

## Federal Tax Regulations, Regulation, §1.168(k)-1. , Internal Revenue Service, Additional first year depreciation deduction

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### (a) Scope and definitions

**(1) Scope.**— This section provides the rules for determining the 30-percent additional first year depreciation deduction allowable under section 168(k)(1) for qualified property and the 50-percent additional first year depreciation deduction allowable under section 168(k)(4) for 50-percent bonus depreciation property.

**(2) Definitions.**— For purposes of section 168(k) and this section, the following definitions apply:

**(i) Depreciable property** is property that is of a character subject to the allowance for depreciation as determined under section 167 and the regulations thereunder.

**(ii) MACRS property** is tangible, depreciable property that is placed in service after December 31, 1986 (or after July 31, 1986, if the taxpayer made an election under section 203(a)(1)(B) of the Tax Reform Act of 1986; 100 Stat. 2143) and subject to section 168, except for property excluded from the application of section 168 as a result of section 168(f) or as a result of a transitional rule.

**(iii) Unadjusted depreciable basis** is the basis of property for purposes of section 1011 without regard to any adjustments described in section 1016(a)(2) and (3). This basis reflects the reduction in basis for the percentage of the taxpayer's use of property for the taxable year other than in the taxpayer's trade or business (or for the production of income), for any portion of the basis the taxpayer properly elects to treat as an expense under section 179 or section 179C, and for any adjustments to basis provided by other provisions of the Internal Revenue Code and the regulations thereunder (other than section 1016(a)(2) and (3)) (for example, a reduction in basis by the amount of the disabled access credit pursuant to section 44(d)(7)). For property subject to a lease, see section 167(c)(2).

**(iv) Adjusted depreciable basis** is the unadjusted depreciable basis of the property, as defined in §1.168(k)-1(a)(2)(iii), less the adjustments described in section 1016(a)(2) and (3).

### (b) Qualified property or 50-percent bonus depreciation property

**(1) In general.**— Qualified property or 50-percent bonus depreciation property is depreciable property that meets all the following requirements in the first taxable year in which the property is subject to depreciation by the taxpayer whether or not depreciation deductions for the property are allowable:

- (i)** The requirements in §1.168(k)-1(b)(2) (description of property);
- (ii)** The requirements in §1.168(k)-1(b)(3) (original use);
- (iii)** The requirements in §1.168(k)-1(b)(4) (acquisition of property); and
- (iv)** The requirements in §1.168(k)-1(b)(5) (placed-in-service date).

### (2) Description of qualified property or 50-percent bonus depreciation property

**(i) In general.**— Depreciable property will meet the requirements of this paragraph (b)(2) if the property is—

- (A)** MACRS property (as defined in §1.168(k)-1(a)(2)(ii)) that has a recovery period of 20 years or less. For purposes of this paragraph (b)(2)(i)(A) and section 168(k)(2)(B)(i)(II) and 168(k)

(4)(C), the recovery period is determined in accordance with section 168(c) regardless of any election made by the taxpayer under section 168(g)(7);

(B) Computer software as defined in, and depreciated under, section 167(f)(1) and the regulations thereunder;

(C) Water utility property as defined in section 168(e)(5) and depreciated under section 168; or

(D) Qualified leasehold improvement property as defined in paragraph (c) of this section and depreciated under section 168.

**(ii) Property not eligible for additional first year depreciation deduction**

**(A) Property that is not qualified property.**— For purposes of the 30-percent additional first year depreciation deduction, depreciable property will not meet the requirements of this paragraph (b)(2) if the property is—

(1) Described in section 168(f);

(2) Required to be depreciated under the alternative depreciation system of section 168(g) pursuant to section 168(g)(1)(A) through (D) or other provisions of the Internal Revenue Code (for example, property described in section 263A(e)(2)(A) if the taxpayer (or any related person as defined in section 263A(e)(2)(B)) has made an election under section 263A(d)(3), or property described in section 280F(b)(1)).

(3) Included in any class of property for which the taxpayer elects not to deduct the 30-percent additional first year depreciation (for further guidance, see paragraph (e) of this section); or

(4) Qualified New York Liberty Zone leasehold improvement property as defined in section 1400L(c)(2).

**(B) Property that is not 50-percent bonus depreciation property.**— For purposes of the 50-percent additional first year depreciation deduction, depreciable property will not meet the requirements of this paragraph (b)(2) if the property is—

(1) Described in paragraph (b)(2)(ii)(A)(1), (2), or (4) of this section; or

(2) Included in any class of property for which the taxpayer elects the 30-percent, instead of the 50-percent, additional first year depreciation deduction or elects not to deduct any additional first year depreciation (for further guidance, see paragraph (e) of this section).

**(3) Original use**

**(i) In general.**— For purposes of the 30-percent additional first year depreciation deduction, depreciable property will meet the requirements of this paragraph (b)(3) if the original use of the property commences with the taxpayer after September 10, 2001. For purposes of the 50-percent additional first year depreciation deduction, depreciable property will meet the requirements of this paragraph (b)(3) if the original use of the property commences with the taxpayer after May 5, 2003. Except as provided in paragraphs (b)(3)(iii) and (iv) of this section, original use means the first use to which the property is put, whether or not that use corresponds to the use of the property by the taxpayer. Thus, additional capital expenditures incurred by a taxpayer to recondition or rebuild property acquired or owned by the taxpayer satisfies the original use requirement. However, the cost of reconditioned or rebuilt property does not satisfy the original use requirement. The question of whether property is reconditioned or rebuilt property is a question of fact. For purposes of this paragraph (b)(3)(i), property that contains used parts will not be treated as reconditioned or rebuilt if the cost of the used parts is not more than 20 percent of the total cost of the property, whether acquired or self-constructed.

## **(ii) Conversion to business or income-producing use**

**(A) Personal use to business or income-producing use.**— If a taxpayer initially acquires new property for personal use and subsequently uses the property in the taxpayer's trade or business or for the taxpayer's production of income, the taxpayer is considered the original user of the property. If a person initially acquires new property for personal use and a taxpayer subsequently acquires the property from the person for use in the taxpayer's trade or business or for the taxpayer's production of income, the taxpayer is not considered the original user of the property.

**(B) Inventory to business or income-producing use.**— If a taxpayer initially acquires new property and holds the property primarily for sale to customers in the ordinary course of the taxpayer's business and subsequently withdraws the property from inventory and uses the property primarily in the taxpayer's trade or business or primarily for the taxpayer's production of income, the taxpayer is considered the original user of the property. If a person initially acquires new property and holds the property primarily for sale to customers in the ordinary course of the person's business and a taxpayer subsequently acquires the property from the person for use primarily in the taxpayer's trade or business or primarily for the taxpayer's production of income, the taxpayer is considered the original user of the property. For purposes of this paragraph (b) (3)(ii)(B), the original use of the property by the taxpayer commences on the date on which the taxpayer uses the property primarily in the taxpayer's trade or business or primarily for the taxpayer's production of income.

## **(iii) Sale-leaseback, syndication, and certain other transactions**

**(A) Sale-leaseback transaction.**— If new property is originally placed in service by a person after September 10, 2001 (for qualified property), or after May 5, 2003 (for 50-percent bonus depreciation property), and is sold to a taxpayer and leased back to the person by the taxpayer within three months after the date the property was originally placed in service by the person, the taxpayer-lessor is considered the original user of the property.

**(B) Syndication transaction and certain other transactions.**— If new property is originally placed in service by a lessor (including by operation of paragraph (b)(5)(ii)(A) of this section) after September 10, 2001 (for qualified property), or after May 5, 2003 (for 50-percent bonus depreciation property), and is sold by the lessor or any subsequent purchaser within three months after the date the property was originally placed in service by the lessor (or, in the case of multiple units of property subject to the same lease, within three months after the date the final unit is placed in service, so long as the period between the time the first unit is placed in service and the time the last unit is placed in service does not exceed 12 months), and the user of the property after the last sale during the three-month period remains the same as when the property was originally placed in service by the lessor, the purchaser of the property in the last sale during the three-month period is considered the original user of the property.

**(C) Sale-leaseback transaction followed by a syndication transaction and certain other transactions.**— If a sale-leaseback transaction that satisfies the requirements in paragraph (b) (3)(iii)(A) of this section is followed by a transaction that satisfies the requirements in paragraph (b)(3)(iii)(B) of this section, the original user of the property is determined in accordance with paragraph (b)(3)(iii)(B) of this section.

**(iv) Fractional interests in property.**— If, in the ordinary course of its business, a taxpayer sells fractional interests in property to third parties unrelated to the taxpayer, each first fractional owner of the property is considered as the original user of its proportionate share of the property. Furthermore, if the taxpayer uses the property before all of the fractional interests of the property are sold but the property continues to be held primarily for sale by the taxpayer, the original use of any fractional interest sold to a third party unrelated to the taxpayer subsequent to the taxpayer's use of the property begins with the first purchaser of that fractional interest. For purposes of this

paragraph (b)(3)(iv), persons are not related if they do not have a relationship described in section 267(b) or 707(b) and the regulations thereunder.

**(v) Examples.**— The application of this paragraph (b)(3) is illustrated by the following examples:

*Example 1.* On August 1, 2002, A buys from B for \$20,000 a machine that has been previously used by B in B's trade or business. On March 1, 2003, A makes a \$5,000 capital expenditure to recondition the machine. The \$20,000 purchase price does not qualify for the additional first year depreciation deduction because the original use requirement of this paragraph (b)(3) is not met. However, the \$5,000 expenditure satisfies the original use requirement of this paragraph (b)(3) and, assuming all other requirements are met, qualifies for the 30-percent additional first year depreciation deduction, regardless of whether the \$5,000 is added to the basis of the machine or is capitalized as a separate asset.

