of the gain recognized to the sellers will be subject to ordinary income taxation by reason of section 1245, and that tax cost will in many instances offset the advan-

54. CODE § 362(a). If gain is recognized to the transferor, the basis of the § 1245 property would be increased in the amount of the recognized gain.
55. It is understood that in connection with transfers to a foreign corporation, the Service takes the position that a contribution to a corporation is tantamount to a § 351 exchange and therefore within the provisions of § 367.
56. Compare Sun Properties, Inc. v. United States, 220 F.2d 171 (5th Cir. 1955), with Aqualane Shores, Inc. v. Commissioner, 269 F.2d 116 (5th Cir. 1959). Section 1239 operates in a limited area of family relationship to cause gain on any such sale to be characterized as ordinary income.
tage of the depreciation deductions resulting from a stepped-up basis to the corporation. Accordingly, the likelihood is that instances in which such "sales" occur will greatly diminish.\textsuperscript{57}

In the tax-free transactions enumerated under section 1245(b)(3), if "boot"\textsuperscript{58} is received by the transferor, section 1245 income may result. For example, a sole shareholder transfers to his controlled corporation section 1245 property having an adjusted basis of $2,000, a recomputed basis of $4,000, and a fair market value of $5,000 in exchange for stock having a fair market value of $4,000 and $1,000 in cash. The $1,000 in cash constitutes boot under section 351(b) and would therefore cause the realized gain of $3,000 to be recognized to the extent of $1,000. At this point, section 1245(b)(3) cuts across and requires the gain to be treated as section 1245 income. The potential section 1245 income inherent in that property is $2,000 (recomputed basis of $4,000 minus the adjusted basis of $2,000). Accordingly, section 1245(b)(3) operates in the boot situation to tax as ordinary income the section 1245 income, but not in excess of the boot. The $1,000 of section 1245 income not subject to tax at the time of the exchange will attach to the property in the corporation's hands, with the result that it would be required (assuming it transfers property prior to taking any further depreciation adjustments) to pick up $1,000 as section 1245 income.\textsuperscript{59}

If the transfer involves a number of assets of which some are section 1245 property and boot is received, the section is silent on how that boot is to be allocated. \textit{A} transfers a number of properties to his controlled corporation in exchange for stock of that corporation with a fair market value of $20,000 and $5,000 in cash. Among the assets transferred is section 1245 property with an adjusted basis of $2,000, a recomputed basis of $8,000, and a fair market value of $10,000, and property other than section 1245 property held for more than six months, with an adjusted basis of $10,000 and a fair market value of $15,000. Thus, \textit{A}'s over-all aggregate gain is $13,000, of which only

\textsuperscript{57} Whereas prior to the enactment of § 1245 the Commissioner took the position that the "sale" was really an exchange within § 1245, now the positions of the taxpayer and Commissioner may be reversed. The taxpayer, to avoid the impact of § 1245, may claim that the "sale" is in fact a tax-free exchange.

\textsuperscript{58} Generally speaking, "boot" is property or money received in addition to stock or securities permitted to be received tax-free under the particular exchange section. Code §§ 351(b), 356(a).

\textsuperscript{59} Selling price $5,000

\begin{tabular}{ll}
Recomputed basis & $4,000 \\
Basis to corporation & \\
Transferor's basis & $2,000 \\
Gain recognized on transfer & 1,000 \\
\end{tabular}

$1,000

\textsuperscript{351} income

\textsuperscript{19641}
$5,000 is recognized under section 351(b). Some allocation of this gain obviously is in order. If the entire $5,000 is allocated to the section 1245 property, this would result in the entire amount of the boot being taxed as ordinary income. On the other hand, if the allocation is in relation to the fair market value of the assets transferred, then $2,000 of the boot would be allocated to the section 1245 property and taxed as ordinary income ($10,000/$25,000 times $5,000). If the allocation was proportionate to the realized gain rather than to fair market value, the section 1245 gain would approximate $3,000 ($8,000/$13,000 times $5,000).60

The exceptions specified in section 1245(b)(3) do not apply, however, to a transfer of section 1245 property to a tax-exempt organization (other than a farm cooperative). The transferor is taxed on the section 1245 income; otherwise there would be no recapture of the depreciation deductions once the property came to rest in the hands of the tax-exempt organization, which, generally speaking, would not have any recognized income on its disposition of the property.61

Exchanges of Like Kind Property

Another significant exception to recognition of section 1245 gain relates to exchanges of like kind property under section 1031 and to involuntary conversions under section 1033.62 There are two situations, however, where section 1245 income will be recognized notwithstanding the tax-free nature of these transactions. The first of these is that section 1245 income will be recognized to the extent that gain is otherwise required to be recognized under sections 1031 and 1033. This principle is illustrated by the following example. A is the owner of a machine with an adjusted basis of $10,000 and a fair market value of $20,000. In an exchange, he receives another machine with a fair market value of $15,000 and cash in the amount of $5,000. The gain recognized on that transaction is $5,000, the amount of the boot. If the recomputed basis of the exchanged machine was $15,000, section 1245 income would likewise be $5,000. Accordingly, all of the recognized gain of $5,000 would be section 1245 income.

