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Treas. Reg. Section 1.1221-1(c)(3)

Meaning of terms

(a) The term "capital assets" includes all classes of property not specifically excluded by section 1221. In determining whether property is a "capital asset", the period for which held is immaterial.

(b) Property used in the trade or business of a taxpayer of a character which is subject to the allowance for depreciation provided in section 167 and real property used in the trade or business of a taxpayer is excluded from the term "capital assets". Gains and losses from the sale or exchange of such property are not treated as gains and losses from the sale or exchange of capital assets, except to the extent provided in section 1231. See §1.1231-1. Property held for the production of income, but not used in a trade or business of the taxpayer, is not excluded from the term "capital assets" even though depreciation may have been allowed with respect to such property under section 23(l) of the Internal Revenue Code of 1939 before its amendment by section 121(c) of the Revenue Act of 1942 (56 Stat. 819). However, gain or loss upon the sale or exchange of land held by a taxpayer primarily for sale to customers in the ordinary course of his business, as in the case of a dealer in real estate, is not subject to the provisions of subchapter P (section 1201 and following), chapter 1 of the Code.

(c)

(1) A copyright, a literary, musical, or artistic composition, and similar property are excluded from the term "capital assets" if held by a taxpayer whose personal efforts created such property, or if held by a taxpayer in whose hands the basis of such property is determined, for purposes of determining gain from a sale or exchange, in whole or in part by reference to the basis of such property in the hands of a taxpayer whose personal efforts created such property. For purposes of this subparagraph, the phrase "similar property" includes for example, such property as a theatrical production, a radio program, a newspaper cartoon strip, or any other property eligible for copyright protection (whether under statute or common law), but does not include a patent or an invention, or a design which may be protected only under the patent law and not under the copyright law.

(2) In the case of sales and other dispositions occurring after July 25, 1969, a letter, a memorandum, or similar property is excluded from the term "capital asset" if held by (i) a taxpayer whose personal efforts created such property, (ii) a taxpayer for whom such property was prepared or produced, or (iii) a taxpayer in whose hands the basis of such property is determined, for purposes of determining gain from a sale or exchange, in whole or in part by reference to the basis of such property in the hands of a taxpayer described in subdivision (i) or (ii) of this subparagraph. In the case of a collection of letters, memorandums, or similar property held by a person who is a taxpayer described in subdivision (i), (ii), or (iii) of this subparagraph as to some of such letters,

memorandums, or similar property but not as to others, this subparagraph shall apply only to those letters, memorandums, or similar property as to which such person is a taxpayer described in such subdivision. For purposes of this subparagraph, the phrase "similar property" includes, for example, such property as a draft of a speech, a manuscript, a research paper, an oral recording of any type, a transcript of an oral recording, a transcript of an oral interview or of dictation, a personal or business diary, a log or journal, a corporate archive, including a corporate charter, office correspondence, a financial record, a drawing, a photograph, or a dispatch. A letter, memorandum, or property similar to a letter or memorandum, addressed to a taxpayer shall be considered as prepared or produced for him. This subparagraph does not apply to property, such as a corporate archive, office correspondence, or a financial record, sold or disposed of as part of a going business if such property has no significant value separate and apart from its relation to and use in such business; it also does not apply to any property to which subparagraph (1) of this paragraph applies (i.e., property to which section 1221(3) applied before its amendment by section 514(a) of the Tax Reform Act of 1969 (83 Stat. 643)).

(3) For purposes of this paragraph, in general, property is created in whole or in part by the personal efforts of a taxpayer if such taxpayer performs literary, theatrical, musical, artistic, or other creative or productive work which affirmatively contributes to the creation of the property, or if such taxpayer directs and guides others in the performance of such work. A taxpayer, such as corporate executive, who merely has administrative control of writers, actors, artists, or personnel and who does not substantially engage in the direction and guidance of such persons in the performance of their work, does not create property by his personal efforts. However, for purposes of subparagraph (2) of this paragraph, a letter or memorandum, or property similar to a letter or memorandum, which is prepared by personnel who are under the administrative control of a taxpayer, such as a corporate executive, shall be deemed to have been prepared or produced for him whether or not such letter, memorandum, or similar property is reviewed by him.

(4) For the application to section 1231 to the sale or exchange of property to which this paragraph applies, see §1.1231-1. For the application of section 170 to the charitable contribution of property to which this paragraph applies, see section 170(e) and the regulations thereunder.

(d) Section 1221(4) excludes from the definition of "capital asset" accounts or notes receivable acquired in the ordinary course of trade or business for services rendered or from the sale of stock in trade or inventory or property held for sale to customers in the ordinary course of trade or business. Thus, if a taxpayer acquires a note receivable for services rendered, reports the fair market value of the note as income, and later sells the note for less than the amount previously reported, the loss is an ordinary loss. On the other hand, if the taxpayer later sells the note for more than the amount originally reported, the excess is treated as ordinary income.

(e) Obligations of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue, are excluded from the term "capital assets." An obligation may be issued on a discount basis even though the price paid exceeds the face amount. Thus, although the Second Liberty Bond Act (31 U.S.C. 754) provides that United States Treasury bills shall be issued on a discount basis, the issuing price paid for a particular bill may, by reason of competitive bidding, actually exceed the face amount of the bill. Since the obligations of the type described in this paragraph are excluded from the term "capital assets", gains or losses from the sale or exchange of such obligations are not subject to the limitations provided in such subchapter P. It is, therefore, not necessary for a taxpayer (other than a life insurance company taxable under part I (section 801 and following), subchapter L, chapter 1 of the Code, as amended by the Life Insurance Company Tax Act of 1955, (70 Stat. 36), and, in the case of taxable years beginning before January 1, 1955, subject to taxation only on interest, dividends, and rents) to segregate the original discount accrued and the gain or loss realized upon the sale or other disposition of any such obligation. See section 454(b) with respect to the original discount accrued. The provisions of this paragraph may be illustrated by the following examples:

Example (1). A (not a life insurance company) buys a $100,000, 90-day Treasury bill upon issuance for $99,998. As of the close of the forty-fifth day of the life of such bill, he sells it to B (not a life insurance company) for $99,999.50. The entire net gain to A of $1.50 may be taken into account as a single item of income, without allocating $1 to interest and $0.50 to gain. If B holds the bill until maturity his net gain of $0.50 may similarly be taken into account as a single item of income, without allocating $1 to interest and $0.50 to loss.

Example (2). The facts in this example are the same as in example (1) except that the selling price to B is $99,998.50. The net gain to A of $0.50 may be taken into account without allocating $1 to interest and $0.50 to loss, and, similarly, if B holds the bill until maturity his entire net gain of $1.50 may be taken into account as a single item of income without allocating $1 to interest and $0.50 to gain.