*Example 2.* C, an automobile dealer, uses some of its automobiles as demonstrators in order to show them to prospective customers. The automobiles that are used as demonstrators by C are held by C primarily for sale to customers in the ordinary course of its business. On September 1, 2002, D buys from C an automobile that was previously used as a demonstrator by C. D will use the automobile solely for business purposes. The use of the automobile by C as a demonstrator does not constitute a "use" for purposes of the original use requirement and, therefore, D will be considered the original user of the automobile for purposes of this paragraph (b)(3). Assuming all other requirements are met, D's purchase price of the automobile qualifies for the 30-percent additional first year depreciation deduction for D, subject to any limitation under section 280F.

*Example 3.* On April 1, 2000, E acquires a horse to be used in E's thoroughbred racing business. On October 1, 2003, F buys the horse from E and will use the horse in F's horse breeding business. The use of the horse by E in its racing business prevents the original use of the horse from commencing with F. Thus, F's purchase price of the horse does not qualify for the additional first year depreciation deduction.

*Example 4.* In the ordinary course of its business, G sells fractional interests in its aircraft to unrelated parties. G holds out for sale eight equal fractional interests in an aircraft. On January 1, 2003, G sells five of the eight fractional interests in the aircraft to H, an unrelated party, and H begins to use its proportionate share of the aircraft immediately upon purchase. On June 1, 2003, G sells to I, an unrelated party to G, the remaining unsold  $\frac{3}{8}$  fractional interests in the aircraft. H is considered the original user as to its  $\frac{5}{8}$  fractional interest in the aircraft and I is considered the original user as to its  $\frac{3}{8}$  fractional interest in the aircraft. Thus, assuming all other requirements are met, H's purchase price for its  $\frac{5}{8}$  fractional interest in the aircraft qualifies for the 30-percent additional first year depreciation deduction and I's purchase price for its  $\frac{3}{8}$  fractional interest in the aircraft qualifies for the 50-percent additional first year depreciation deduction.

*Example 5.* On September 1, 2001, JJ, an equipment dealer, buys new tractors that are held by JJ primarily for sale to customers in the ordinary course of its business. On October 15, 2001, JJ withdraws the tractors from inventory and begins to use the tractors primarily for producing rental income. The holding of the tractors by JJ as inventory does not constitute a "use" for purposes of the original use requirement and, therefore, the original use of the tractors commences with JJ on October 15, 2001, for purposes of paragraph (b)(3) of this section. However, the tractors are not eligible for the additional first year depreciation deduction because JJ acquired the tractors before September 11, 2001.

#### **(4) Acquisition of property**

##### **(i) In general**

**(A) Qualified property.**— For purposes of the 30-percent additional first year depreciation deduction, depreciable property will meet the requirements of this paragraph (b)(4) if the property is—

(1) Acquired by the taxpayer after September 10, 2001, and before January 1, 2005, but only if no written binding contract for the acquisition of the property was in effect before September 11, 2001; or

(2) Acquired by the taxpayer pursuant to a written binding contract that was entered into after September 10, 2001, and before January 1, 2005.

**(B) 50-percent bonus depreciation property.**— For purposes of the 50-percent additional first year depreciation deduction, depreciable property will meet the requirements of this paragraph (b)(4) if the property is—

(1) Acquired by the taxpayer after May 5, 2003, and before January 1, 2005, but only if no written binding contract for the acquisition of the property was in effect before May 6, 2003; or

(2) Acquired by the taxpayer pursuant to a written binding contract that was entered into after May 5, 2003, and before January 1, 2005.

## **(ii) Definition of binding contract**

**(A) In general.**— A contract is binding only if it is enforceable under State law against the taxpayer or a predecessor, and does not limit damages to a specified amount (for example, by use of a liquidated damages provision). For this purpose, a contractual provision that limits damages to an amount equal to at least 5 percent of the total contract price will not be treated as limiting damages to a specified amount. In determining whether a contract limits damages, the fact that there may be little or no damages because the contract price does not significantly differ from fair market value will not be taken into account. For example, if a taxpayer entered into an irrevocable written contract to purchase an asset for \$100 and the contract contained no provision for liquidated damages, the contract is considered binding notwithstanding the fact that the asset had a fair market value of \$99 and under local law the seller would only recover the difference in the event the purchaser failed to perform. If the contract provided for a full refund of the purchase price in lieu of any damages allowable by law in the event of breach or cancellation, the contract is not considered binding.

**(B) Conditions.**— A contract is binding even if subject to a condition, as long as the condition is not within the control of either party or a predecessor. A contract will continue to be binding if the parties make insubstantial changes in its terms and conditions or because any term is to be determined by a standard beyond the control of either party. A contract that imposes significant obligations on the taxpayer or a predecessor will be treated as binding notwithstanding the fact that certain terms remain to be negotiated by the parties to the contract.

**(C) Options.**— An option to either acquire or sell property is not a binding contract.

**(D) Supply agreements.**— A binding contract does not include a supply or similar agreement if the amount and design specifications of the property to be purchased have not been specified. The contract will not be a binding contract for the property to be purchased until both the amount and the design specifications are specified. For example, if the provisions of a supply or similar agreement state the design specifications of the property to be purchased, a purchase order under the agreement for a specific number of assets is treated as a binding contract.

**(E) Components.**— A binding contract to acquire one or more components of a larger property will not be treated as a binding contract to acquire the larger property. If a binding contract to acquire the component does not satisfy the requirements of this paragraph (b)(4), the component does not qualify for the 30-percent or 50-percent additional first year depreciation deduction, as applicable.

## **(iii) Self-constructed property**

**(A) In general.**— If a taxpayer manufactures, constructs, or produces property for use by the taxpayer in its trade or business (or for its production of income), the acquisition rules in paragraph (b)(4)(i) of this section are treated as met for qualified property if the taxpayer begins manufacturing, constructing, or producing the property after September 10, 2001, and before January 1, 2005, and for 50-percent bonus depreciation property if the taxpayer begins manufacturing, constructing, or producing the property after May 5, 2003, and before January 1, 2005. Property that is manufactured, constructed, or produced for the taxpayer by another person under a written binding contract (as defined in paragraph (b)(4)(ii) of this section) that is entered into prior to the manufacture, construction, or production of the property for use by the taxpayer in its trade or business (or for its production of income) is considered to be manufactured, constructed, or produced by the taxpayer. If a taxpayer enters into a written binding contract (as defined in paragraph (b)(4)(ii) of this section) after September 10, 2001, and before January 1, 2005, with another person to manufacture, construct, or produce property described in section 168(k)(2)(B) (longer production period property) or section 168(k)(2)(C) (certain aircraft) and the manufacture, construction, or production of this property begins after December 31, 2004, the acquisition rule in paragraph (b)(4)(i)(A)(2) or (b)(4)(i)(B)(2) of this section is met.

### **(B) When does manufacture, construction, or production begin**

**(1) In general.**— For purposes of paragraph (b)(4)(iii) of this section, manufacture, construction, or production of property begins when physical work of a significant nature begins. Physical work does not include preliminary activities such as planning or designing, securing financing, exploring, or researching. The determination of when physical work of a significant nature begins depends on the facts and circumstances. For example, if a retail motor fuels outlet or other facility is to be constructed on-site, construction begins when physical work of a significant nature commences at the site; that is, when work begins on the excavation for footings, pouring the pads for the outlet, or the driving of foundation pilings into the ground. Preliminary work, such as clearing a site, test drilling to determine soil condition, or excavation to change the contour of the land (as distinguished from excavation for footings) does not constitute the beginning of construction. However, if a retail motor fuels outlet or other facility is to be assembled on-site from modular units manufactured off-site and delivered to the site where the outlet will be used, manufacturing begins when physical work of a significant nature commences at the off-site location.

**(2) Safe harbor.**— For purposes of paragraph (b)(4)(iii)(B)(1) of this section, a taxpayer may choose to determine when physical work of a significant nature begins in accordance with this paragraph (b)(4)(iii)(B)(2). Physical work of a significant nature will not be considered to begin before the taxpayer incurs (in the case of an accrual basis taxpayer) or pays (in the case of a cash basis taxpayer) more than 10 percent of the total cost of the property (excluding the cost of any land and preliminary activities such as planning or designing, securing financing, exploring, or researching). When property is manufactured, constructed, or produced for the taxpayer by another person, this safe harbor test must be satisfied by the taxpayer. For example, if a retail motor fuels outlet or other facility is to be constructed for an accrual basis taxpayer by another person for the total cost of \$200,000 (excluding the cost of any land and preliminary activities such as planning or designing, securing financing, exploring, or researching), construction is deemed to begin for purposes of this paragraph (b)(4)(iii)(B)(2) when the taxpayer has incurred more than 10 percent (more than \$20,000) of the total cost of the property. A taxpayer chooses to apply this paragraph (b)(4)(iii)(B)(2) by filing an income tax return for the placed-in-service year of the property that determines when physical work of a significant nature begins consistent with this paragraph (b)(4)(iii)(B)(2).

### **(C) Components of self-constructed property**

**(1) Acquired components.**— If a binding contract (as defined in paragraph (b)(4)(ii) of this section) to acquire a component does not satisfy the requirements of paragraph (b)(4)(i) of this section, the component does not qualify for the 30-percent or 50-percent additional first year depreciation deduction, as applicable. A binding contract (as defined in paragraph (b)(4)(ii) of this section) to acquire one or more components of a larger self-constructed property will not preclude the larger self-constructed property from satisfying the acquisition rules in paragraph (b)(4)(iii)(A) of this section. Accordingly, the unadjusted depreciable basis of the larger self-constructed property that is eligible for the 30-percent or 50-percent additional first year depreciation deduction, as applicable (assuming all other requirements are met), must not include the unadjusted depreciable basis of any component that does not satisfy the requirements of paragraph (b)(4)(i) of this section. If the manufacture, construction, or production of the larger self-constructed property begins before September 11, 2001, for qualified property, or before May 6, 2003, for 50-percent bonus depreciation property, the larger self-constructed property and any acquired components related to the larger self-constructed property do not qualify for the 30-percent or 50-percent additional first year depreciation deduction, as applicable. If a binding contract to acquire the component is entered into after September 10, 2001, for qualified property, or after May 5, 2003, for 50-percent bonus depreciation property, and before January 1, 2005, but the manufacture, construction, or production of the larger self-constructed property does not begin before January 1, 2005, the component qualifies for the additional first year depreciation deduction (assuming all other requirements are met) but the larger self-constructed property does not.