To prevent the double taxation of section 1245 income upon A’s subsequent disposition of the machine, his basis should be adjusted to the extent of $5,000 to reflect the gain recognized to A on the receipt

60. The Regulations promulgated under §§ 351 and 356 fail to reflect the method of allocating boot. In most instances where allocation is required, a fair market value method is employed. See CODE § 1031(d); Treas. Reg. § 1.357-2 (1955).
61. The committee reports caution that no implication is to be drawn from this provision as to whether such a transfer qualifies for nonrecognition under the enumerated sections set forth in § 1245(b)(3). Apparently, this is an open question. S. REP. NO. 1881.
62. CODE § 1245(b)(4).
of boot. A, therefore, would have a $10,000 basis for the machine. His depreciation deduction will reflect that new basis, and, presumably, when he later sells the machine, his recomputed basis will likewise reflect the depreciation deductions taken on the additional $5,000 of basis.

The second situation which requires recognition of section 1245 income under situations falling within sections 1031 and 1033 comes into play when the property received in the exchange is not section 1245 property and is not taken into account as boot under the first situation. This provision can cause unexpected section 1245 income to occur in what may be described as a typical section 1031 exchange of real estate.

A transfers land and a factory building for an office building. A portion of this exchange includes property which under local law is considered to be a fixture and therefore real property, but which for section 1245 purposes is section 1245 property. Since the office building is not section 1245 property, the exchange falls squarely within section 1245(b)(4)(B). A will be subject to section 1245 income on the fixtures given up in the exchange, even though the exchange itself is tax free under section 1031. This result is particularly harsh since A's basis for the "fixtures" will carry over into the transferee's hands. Thus, the ordinary income potential would be recaptured on a subsequent disposition.

Another illustration of the application of section 1245(b)(4)(B) occurs in an involuntary conversion where the taxpayer whose property has been involuntarily converted utilizes the proceeds to purchase a controlling stock interest in a corporation which owns property similar or related in service or use to the converted property. There is immediate recognition of the section 1245 gain. Justification for this result exists. Unlike the section 1031 exchange example, if section 1245 income was not recognized at the time of the purchase of the stock, all opportunity to recoup the depreciation deductions encased in the converted property would be lost, since the stock purchased is not section 1245 property.

Problems in the area of allocation of boot arise in like kind exchanges, as they did in the tax-free transactions. Assume an exchange occurs of the operating assets of a business for identical operating assets of another business. The assets exchanged include section 1245 property, land, and buildings. For purposes of section 1031, the exchange

63. **Code** § 1031(d).
64. **Code** § 1245(b)(4)(B).
65. **Code** § 1245(a)(3).
66. For a discussion of these problems, see p. 299 supra.
will be regarded as an exchange of "property of like kind" even though the assets group by group differ in value. If the exchange is fragmented, it could be contended that to the extent non-section 1245 property is acquired in exchange for section 1245 property, because of the differences in value, section 1245 income is generated at the time of the exchange to the extent of the fair market value of non-section 1245 property. It is submitted that this type of exchange should be regarded as a "package" and that section 1245 income should not be recognized.

Where boot is given up and received in a section 1031 exchange, an allocation problem exists. A exchanges section 1245 property with a zero adjusted basis and a fair market value of $10,000. He also exchanges stock in a corporation with a cost and fair market value of $10,000 for other section 1245 property plus $10,000 in cash. The question is whether the $10,000 in cash is to be allocated entirely to the section 1245 property; whether the $10,000 cash is to be allocated to the stock; or whether it must be allocated proportionately to the section 1245 property and the stock. Obviously, it would be to A's immediate tax advantage to allocate the cash received to the stock because such an allocation would eliminate any section 1245 income in the exchange. In these situations, efforts should be made to allocate the boot received first to the boot given up, with any excess applied to the section 1245 property.

Contributions to Partnerships and Sales of Partnership Interests

Section 1245 contains a number of provisions relating to partnerships. Consistent with the principles affecting the other exceptions, the section provides for nonrecognition of section 1245 income when a contribution is made to a partnership in exchange for a partnership interest, and in certain partnership distributions. In both of these situations no gain generally is recognized and there is a carryover basis, so that the prior depreciation deductions will be recaptured at ordinary income rates. The section details the rules where partnership property is distributed to a partner in a partial or complete liquidation of his partnership interest. First, the basis of section 1245 property received by a partner as a distribution from the partnership is the same as it was in the hands of the partnership. If a basis allocation is required, such

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68. Rev. Rul. 365, supra note 67, is not to be interpreted as approving every exchange of property of one kind for property of another kind merely because all the properties were used in the same type of business. See Williams v. McGowan, 152 F.2d 570 (2d Cir. 1945), involving a sale of a sole proprietorship.
69. CODE § 1245(b) (3) enumerates §§ 721 and 731.
70. CODE § 1245(b) (6) (A).
basis is allocated first to the section 1245 property.\textsuperscript{71} Thus, if in a complete liquidation of a partnership interest for which a partner's basis is $10,000 he receives section 1245 property having a basis of $15,000 to the partnership, the basis allocated to the section 1245 property is $10,000.