**(2) Self-constructed components.**— If the manufacture, construction, or production of a component does not satisfy the requirements of paragraph (b)(4)(iii)(A) of this section, the component does not qualify for the 30-percent or 50-percent additional first year depreciation deduction, as applicable. However, if the manufacture, construction, or production of a component does not satisfy the requirements of paragraph (b)(4)(iii)(A) of this section, but the manufacture, construction, or production of the larger self-constructed property satisfies the requirements of paragraph (b)(4)(iii)(A) of this section, the larger self-constructed property qualifies for the 30-percent or 50-percent additional first year depreciation deduction, as applicable (assuming all other requirements are met) even though the component does not qualify for the 30-percent or 50-percent additional first year depreciation deduction. Accordingly, the unadjusted depreciable basis of the larger self-constructed property that is eligible for the 30-percent or 50-percent additional first year depreciation deduction, as applicable (assuming all other requirements are met), must not include the unadjusted depreciable basis of any component that does not qualify for the 30-percent or 50-percent additional first year depreciation deduction. If the manufacture, construction, or production of the larger self-constructed property began before September 11, 2001, for qualified property, or before May 6, 2003, for 50-percent bonus depreciation property, the larger self-constructed property and any self-constructed components related to the larger self-constructed property do not qualify for the 30-percent or 50-percent additional first year depreciation deduction, as applicable. If the manufacture, construction, or production of a component begins after September 10, 2001, for qualified property, or after May 5, 2003, for 50-percent bonus depreciation property, and before January 1, 2005, but the manufacture, construction, or production of the larger self-constructed property does not begin before January 1, 2005, the component qualifies for the additional first year depreciation deduction (assuming all other requirements are met) but the larger self-constructed property does not.

#### **(iv) Disqualified transactions**

**(A) In general.**— Property does not satisfy the requirements of this paragraph (b)(4) if the user of the property as of the date on which the property was originally placed in service (including by operation of paragraphs (b)(5)(ii), (iii), and (iv) of this section), or a related party to the user or to the taxpayer, acquired, or had a written binding contract (as defined in paragraph (b)(4)(ii) of this section) in effect for the acquisition of the property at any time before September 11, 2001 (for qualified property), or before May 6, 2003 (for 50-percent bonus depreciation property).

In addition, property manufactured, constructed, or produced for the use by the user of the property or by a related party to the user or to the taxpayer does not satisfy the requirements of this paragraph (b)(4) if the manufacture, construction, or production of the property for the user or the related party began at any time before September 11, 2001 (for qualified property), or before May 6, 2003 (for 50-percent bonus depreciation property).

**(B) Related party defined.**— For purposes of this paragraph (b)(4)(iv), persons are related if they have a relationship specified in section 267(b) or 707(b) and the regulations thereunder.

**(v) Examples.**— The application of this paragraph (b)(4) is illustrated by the following examples:

*Example 1.* On September 1, 2001, J, a corporation, entered into a written agreement with K, a manufacturer, to purchase 20 new lamps for \$100 each within the next two years. Although the agreement specifies the number of lamps to be purchased, the agreement does not specify the design of the lamps to be purchased. Accordingly, the agreement is not a binding contract pursuant to paragraph (b)(4)(ii)(D) of this section.

*Example 2.* Same facts as *Example 1*. On December 1, 2001, J placed a purchase order with K to purchase 20 new model XPC5 lamps for \$100 each for a total amount of \$2,000. Because the agreement specifies the number of lamps to be purchased and the purchase order specifies the design of the lamps to be purchased, the purchase order placed by J with K on December 1, 2001, is a binding contract pursuant to paragraph (b)(4)(ii)(D) of this section. Accordingly, the cost of the 20 lamps qualifies for the 30-percent additional first year depreciation deduction.

*Example 3.* Same facts as *Example 1* except that the written agreement between J and K is to purchase 100 model XPC5 lamps for \$100 each within the next two years. Because this agreement specifies the amount and design of the lamps to be purchased, the agreement is a binding contract pursuant to paragraph (b)(4)(ii)(D) of this section. Accordingly, because the agreement was entered into before September 11, 2001, any lamp acquired by J under this contract does not qualify for the additional first year depreciation deduction.

*Example 4.* On September 1, 2001, L began constructing an electric generation power plant for its own use. On November 1, 2002, L ceases construction of the power plant prior to its completion. Between September 1, 2001, and November 1, 2002, L incurred \$3,000,000 for the construction of the power plant. On May 6, 2003, L resumed construction of the power plant and completed its construction on August 31, 2003. Between May 6, 2003, and August 31, 2003, L incurred another \$1,600,000 to complete the construction of the power plant and, on September 1, 2003, L placed the power plant in service. None of L's total expenditures of \$4,600,000 qualify for the additional first year depreciation deduction because, pursuant to paragraph (b)(4)(iii)(A) of this section, L began constructing the power plant before September 11, 2001.

*Example 5.* Same facts as *Example 4* except that L began constructing the electric generation power plant for its own use on October 1, 2001. L's total expenditures of \$4,600,000 qualify for the additional first year depreciation deduction because, pursuant to paragraph (b)(4)(iii)(A) of this section, L began constructing the power plant after September 10, 2001, and placed the power plant in service before January 1, 2005. Accordingly, the additional first year depreciation deduction for the power plant will be \$1,380,000, computed as \$4,600,000 multiplied by 30 percent.

*Example 6.* On August 1, 2001, M entered into a written binding contract to acquire a new turbine. The new turbine is a component part of a new electric generation power plant that is being constructed on M's behalf. The construction of the new electric generation power plant commenced in November 2001, and the new electric generation power plant was completed in November 2002. Because M entered into a written binding contract to acquire a component part (the new turbine) prior to September 11, 2001, pursuant to paragraph (b)(4)(iii)(C) of this section, the component part does not qualify for the additional first year depreciation deduction. However, pursuant to paragraphs (b)(4)(iii)(A) and (C) of this section, the new plant constructed for M will qualify for the 30-percent additional first year depreciation deduction because construction of the new plant began after September 10, 2001, and before May 6, 2003. Accordingly, the unadjusted depreciable basis



of the new plant that is eligible for the 30-percent additional first year depreciation deduction must not include the unadjusted depreciable basis of the new turbine.

*Example 7.* Same facts as *Example 6* except that *M* entered into the written binding contract to acquire the new turbine on September 30, 2002, and construction of the new plant commenced on August 1, 2001. Because *M* began construction of the new plant prior to September 11, 2001, pursuant to paragraphs (b)(4)(iii)(A) and (C) of this section, neither the new plant constructed for *M* nor the turbine will qualify for the additional first year depreciation deduction because self-construction of the new plant began prior to September 11, 2001.

*Example 8.* On September 1, 2001, *N* began constructing property for its own use. On October 1, 2001, *N* sold its rights to the property to *O*, a related party under section 267(b). Pursuant to paragraph (b)(4)(iv) of this section, the property is not eligible for the additional first year depreciation deduction because *N* and *O* are related parties and construction of the property by *N* began prior to September 11, 2001.

*Example 9.* On September 1, 2001, *P* entered into a written binding contract to acquire property. On October 1, 2001, *P* sold its rights to the property to *Q*, a related party under section 267(b). Pursuant to paragraph (b)(4)(iv) of this section, the property is not eligible for the additional first year depreciation deduction because *P* and *Q* are related parties and a written binding contract for the acquisition of the property was in effect prior to September 11, 2001.

*Example 10.* Prior to September 11, 2001, *R* began constructing an electric generation power plant for its own use. On May 1, 2003, prior to the completion of the power plant, *R* transferred the rights to own and use this power plant to *S*, an unrelated party, for \$6,000,000. Between May 6, 2003, and June 30, 2003, *S*, a calendar-year taxpayer, began construction, and incurred another \$1,200,000 to complete the construction, of the power plant and, on August 1, 2003, *S* placed the power plant in service. Because *R* and *S* are not related parties, the transaction between *R* and *S* will not be a disqualified transaction pursuant to paragraph (b)(4)(iv) of this section. Accordingly, *S*'s total expenditures of \$7,200,000 for the power plant qualify for the additional first year depreciation deduction. *S*'s additional first year depreciation deduction for the power plant will be \$2,400,000, computed as \$6,000,000 multiplied by 30 percent, plus \$1,200,000 multiplied by 50 percent. The \$6,000,000 portion of the total \$7,200,000 unadjusted depreciable basis qualifies for the 30-percent additional first year depreciation deduction because that portion of the total unadjusted depreciable basis was acquired by *S* after September 10, 2001, and before May 6, 2003. However, because *S* began construction to complete the power plant after May 5, 2003, the \$1,200,000 portion of the total \$7,200,000 unadjusted depreciable basis qualifies for the 50-percent additional first year depreciation deduction.

*Example 11.* On September 1, 2001, *T* acquired and placed in service equipment. On October 15, 2001, *T* sells the equipment to *U*, an unrelated party, and leases the property back from *U* in a sale-leaseback transaction. Pursuant to paragraph (b)(4)(iv) of this section, the equipment does not qualify for the additional first year depreciation deduction because *T*, the user of the equipment, acquired the equipment prior to September 11, 2001. In addition, the sale-leaseback rules in paragraphs (b)(3)(iii)(A) and (b)(5)(ii)(A) of this section do not apply because the equipment was originally placed in service by *T* before September 11, 2001.