To insure the recapture at the distributee partner's level of the depreciation deductions taken by the partnership prior to the distribution, the distributee partner, for purposes of computing his recomputed basis, adds to it the section 1245 income that would have been recognized to the partnership if it had sold the property at its fair market value immediately before the distribution.\textsuperscript{72} However, if in the liquidation of his partnership interest a partner received a non-pro rata distribution which resulted in the application of section 751(b), then section 1245 gain is recognized at the time of distribution. Thus, if the \textit{ABC} partnership owned section 1245 property, land, and cash, and in liquidation of his partnership interest \textit{A} receives all the section 1245 property, such a non-pro rata distribution is treated as though the partnership composed of \textit{B} and \textit{C} exchanged its pro rata interest in the section 1245 property for other assets.\textsuperscript{73} The section 1245 property is treated as an "unrealized receivable,"\textsuperscript{74} and there is immediate recognition of the section 1245 income to the partnership to the extent of its surrender of its pro rata share of the section 1245 property. To prevent the double taxation of that income in determining his recomputed basis of the section 1245 property, \textit{A} reduces it by the amount of the gain recognized to the partnership by reason of section 751(b).\textsuperscript{75} If the non-pro rata distribution was of such a nature that \textit{A} received property other than the section 1245 property, at the time of such distribution \textit{A} would be burdened with the section 1245 gain to the extent he gave up his pro rata interest in that property. The partnership should be entitled to adjust its basis for the section 1245 property to reflect the gain taxed to \textit{A} so as to prevent the section 1245 income from being taxed twice.\textsuperscript{76}

By reason of the expansion of the definition of "unrealized receivables" to include section 1245 property, upon the sale of a partnership interest or upon receipt of payments from the partnership by a retiring partner or deceased partner's successor-in-interest, section 1245 income will be recognized to the extent of the ordinary income potential.\textsuperscript{77} The

\begin{footnotesize}
\textsuperscript{71} CODE § 732(c).
\textsuperscript{72} CODE § 1245(b) (6) (B).
\textsuperscript{73} CODE § 751(b).
\textsuperscript{74} CODE § 751(c).
\textsuperscript{75} CODE § 1245(b) (6) (B).
\textsuperscript{76} CODE § 1245(c) provides that the Secretary or his delegate will issue regulations to provide for the adjustment of basis to reflect the recognized § 1245 gain. See CODE § 734.
\textsuperscript{77} CODE § 751 (a).
\end{footnotesize}
recognition of such gain to the partner would require that the basis of the section 1245 property held by the partnership be increased to reflect that gain.

**Miscellaneous Problems**

The enactment of section 1245, which requires that gain which otherwise would be taxable as capital gain be treated as ordinary income, creates problems in other areas where the character of the gain and its recognition are important.

A corporation which is otherwise collapsible may escape the ordinary income treatment imposed upon a collapsible corporation if it can maneuver itself into the complicated provisions of section 341(e). One of the keys to relieving a corporation from collapsibility is whether the property owned by the corporation would, if sold, give rise to capital gain rather than ordinary income. In resolving this question, the application of section 1245 to the disposition is to be ignored.\(^78\)

If a personal holding company sells a capital asset or property described in section 1231 at a gain, that gain minus the tax is deducted from the taxable income of the personal holding company in arriving at its undistributed personal holding company income.\(^79\) If the property sold by the personal holding company is section 1245 property, it is doubtful, in view of the language of section 545(b)(5) restricting the deduction to long-term capital gain, that the section 1245 gain would be allowed as a deduction.\(^80\) Thus, a personal holding company which disposes of section 1245 property probably will have to distribute the gain recognized on that disposition if it wishes to avoid the personal holding company tax.

Normally, affiliated companies which file a consolidated return exclude inter-company transactions from the consolidated income.\(^81\) This rule is in direct conflict with section 1245(d), which categorically states that section 1245 gain is to be recognized regardless of any other income tax provision of the Code. In view of this specific direction of section 1245, it will be interesting to see whether the Commissioner will promulgate regulations under section 1502 excepting the recognition of

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78. **Code** § 341(e)(12).
79. **Code** § 545(b)(5).
80. A similar problem of characterization arises in connection with the definition of "unrelated business taxable income" which excludes gains from the sale, exchange, or other disposition of property other than stock in trade and inventory. *Query:* whether § 1245 gain should be excluded.