*Example 12.* On July 1, 2001, *KK* began constructing property for its own use. *KK* placed this property in service on September 15, 2001. On October 15, 2001, *KK* sells the property to *LL*, an unrelated party, and leases the property back from *LL* in a sale-leaseback transaction. Pursuant to paragraph (b)(4)(iv) of this section, the property does not qualify for the additional first year depreciation deduction because the property was constructed for *KK*, the user of the property, and that construction began prior to September 11, 2001.

*Example 13.* On June 1, 2004, *MM* decided to construct property described in section 168(k)(2)(B) for its own use. However, one of the component parts of the property had to be manufactured by another person for *MM*. On August 15, 2004, *MM* entered into a written binding contract with *NN* to acquire this component part of the property for \$100,000. The manufacture of the component part commenced on September 1, 2004, and *MM* received the completed component part on

February 1, 2005. The cost of this component part is 9 percent of the total cost of the property to be constructed by MM. MM began constructing the property described in section 168(k)(2)(B) on January 15, 2005, and placed this property (including all component parts) in service on November 1, 2005. Pursuant to paragraph (b)(4)(iii)(C)(2) of this section, the self-constructed component part of \$100,000 manufactured by NN for MM is eligible for the additional first year depreciation deduction (assuming all other requirements are met) because the manufacturing of the component part began after September 10, 2001, and before January 1, 2005, and the property described in section 168(k)(2)(B), the larger self-constructed property, was placed in service by MM before January 1, 2006. However, pursuant to paragraph (b)(4)(iii)(A) of this section, the cost of the property described in section 168(k)(2)(B) (excluding the cost of the self-constructed component part of \$100,000 manufactured by NN for MM) is not eligible for the additional first year depreciation deduction because construction of the property began after December 31, 2004.

*Example 14.* On December 1, 2004, OO entered into a written binding contract (as defined in paragraph (b)(4)(ii) of this section) with PP to manufacture an aircraft described in section 168(k)(2)(C) for use in OO's trade or business. PP begins to manufacture the aircraft on February 1, 2005. OO places the aircraft in service on August 1, 2005. Pursuant to paragraph (b)(4)(iii)(A) of this section, the aircraft meets the requirements of paragraph (b)(4)(i)(B)(2) of this section because the aircraft was acquired by OO pursuant to a written binding contract entered into after May 5, 2003, and before January 1, 2005.

## **(5) Placed-in-service date**

**(i) In general.**— Depreciable property will meet the requirements of this paragraph (b)(5) if the property is placed in service by the taxpayer for use in its trade or business or for production of income before January 1, 2005, or, in the case of property described in section 168(k)(2)(B) or (C), is placed in service by the taxpayer for use in its trade or business or for production of income before January 1, 2006 (or placed in service by the taxpayer for use in its trade or business or for production of income before January 1, 2007, in the case of property described in section 168(k)(2)(B) or (C) to which section 105 of the Gulf Opportunity Zone Act of 2005 (Public Law 109-135, 119 Stat. 2577) applies (for further guidance, see Announcement 2006-29 (2006-19 I.R.B. 879) and §601.601(d)(2)(ii)(b) of this chapter)).

### **(ii) Sale-leaseback, syndication, and certain other transactions**

**(A) Sale-leaseback transaction.**— If qualified property is originally placed in service after September 10, 2001, or 50-percent bonus depreciation property is originally placed in service after May 5, 2003, by a person and sold to a taxpayer and leased back to the person by the taxpayer within three months after the date the property was originally placed in service by the person, the property is treated as originally placed in service by the taxpayer-lessee not earlier than the date on which the property is used by the lessee under the leaseback.

**(B) Syndication transaction and certain other transactions.**— If qualified property is originally placed in service after September 10, 2001, or 50-percent bonus depreciation property is originally placed in service after May 5, 2003, by a lessor (including by operation of paragraph (b)(5)(ii)(A) of this section) and is sold by the lessor or any subsequent purchaser within three months after the date the property was originally placed in service by the lessor (or, in the case of multiple units of property subject to the same lease, within three months after the date the final unit is placed in service, so long as the period between the time the first unit is placed in service and the time the last unit is placed in service does not exceed 12 months), and the user of the property after the last sale during this three-month period remains the same as when the property was originally placed in service by the lessor, the property is treated as originally placed in service by the purchaser of the property in the last sale during the three-month period but not earlier than the date of the last sale.

**(C) Sale-leaseback transaction followed by a syndication transaction and certain other transactions.**— If a sale-leaseback transaction that satisfies the requirements in paragraph

(b)(5)(ii)(A) of this section is followed by a transaction that satisfies the requirements in paragraph (b)(5)(ii)(B) of this section, the placed-in-service date of the property is determined in accordance with paragraph (b)(5)(ii)(B) of this section.

**(iii) Technical termination of a partnership.**— For purposes of this paragraph (b)(5), in the case of a technical termination of a partnership under section 708(b)(1)(B), qualified property or 50-percent bonus depreciation property placed in service by the terminated partnership during the taxable year of termination is treated as originally placed in service by the new partnership on the date the qualified property or the 50-percent bonus depreciation property is contributed by the terminated partnership to the new partnership.

**(iv) Section 168(i)(7) transactions.**— For purposes of this paragraph (b)(5), if qualified property or 50-percent bonus depreciation property is transferred in a transaction described in section 168(i)(7) in the same taxable year that the qualified property or the 50-percent bonus depreciation property is placed in service by the transferor, the transferred property is treated as originally placed in service on the date the transferor placed in service the qualified property or the 50-percent bonus depreciation property, as applicable. In the case of multiple transfers of qualified property or 50-percent bonus depreciation property in multiple transactions described in section 168(i)(7) in the same taxable year, the placed in service date of the transferred property is deemed to be the date on which the first transferor placed in service the qualified property or the 50-percent bonus depreciation property, as applicable.

**(v) Example.**— The application of this paragraph (b)(5) is illustrated by the following example:

*Example.* On September 15, 2004, QQ acquired and placed in service new equipment. This equipment is not described in section 168(k)(2)(B) or (C). On December 1, 2004, QQ sells the equipment to RR and leases the equipment back from RR in a sale-leaseback transaction. On February 15, 2005, RR sells the equipment to TT subject to the lease with QQ. As of February 15, 2005, QQ is still the user of the equipment. The sale-leaseback transaction of December 1, 2004, between QQ and RR satisfies the requirements of paragraph (b)(5)(ii)(A) of this section. The sale transaction of February 15, 2005, between RR and TT satisfies the requirements of paragraph (b)(5)(ii)(B) of this section. Consequently, pursuant to paragraph (b)(5)(ii)(C) of this section, the equipment is treated as originally placed in service by TT on February 15, 2005. Further, pursuant to paragraph (b)(3)(iii)(C) of this section, TT is considered the original user of the equipment. Accordingly, the equipment is not eligible for the additional first year depreciation deduction.

### **(c) Qualified leasehold improvement property**

**(1) In general.**— For purposes of section 168(k), qualified leasehold improvement property means any improvement, which is section 1250 property, to an interior portion of a building that is nonresidential real property if—

- (i)** The improvement is made under or pursuant to a lease by the lessee (or any sublessee) of the interior portion, or by the lessor of that interior portion;
- (ii)** The interior portion of the building is to be occupied exclusively by the lessee (or any sublessee) of that interior portion; and
- (iii)** The improvement is placed in service more than 3 years after the date the building was first placed in service by any person.

**(2) Certain improvements not included.**— Qualified leasehold improvement property does not include any improvement for which the expenditure is attributable to:

- (i)** The enlargement of the building;
- (ii)** Any elevator or escalator;

- (iii) Any structural component benefiting a common area; or
- (iv) The internal structural framework of the building.

**(3) Definitions.**— For purposes of this paragraph (c), the following definitions apply:

- (i) *Building* has the same meaning as that term is defined in §1.48-1(e)(1).
- (ii) *Common area* means any portion of a building that is equally available to all users of the building on the same basis for uses that are incidental to the primary use of the building. For example, stairways, hallways, lobbies, common seating areas, interior and exterior pedestrian walkways and pedestrian bridges, loading docks and areas, and rest rooms generally are treated as common areas if they are used by different lessees of a building.
- (iii) *Elevator* and *escalator* have the same meanings as those terms are defined in §1.48-1(m)(2).
- (iv) *Enlargement* has the same meaning as that term is defined in §1.48-12(c)(10).
- (v) *Internal structural framework* has the same meaning as that term is defined in §1.48-12(b)(3)(i)(D)(iii).
- (vi) *Lease* has the same meaning as that term is defined in section 168(h)(7). In addition, a commitment to enter into a lease is treated as a lease, and the parties to the commitment are treated as lessor and lessee. However, a lease between related persons is not considered a lease. For purposes of the preceding sentence, related persons are—
  - (A) Members of an affiliated group (as defined in section 1504 and the regulations thereunder); and
  - (B) Persons having a relationship described in section 267(b) and the regulations thereunder. For purposes of applying section 267(b), the language "80 percent or more" is used instead of "more than 50 percent."
- (vii) *Nonresidential real property* has the same meaning as that term is defined in section 168(e)(2)(B).
- (viii) *Structural component* has the same meaning as that term is defined in §1.48-1(e)(2).

**(d) Computation of depreciation deduction for qualified property or 50-percent bonus depreciation property**

**(1) Additional first year depreciation deduction**

(i) *In general.*— Except as provided in paragraph (f) of this section, the additional first year depreciation deduction is allowable in the first taxable year in which the qualified property or 50-percent bonus depreciation property is placed in service by the taxpayer for use in its trade or business or for the production of income. Except as provided in paragraph (f)(5) of this section, the allowable additional first year depreciation deduction for qualified property is determined by multiplying the unadjusted depreciable basis (as defined in §1.168(k)-1(a)(2)(iii)) of the qualified property by 30 percent. Except as provided in paragraph (f)(5) of this section, the allowable additional first year depreciation deduction for 50-percent bonus depreciation property is determined by multiplying the unadjusted depreciable basis (as defined in §1.168(k)-1(a)(2)(iii)) of the 50-percent bonus depreciation property by 50 percent. Except as provided in paragraph (f)(1) of this section, the 30-percent or 50-percent additional first year depreciation deduction is not affected by a taxable year of less than 12 months. See paragraph (f)(1) of this section for qualified property or 50-percent bonus depreciation property placed in service and disposed of in the same taxable year. See paragraph (f)(5) of this section for qualified property or 50-percent bonus depreciation property acquired in a like-kind exchange or as a result of an involuntary conversion.

**(ii) Property having a longer production period.**— For purposes of paragraph (d)(1)(i) of this section, the unadjusted depreciable basis (as defined in §1.168(k)-1(a)(2)(iii)) of qualified property or 50-percent bonus depreciation property described in section 168(k)(2)(B) is limited to the property's unadjusted depreciable basis attributable to the property's manufacture, construction, or production after September 10, 2001 (for qualified property), or May 5, 2003 (for 50-percent bonus depreciation property), and before January 1, 2005.

**(iii) Alternative minimum tax.**— The 30-percent or 50-percent additional first year depreciation deduction is allowed for alternative minimum tax purposes for the taxable year in which the qualified property or the 50-percent bonus depreciation property is placed in service by the taxpayer. In general, the 30-percent or 50-percent additional first year depreciation deduction for alternative minimum tax purposes is based on the unadjusted depreciable basis of the property for alternative minimum tax purposes. However, see paragraph (f)(5)(iii)(D) of this section for qualified property or 50-percent bonus depreciation property acquired in a like-kind exchange or as a result of an involuntary conversion.

## **(2) Otherwise allowable depreciation deduction**

**(i) In general.**— Before determining the amount otherwise allowable as a depreciation deduction for the qualified property or the 50-percent bonus depreciation property for the placed-in-service year and any subsequent taxable year, the taxpayer must determine the remaining adjusted depreciable basis of the qualified property or the 50-percent bonus depreciation property. This remaining adjusted depreciable basis is equal to the unadjusted depreciable basis of the qualified property or the 50-percent bonus depreciation property reduced by the amount of the additional first year depreciation allowed or allowable, whichever is greater. The remaining adjusted depreciable basis of the qualified property or the 50-percent bonus depreciation property is then depreciated using the applicable depreciation provisions under the Internal Revenue Code for the qualified property or the 50-percent bonus depreciation property. The remaining adjusted depreciable basis of the qualified property or the 50-percent bonus depreciation property that is MACRS property is also the basis to which the annual depreciation rates in the optional depreciation tables apply (for further guidance, see section 8 of Rev. Proc. 87-57 (1987-2 C.B. 687) and §601.601(d)(2)(ii)(b) of this chapter). The depreciation deduction allowable for the remaining adjusted depreciable basis of the qualified property or the 50-percent bonus depreciation property is affected by a taxable year of less than 12 months.

**(ii) Alternative minimum tax.**— For alternative minimum tax purposes, the depreciation deduction allowable for the remaining adjusted depreciable basis of the qualified property or the 50-percent bonus depreciation property is based on the remaining adjusted depreciable basis for alternative minimum tax purposes. The remaining adjusted depreciable basis of the qualified property or the 50-percent bonus depreciable property for alternative minimum tax purposes is depreciated using the same depreciation method, recovery period (or useful life in the case of computer software), and convention that apply to the qualified property or the 50-percent bonus depreciation property for regular tax purposes.

**(3) Examples.**— This paragraph (d) is illustrated by the following examples:

*Example 1.* On March 1, 2003, V, a calendar-year taxpayer, purchased and placed in service qualified property that costs \$1 million and is 5-year property under section 168(e). V depreciates its 5-year property placed in service in 2003 using the optional depreciation table that corresponds with the general depreciation system, the 200-percent declining balance method, a 5-year recovery period, and the half-year convention. For 2003, V is allowed a 30-percent additional first year depreciation deduction of \$300,000 (the unadjusted depreciable basis of \$1 million multiplied by .30). Next, V must reduce the unadjusted depreciable basis of \$1 million by the additional first year depreciation deduction of \$300,000 to determine the remaining adjusted depreciable basis of \$700,000. Then, V's depreciation deduction allowable in 2003 for the remaining adjusted depreciable basis of \$700,000 is \$140,000 (the remaining adjusted depreciable basis of \$700,000 multiplied by the annual depreciation rate of .20 for recovery year 1).

*Example 2.* On June 1, 2003, *W*, a calendar-year taxpayer, purchased and placed in service 50-percent bonus depreciation property that costs \$126,000. The property qualifies for the expensing election under section 179 and is 5-year property under section 168(e). *W* did not purchase any other section 179 property in 2003. *W* makes the election under section 179 for the property and depreciates its 5-year property placed in service in 2003 using the optional depreciation table that corresponds with the general depreciation system, the 200-percent declining balance method, a 5-year recovery period, and the half-year convention. For 2003, *W* is first allowed a \$100,000 deduction under section 179. Next, *W* must reduce the cost of \$126,000 by the section 179 deduction of \$100,000 to determine the unadjusted depreciable basis of \$26,000. Then, for 2003, *W* is allowed a 50-percent additional first year depreciation deduction of \$13,000 (the unadjusted depreciable basis of \$26,000 multiplied by .50). Next, *W* must reduce the unadjusted depreciable basis of \$26,000 by the additional first year depreciation deduction of \$13,000 to determine the remaining adjusted depreciable basis of \$13,000. Then, *W*'s depreciation deduction allowable in 2003 for the remaining adjusted depreciable basis of \$13,000 is \$2,600 (the remaining adjusted depreciable basis of \$13,000 multiplied by the annual depreciation rate of .20 for recovery year 1).

### **(e) Election not to deduct additional first year depreciation**

**(1) In general.**— If a taxpayer makes an election under this paragraph (e), the election applies to all qualified property or 50-percent bonus depreciation property, as applicable, that is in the same class of property and placed in service in the same taxable year. The rules of this paragraph (e) apply to the following elections provided under section 168(k):

**(i) Qualified property.**— A taxpayer may make an election not to deduct the 30-percent additional first year depreciation for any class of property that is qualified property placed in service during the taxable year. If this election is made, no additional first year depreciation deduction is allowable for the property placed in service during the taxable year in the class of property.

**(ii) 50-percent bonus depreciation property.**— For any class of property that is 50-percent bonus depreciation property placed in service during the taxable year, a taxpayer may make an election—

**(A)** To deduct the 30-percent, instead of the 50-percent, additional first year depreciation. If this election is made, the allowable additional first year depreciation deduction is determined as though the class of property is qualified property under section 168(k)(2); or

**(B)** Not to deduct both the 30-percent and the 50-percent additional first year depreciation. If this election is made, no additional first year depreciation deduction is allowable for the class of property.

**(2) Definition of class of property.**— For purposes of this paragraph (e), the term class of property means:

**(i)** Except for the property described in paragraphs (e)(2)(ii) and (iv) of this section, each class of property described in section 168(e) (for example, 5-year property);

**(ii)** Water utility property as defined in section 168(e)(5) and depreciated under section 168;

**(iii)** Computer software as defined in, and depreciated under, section 167(f)(1) and the regulations thereunder; or

**(iv)** Qualified leasehold improvement property as defined in paragraph (c) of this section and depreciated under section 168.

### **(3) Time and manner for making election**

**(i) Time for making election.**— Except as provided in paragraph (e)(4) of this section, any election specified in paragraph (e)(1) of this section must be made by the due date (including

extensions) of the Federal tax return for the taxable year in which the qualified property or the 50-percent bonus depreciation property, as applicable, is placed in service by the taxpayer.

**(ii) Manner of making election.**— Except as provided in paragraph (e)(4) of this section, any election specified in paragraph (e)(1) of this section must be made in the manner prescribed on Form 4562, "Depreciation and Amortization," and its instructions. The election is made separately by each person owning qualified property or 50-percent bonus depreciation property (for example, for each member of a consolidated group by the common parent of the group, by the partnership, or by the S corporation). If Form 4562 is revised or renumbered, any reference in this section to that form shall be treated as a reference to the revised or renumbered form.

**(4) Special rules for 2000 or 2001 returns.**— For the election specified in paragraph (e)(1)(i) of this section for qualified property placed in service by the taxpayer during the taxable year that included September 11, 2001, the taxpayer should refer to the guidance provided by the Internal Revenue Service for the time and manner of making this election on the 2000 or 2001 Federal tax return for the taxable year that included September 11, 2001 (for further guidance, see sections 3.03(3) and 4 of Rev. Proc. 2002-33 (2002-1 C.B. 963), Rev. Proc. 2003-50 (2003-29 I.R.B. 119), and §601.601(d)(2)(ii)(b) of this chapter).

**(5) Failure to make election.**— If a taxpayer does not make the applicable election specified in paragraph (e)(1) of this section within the time and in the manner prescribed in paragraph (e)(3) or (4) of this section, the amount of depreciation allowable for that property under section 167(f)(1) or under section 168, as applicable, must be determined for the placed-in-service year and for all subsequent taxable years by taking into account the additional first year depreciation deduction. Thus, any election specified in paragraph (e)(1) of this section shall not be made by the taxpayer in any other manner (for example, the election cannot be made through a request under section 446(e) to change the taxpayer's method of accounting).

**(6) Alternative minimum tax.**— If a taxpayer makes an election specified in paragraph (e)(1) of this section for a class of property, the depreciation adjustments under section 56 and the regulations under section 56 apply to the property to which that election applies for purposes of computing the taxpayer's alternative minimum taxable income.

## **(7) Revocation of election**

**(i) In general.**— Except as provided in paragraph (e)(7)(ii) of this section, an election specified in paragraph (e)(1) of this section, once made, may be revoked only with the written consent of the Commissioner of Internal Revenue. To seek the Commissioner's consent, the taxpayer must submit a request for a letter ruling.

**(ii) Automatic 6-month extension.**— If a taxpayer made an election specified in paragraph (e)(1) of this section for a class of property, an automatic extension of 6 months from the due date of the taxpayer's Federal tax return (excluding extensions) for the placed-in-service year of the class of property is granted to revoke that election, provided the taxpayer timely filed the taxpayer's Federal tax return for the placed-in-service year of the class of property and, within this 6-month extension period, the taxpayer (and all taxpayers whose tax liability would be affected by the election) files an amended Federal tax return for the placed-in-service year of the class of property in a manner that is consistent with the revocation of the election.

## **(f) Special rules**

### **(1) Property placed in service and disposed of in the same taxable year**

**(i) In general.**— Except as provided in paragraphs (f)(1)(ii) and (iii) of this section, the additional first year depreciation deduction is not allowed for qualified property or 50-percent bonus depreciation property placed in service and disposed of during the same taxable year. Also if qualified property or 50-percent bonus depreciation property is placed in service and disposed of during the same taxable year and then reacquired and again placed in service in a subsequent

taxable year, the additional first year depreciation deduction is not allowable for the property in the subsequent taxable year.

**(ii) Technical termination of a partnership.**— In the case of a technical termination of a partnership under section 708(b)(1)(B), the additional first year depreciation deduction is allowable for any qualified property or 50-percent bonus depreciation property placed in service by the terminated partnership during the taxable year of termination and contributed by the terminated partnership to the new partnership. The allowable additional first year depreciation deduction for the qualified property or the 50-percent bonus depreciation property shall not be claimed by the terminated partnership but instead shall be claimed by the new partnership for the new partnership's taxable year in which the qualified property or the 50-percent bonus depreciation property was contributed by the terminated partnership to the new partnership. However, if qualified property or 50-percent bonus depreciation property is both placed in service and contributed to a new partnership in a transaction described in section 708(b)(1)(B) by the terminated partnership during the taxable year of termination, and if such property is disposed of by the new partnership in the same taxable year the new partnership received such property from the terminated partnership, then no additional first year depreciation deduction is allowable to either partnership.

**(iii) Section 168(i)(7) transactions.**— If any qualified property or 50-percent bonus depreciation property is transferred in a transaction described in section 168(i)(7) in the same taxable year that the qualified property or the 50-percent bonus depreciation property is placed in service by the transferor, the additional first year depreciation deduction is allowable for the qualified property or the 50-percent bonus depreciation property. The allowable additional first year depreciation deduction for the qualified property or the 50-percent bonus depreciation property for the transferor's taxable year in which the property is placed in service is allocated between the transferor and the transferee on a monthly basis. This allocation shall be made in accordance with the rules in §1.168(d)-1(b)(7)(ii) for allocating the depreciation deduction between the transferor and the transferee. However, if qualified property or 50-percent bonus depreciation property is both placed in service and transferred in a transaction described in section 168(i)(7) by the transferor during the same taxable year, and if such property is disposed of by the transferee (other than by a transaction described in section 168(i)(7)) during the same taxable year the transferee received such property from the transferor, then no additional first year depreciation deduction is allowable to either party.

**(iv) Examples.**— The application of this paragraph (f)(1) is illustrated by the following examples:

*Example 1.* X and Y are equal partners in *Partnership XY*, a general partnership. On February 1, 2002, *Partnership XY* purchased and placed in service new equipment at a cost of \$30,000. On March 1, 2002, X sells its entire 50 percent interest to Z in a transfer that terminates the partnership under section 708(b)(1)(B). As a result, terminated *Partnership XY* is deemed to have contributed the equipment to new *Partnership XY*. Pursuant to paragraph (f)(1)(ii) of this section, new *Partnership XY*, not terminated *Partnership XY*, is eligible to claim the 30-percent additional first year depreciation deduction allowable for the equipment for the taxable year 2002 (assuming all other requirements are met).

*Example 2.* On January 5, 2002, *BB* purchased and placed in service new office desks for a total amount of \$8,000. On August 20, 2002, *BB* transferred the office desks to *Partnership BC* in a transaction described in section 721. *BB* and *Partnership BC* are calendar-year taxpayers. Because the transaction between *BB* and *Partnership BC* is a transaction described in section 168(i)(7), pursuant to paragraph (f)(1)(iii) of this section the 30-percent additional first year depreciation deduction allowable for the desks is allocated between *BB* and *Partnership BC* in accordance with the rules in §1.168(d)-1(b)(7)(ii) for allocating the depreciation deduction between the transferor and the transferee. Accordingly, the 30-percent additional first year depreciation deduction allowable for the desks for 2002 of \$2,400 (the unadjusted depreciable basis of \$8,000 multiplied by .30) is allocated between *BB* and *Partnership BC* based on the number of months that *BB* and *Partnership BC* held the desks in service. Thus, because the desks were held in service by



*BB* for 7 of 12 months, which includes the month in which *BB* placed the desks in service but does not include the month in which the desks were transferred, *BB* is allocated \$1,400 ( $7/12 \times \$2,400$  additional first year depreciation deduction). *Partnership BC* is allocated \$1,000, the remaining  $5/12$  of the \$2,400 additional first year depreciation deduction allowable for the desks.

**(2) Redetermination of basis.**— If the unadjusted depreciable basis (as defined in §1.168(k)-1(a)(2)(iii)) of qualified property or 50-percent bonus depreciation property is redetermined (for example, due to contingent purchase price or discharge of indebtedness) before January 1, 2005, or, in the case of property described in section 168(k)(2)(B) or (C), is redetermined before January 1, 2006 (or redetermined before January 1, 2007, in the case of property described in section 168(k)(2)(B) or (C) to which section 105 of the Gulf Opportunity Zone Act of 2005 (Public Law 109-135, 119 Stat. 2577) applies (for further guidance, see Announcement 2006-29 (2006-19 I.R.B. 879) and §601.601(d)(2)(ii) (b) of this chapter)), the additional first year depreciation deduction allowable for the qualified property or the 50-percent bonus depreciation property is redetermined as follows:

**(i) Increase in basis.**— For the taxable year in which an increase in basis of qualified property or 50-percent bonus depreciation property occurs, the taxpayer shall claim an additional first year depreciation deduction for qualified property by multiplying the amount of the increase in basis for this property by 30 percent or, for 50-percent bonus depreciation property, by multiplying the amount of the increase in basis for this property by 50 percent. For purposes of this paragraph (f)(2)(i), the 30-percent additional first year depreciation deduction applies to the increase in basis if the underlying property is qualified property and the 50-percent additional first year depreciation deduction applies to the increase in basis if the underlying property is 50-percent bonus depreciation property. To determine the amount otherwise allowable as a depreciation deduction for the increase in basis of qualified property or 50-percent bonus depreciation property, the amount of the increase in basis of the qualified property or the 50-percent bonus depreciation property must be reduced by the additional first year depreciation deduction allowed or allowable, whichever is greater, for the increase in basis and the remaining increase in basis of—

**(A)** Qualified property or 50-percent bonus depreciation property (except for computer software described in paragraph (b)(2)(i)(B) of this section) is depreciated over the recovery period of the qualified property or the 50-percent bonus depreciation property, as applicable, remaining as of the beginning of the taxable year in which the increase in basis occurs, and using the same depreciation method and convention applicable to the qualified property or 50-percent bonus depreciation property, as applicable, that applies for the taxable year in which the increase in basis occurs; and

**(B)** Computer software (as defined in paragraph (b)(2)(i)(B) of this section) that is qualified property or 50-percent bonus depreciation property is depreciated ratably over the remainder of the 36-month period (the useful life under section 167(f)(1)) as of the beginning of the first day of the month in which the increase in basis occurs.

**(ii) Decrease in basis.**— For the taxable year in which a decrease in basis of qualified property or 50-percent bonus depreciation property occurs, the taxpayer shall reduce the total amount otherwise allowable as a depreciation deduction for all of the taxpayer's depreciable property by the excess additional first year depreciation deduction previously claimed for the qualified property or the 50-percent bonus depreciation property. If, for such taxable year, the excess additional first year depreciation deduction exceeds the total amount otherwise allowable as a depreciation deduction for all of the taxpayer's depreciable property, the taxpayer shall take into account a negative depreciation deduction in computing taxable income. The excess additional first year depreciation deduction for qualified property is determined by multiplying the amount of the decrease in basis for this property by 30 percent. The excess additional first year depreciation deduction for 50-percent bonus depreciation property is determined by multiplying the amount of the decrease in basis for this property by 50 percent. For purposes of this paragraph (f)(2)(ii), the 30-percent additional first year depreciation deduction applies to the

decrease in basis if the underlying property is qualified property and the 50-percent additional first year depreciation deduction applies to the decrease in basis if the underlying property is 50-percent bonus depreciation property. Also, if the taxpayer establishes by adequate records or other sufficient evidence that the taxpayer claimed less than the additional first year depreciation deduction allowable for the qualified property or the 50-percent bonus depreciation property before the decrease in basis or if the taxpayer claimed more than the additional first year depreciation deduction allowable for the qualified property or the 50-percent bonus depreciation property before the decrease in basis, the excess additional first year depreciation deduction is determined by multiplying the amount of the decrease in basis by the additional first year depreciation deduction percentage actually claimed by the taxpayer for the qualified property or the 50-percent bonus depreciation property, as applicable, before the decrease in basis. To determine the amount to reduce the total amount otherwise allowable as a depreciation deduction for all of the taxpayer's depreciable property for the excess depreciation previously claimed (other than the additional first year depreciation deduction) resulting from the decrease in basis of the qualified property or the 50-percent bonus depreciation property, the amount of the decrease in basis of the qualified property or the 50-percent bonus depreciation property must be adjusted by the excess additional first year depreciation deduction that reduced the total amount otherwise allowable as a depreciation deduction (as determined under this paragraph) and the remaining decrease in basis of—

**(A)** Qualified property or 50-percent bonus depreciation property (except for computer software described in paragraph (b)(2)(i)(B) of this section) reduces the amount otherwise allowable as a depreciation deduction over the recovery period of the qualified property or the 50-percent bonus depreciation property, as applicable, remaining as of the beginning of the taxable year in which the decrease in basis occurs, and using the same depreciation method and convention of the qualified property or 50-percent bonus depreciation property, as applicable, that applies in the taxable year in which the decrease in basis occurs. If, for any taxable year, the reduction to the amount otherwise allowable as a depreciation deduction (as determined under this paragraph (f)(2)(ii)(A)) exceeds the total amount otherwise allowable as a depreciation deduction for all of the taxpayer's depreciable property, the taxpayer shall take into account a negative depreciation deduction in computing taxable income; and

**(B)** Computer software (as defined in paragraph (b)(2)(i)(B) of this section) that is qualified property or 50-percent bonus depreciation property reduces the amount otherwise allowable as a depreciation deduction over the remainder of the 36-month period (the useful life under section 167(f)(1)) as of the beginning of the first day of the month in which the decrease in basis occurs. If, for any taxable year, the reduction to the amount otherwise allowable as a depreciation deduction (as determined under this paragraph (f)(2)(ii)(B)) exceeds the total amount otherwise allowable as a depreciation deduction for all of the taxpayer's depreciable property, the taxpayer shall take into account a negative depreciation deduction in computing taxable income.

**(iii) Definition.**— Except as otherwise expressly provided by the Internal Revenue Code (for example, section 1017(a)), the regulations under the Internal Revenue Code, or other guidance published in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(b) of this chapter), for purposes of this paragraph (f)(2)—

**(A)** An increase in basis occurs in the taxable year an amount is taken into account under section 461; and

**(B)** A decrease in basis occurs in the taxable year an amount would be taken into account under section 451.

**(iv) Examples.**— The application of this paragraph (f)(2) is illustrated by the following examples:

*Example 1.* (i) On May 15, 2002, CC, a cash-basis taxpayer, purchased and placed in service qualified property that is 5-year property at a cost of \$200,000. In addition to the \$200,000, CC

agrees to pay the seller 25 percent of the gross profits from the operation of the property in 2002. On May 15, 2003, CC paid to the seller an additional \$10,000. CC depreciates the 5-year property placed in service in 2002 using the optional depreciation table that corresponds with the general depreciation system, the 200-percent declining balance method, a 5-year recovery period, and the half-year convention.

(ii) For 2002, CC is allowed a 30-percent additional first year depreciation deduction of \$60,000 (the unadjusted depreciable basis of \$200,000 multiplied by .30). In addition, CC's depreciation deduction for 2002 for the remaining adjusted depreciable basis of \$140,000 (the unadjusted depreciable basis of \$200,000 reduced by the additional first year depreciation deduction of \$60,000) is \$28,000 (the remaining adjusted depreciable basis of \$140,000 multiplied by the annual depreciation rate of .20 for recovery year 1).

(iii) For 2003, CC's depreciation deduction for the remaining adjusted depreciable basis of \$140,000 is \$44,800 (the remaining adjusted depreciable basis of \$140,000 multiplied by the annual depreciation rate of .32 for recovery year 2). In addition, pursuant to paragraph (f)(2)(i) of this section, CC is allowed an additional first year depreciation deduction for 2003 for the \$10,000 increase in basis of the qualified property. Consequently, CC is allowed an additional first year depreciation deduction of \$3,000 (the increase in basis of \$10,000 multiplied by .30). Also, CC is allowed a depreciation deduction for 2003 attributable to the remaining increase in basis of \$7,000 (the increase in basis of \$10,000 reduced by the additional first year depreciation deduction of \$3,000). The depreciation deduction allowable for 2003 attributable to the remaining increase in basis of \$7,000 is \$3,111 (the remaining increase in basis of \$7,000 multiplied by .4444, which is equal to  $1/\text{remaining recovery period of 4.5 years at January 1, 2003}$ , multiplied by 2). Accordingly, for 2003, CC's total depreciation deduction allowable for the qualified property is \$50,911.

*Example 2.* (i) On May 15, 2002, DD, a calendar-year taxpayer, purchased and placed in service qualified property that is 5-year property at a cost of \$400,000. To purchase the property, DD borrowed \$250,000 from Bank2. On May 15, 2003, Bank2 forgives \$50,000 of the indebtedness. DD makes the election provided in section 108(b)(5) to apply any portion of the reduction under section 1017 to the basis of the depreciable property of the taxpayer. DD depreciates the 5-year property placed in service in 2002 using the optional depreciation table that corresponds with the general depreciation system, the 200-percent declining balance method, a 5-year recovery period, and the half-year convention.

(ii) For 2002, DD is allowed a 30-percent additional first year depreciation deduction of \$120,000 (the unadjusted depreciable basis of \$400,000 multiplied by .30). In addition, DD's depreciation deduction allowable for 2002 for the remaining adjusted depreciable basis of \$280,000 (the unadjusted depreciable basis of \$400,000 reduced by the additional first year depreciation deduction of \$120,000) is \$56,000 (the remaining adjusted depreciable basis of \$280,000 multiplied by the annual depreciation rate of .20 for recovery year 1).

(iii) For 2003, DD's deduction for the remaining adjusted depreciable basis of \$280,000 is \$89,600 (the remaining adjusted depreciable basis of \$280,000 multiplied by the annual depreciation rate .32 for recovery year 2). Although Bank2 forgave the indebtedness in 2003, the basis of the property is reduced on January 1, 2004, pursuant to sections 108(b)(5) and 1017(a) under which basis is reduced at the beginning of the taxable year following the taxable year in which the discharge of indebtedness occurs.

(iv) For 2004, DD's deduction for the remaining adjusted depreciable basis of \$280,000 is \$53,760 (the remaining adjusted depreciable basis of \$280,000 multiplied by the annual depreciation rate .192 for recovery year 3). However, pursuant to paragraph (f)(2)(ii) of this section, DD must reduce the amount otherwise allowable as a depreciation deduction for 2004 by the excess depreciation previously claimed for the \$50,000 decrease in basis of the qualified property. Consequently, DD must reduce the amount of depreciation otherwise allowable for 2004 by the excess additional first year depreciation of \$15,000 (the decrease in basis of \$50,000 multiplied by .30). Also, DD must reduce the amount of depreciation otherwise allowable for 2004 by the excess depreciation attributable to the remaining decrease in basis of \$35,000 (the decrease

in basis of \$50,000 reduced by the excess additional first year depreciation of \$15,000). The reduction in the amount of depreciation otherwise allowable for 2004 for the remaining decrease in basis of \$35,000 is \$19,999 (the remaining decrease in basis of \$35,000 multiplied by .5714, which is equal to 1/remaining recovery period of 3.5 years at January 1, 2004, multiplied by 2). Accordingly, assuming the qualified property is the only depreciable property owned by DD, for 2004, DD's total depreciation deduction allowable for the qualified property is \$18,761 (\$53,760 minus \$15,000 minus \$19,999).

**(3) Section 1245 and 1250 depreciation recapture.**— For purposes of section 1245 and the regulations thereunder, the additional first year depreciation deduction is an amount allowed or allowable for depreciation. Further, for purposes of section 1250(b) and the regulations thereunder, the additional first year depreciation deduction is not a straight line method.

**(4) Coordination with section 169.**— The additional first year depreciation deduction is allowable in the placed-in-service year of a certified pollution control facility (as defined in §1.169-2(a)) that is qualified property or 50-percent bonus depreciation property, even if the taxpayer makes the election to amortize the certified pollution control facility under section 169 and the regulations thereunder in the certified pollution control facility's placed-in-service year.

### **(5) Like-kind exchanges and involuntary conversions**

**(i) Scope.**— The rules of this paragraph (f)(5) apply to acquired MACRS property or acquired computer software that is qualified property or 50-percent bonus depreciation property at the time of replacement provided the time of replacement is after September 10, 2001, and before January 1, 2005, or, in the case of acquired MACRS property or acquired computer software that is qualified property, or 50-percent bonus depreciation property, described in section 168(k)(2)(B) or (C), the time of replacement is after September 10, 2001, and before January 1, 2006 (or the time of replacement is after September 10, 2001, and before January 1, 2007, in the case of property described in section 168(k)(2)(B) or (C) to which section 105 of the Gulf Opportunity Zone Act of 2005 (Public Law 109-135, 119 Stat. 2577) applies (for further guidance, see Announcement 2006-29 (2006-19 I.R.B. 879) and §601.601(d)(2)(ii)(b) of this chapter)).

**(ii) Definitions.**— For purposes of this paragraph (f)(5), the following definitions apply:

**(A) Acquired MACRS property** is MACRS property in the hands of the acquiring taxpayer that is acquired in a transaction described in section 1031(a), (b), or (c) for other MACRS property or that is acquired in connection with an involuntary conversion of other MACRS property in a transaction to which section 1033 applies.

**(B) Exchanged or involuntarily converted MACRS property** is MACRS property that is transferred by the taxpayer in a transaction described in section 1031(a), (b), or (c), or that is converted as a result of an involuntary conversion to which section 1033 applies.

**(C) Acquired computer software** is computer software (as defined in paragraph (b)(2)(i)(B) of this section) in the hands of the acquiring taxpayer that is acquired in a like-kind exchange under section 1031 or as a result of an involuntary conversion under section 1033.

**(D) Exchanged or involuntarily converted computer software** is computer software (as defined in paragraph (b)(2)(i)(B) of this section) that is transferred by the taxpayer in a like-kind exchange under section 1031 or that is converted as a result of an involuntary conversion under section 1033.

**(E) Time of disposition** is when the disposition of the exchanged or involuntarily converted MACRS property or the exchanged or involuntarily converted computer software, as applicable, takes place.

**(F)** Except as provided in paragraph (f)(5)(v) of this section, the *time of replacement* is the later of—

- (1) When the acquired MACRS property or acquired computer software is placed in service; or
  - (2) The time of disposition of the exchanged or involuntarily converted property.
- (G) *Carryover basis* is the lesser of:
- (1) the basis in the acquired MACRS property or acquired computer software, as applicable and as determined under section 1031(d) or 1033(b) and the regulations thereunder; or
  - (2) the adjusted depreciable basis of the exchanged or involuntarily converted MACRS property or the exchanged or involuntarily converted computer software, as applicable.
- (H) *Excess basis* is any excess of the basis in the acquired MACRS property or acquired computer software, as applicable and as determined under section 1031(d) or 1033(b) and the regulations thereunder, over the carryover basis as determined under paragraph (f)(5)(ii)(G) of this section.
- (I) *Remaining carryover basis* is the carryover basis as determined under paragraph (f)(5)(ii)(G) of this section reduced by—
- (1) The percentage of the taxpayer's use of property for the taxable year other than in the taxpayer's trade or business (or for the production of income); and
  - (2) Any adjustments to basis provided by other provisions of the Code and the regulations thereunder (including section 1016(a)(2) and (3)) for periods prior to the disposition of the exchanged or involuntarily converted property.
- (J) *Remaining excess basis* is the excess basis as determined under paragraph (f)(5)(ii)(H) of this section reduced by—
- (1) The percentage of the taxpayer's use of property for the taxable year other than in the taxpayer's trade or business (or for the production of income);
  - (2) Any portion of the basis the taxpayer properly elects to treat as an expense under section 179 or section 179C;
  - (3) Any adjustments to basis provided by other provisions of the Code and the regulations thereunder.
- (K) *Year of disposition* is the taxable year that includes the time of disposition.
- (L) *Year of replacement* is the taxable year that includes the time of replacement.

### **(iii) Computation**

**(A) In general.**— Assuming all other requirements of section 168(k) and this section are met, the remaining carryover basis for the year of replacement and the remaining excess basis, if any, for the year of replacement for the acquired MACRS property or the acquired computer software, as applicable, are eligible for the additional first year depreciation deduction. The 30-percent additional first year depreciation deduction applies to the remaining carryover basis and the remaining excess basis, if any, of the acquired MACRS property or the acquired computer software if the time of replacement is after September 10, 2001, and before May 6, 2003, or if the taxpayer made the election provided in paragraph (e)(1)(ii)(A) of this section. The 50-percent additional first year depreciation deduction applies to the remaining carryover basis and the remaining excess basis, if any, of the acquired MACRS property or the acquired computer software if the time of replacement is after May 5, 2003, and before January 1, 2005, or, in the case of acquired MACRS property or acquired computer software that is 50-percent

bonus depreciation property described in section 168(k)(2)(B) or (C), the time of replacement is after May 5, 2003, and before January 1, 2006 (or the time of replacement is after May 5, 2003, and before January 1, 2007, in the case of 50-percent bonus depreciation property described in section 168(k)(2)(B) or (C) to which section 105 of the Gulf Opportunity Zone Act of 2005 (Public Law 109-135, 119 Stat. 2577) applies (for further guidance, see Announcement 2006-29 (2006-19 I.R.B. 879) and §601.601(d)(2)(ii)(b) of this chapter)). The additional first year depreciation deduction is computed separately for the remaining carryover basis and the remaining excess basis.

**(B) Year of disposition and year of replacement.**— The additional first year depreciation deduction is allowable for the acquired MACRS property or acquired computer software in the year of replacement. However, the additional first year depreciation deduction is not allowable for the exchanged or involuntarily converted MACRS property or the exchanged or involuntarily converted computer software if the exchanged or involuntarily converted MACRS property or the exchanged or involuntarily converted computer software, as applicable, is placed in service and disposed of in an exchange or involuntary conversion in the same taxable year.

**(C) Property having a longer production period.**— For purposes of paragraph (f)(5)(iii)(A) of this section, the total of the remaining carryover basis and the remaining excess basis, if any, of the acquired MACRS property that is qualified property or 50-percent bonus depreciation property described in section 168(k)(2)(B) is limited to the total of the property's remaining carryover basis and remaining excess basis, if any, attributable to the property's manufacture, construction, or production after September 10, 2001 (for qualified property), or May 5, 2003 (for 50-percent bonus depreciation property), and before January 1, 2005.

**(D) Alternative minimum tax.**— The 30-percent or 50-percent additional first year depreciation deduction is allowed for alternative minimum tax purposes for the year of replacement of acquired MACRS property or acquired computer software that is qualified property or 50-percent bonus depreciation property. The 30-percent or 50-percent additional first year depreciation deduction for alternative minimum tax purposes is based on the remaining carryover basis and the remaining excess basis, if any, of the acquired MACRS property or the acquired computer software for alternative minimum tax purposes.

**(iv) Sale-leaseback transaction.**— For purposes of this paragraph (f)(5), if MACRS property or computer software is sold to a taxpayer and leased back to a person by the taxpayer within three months after the time of disposition of the MACRS property or computer software, as applicable, the time of replacement for this MACRS property or computer software, as applicable, shall not be earlier than the date on which the MACRS property or computer software, as applicable, is used by the lessee under the leaseback.

**(v) Acquired MACRS property or acquired computer software that is acquired and placed in service before disposition of involuntarily converted MACRS property or involuntarily converted computer software.**— If, in an involuntary conversion, a taxpayer acquires and places in service the acquired MACRS property or the acquired computer software before the time of disposition of the involuntarily converted MACRS property or the involuntarily converted computer software and the time of disposition of the involuntarily converted MACRS property or the involuntarily converted computer software is after December 31, 2004, or, in the case of property described in section 168(k)(2)(B) or (C), after December 31, 2005 (or after December 31, 2006, in the case of property described in section 168(k)(2)(B) or (C) to which section 105 of the Gulf Opportunity Zone Act of 2005 (Public Law 109-135, 119 Stat. 2577) applies (for further guidance, see Announcement 2006-29 (2006-19 I.R.B. 879) and §601.601(d)(2)(ii)(b) of this chapter)), then—

**(A) Time of replacement.**— The time of replacement for purposes of this paragraph (f)(5) is when the acquired MACRS property or acquired computer software is placed in service by the taxpayer, provided the threat or imminence of requisition or condemnation of the involuntarily converted MACRS property or involuntarily converted computer software existed before January

1, 2005, or, in the case of property described in section 168(k)(2)(B) or (C), existed before January 1, 2006 (or existed before January 1, 2007, in the case of property described in section 168(k)(2)(B) or (C) to which section 105 of the Gulf Opportunity Zone Act of 2005 (Public Law 109-135, 119 Stat. 2577) applies (for further guidance, see Announcement 2006-29 (2006-19 I.R.B. 879) and §601.601(d)(2)(ii)(b) of this chapter)); and

**(B) Depreciation of acquired MACRS property or acquired computer software.**— The taxpayer depreciates the acquired MACRS property or acquired computer software in accordance with paragraph (d) of this section. However, at the time of disposition of the involuntarily converted MACRS property, the taxpayer determines the exchanged basis (as defined in §1.168(i)-6(b)(7)) and the excess basis (as defined in § 1.168(i)-6(b)(8)) of the acquired MACRS property and begins to depreciate the depreciable exchanged basis (as defined in §1.168(i)-6(b)(9) of the acquired MACRS property in accordance with §1.168(i)-6(c). The depreciable excess basis (as defined in §1.168(i)-6(b)(10)) of the acquired MACRS property continues to be depreciated by the taxpayer in accordance with the first sentence of this paragraph (f)(5)(v)(B). Further, in the year of disposition of the involuntarily converted MACRS property, the taxpayer must include in taxable income the excess of the depreciation deductions allowable, including the additional first year depreciation deduction allowable, on the unadjusted depreciable basis of the acquired MACRS property over the additional first year depreciation deduction that would have been allowable to the taxpayer on the remaining carryover basis of the acquired MACRS property at the time of replacement (as defined in paragraph (f)(5)(v)(A) of this section) plus the depreciation deductions that would have been allowable, including the additional first year depreciation deduction allowable, to the taxpayer on the depreciable excess basis of the acquired MACRS property from the date the acquired MACRS property was placed in service by the taxpayer (taking into account the applicable convention) to the time of disposition of the involuntarily converted MACRS property. Similar rules apply to acquired computer software.

**(vi) Examples.**— The application of this paragraph (f)(5) is illustrated by the following examples:

*Example 1.* (i) In December 2002, EE, a calendar-year corporation, acquired for \$200,000 and placed in service Canopy V1, a gas station canopy. Canopy V1 is qualified property under section 168(k)(1) and is 5-year property under section 168(e). EE depreciated Canopy V1 under the general depreciation system of section 168(a) by using the 200-percent declining balance method of depreciation, a 5-year recovery period, and the half-year convention. EE elected to use the optional depreciation tables to compute the depreciation allowance for Canopy V1. On January 1, 2003, Canopy V1 was destroyed in a fire and was no longer usable in EE's business. On June 1, 2003, in an involuntary conversion, EE acquired and placed in service new Canopy W1 with all of the \$160,000 of insurance proceeds EE received due to the loss of Canopy V1. Canopy W1 is 50-percent bonus depreciation property under section 168(k)(4) and is 5-year property under section 168(e). Pursuant to paragraph (g)(3)(ii) of this section and §1.168(i)-6(k)(2)(i), EE decided to apply §1.168(i)-6 to the involuntary conversion of Canopy V1 with the replacement of Canopy W1, the acquired MACRS property.

(ii) For 2002, EE is allowed a 30-percent additional first year depreciation deduction of \$60,000 for Canopy V1 (the unadjusted depreciable basis of \$200,000 multiplied by .30), and a regular MACRS depreciation deduction of \$28,000 for Canopy V1 (the remaining adjusted depreciable basis of \$140,000 multiplied by the annual depreciation rate of .20 for recovery year 1).

(iii) For 2003, EE is allowed a regular MACRS depreciation deduction of \$22,400 for Canopy V1 (the remaining adjusted depreciable basis of \$140,000 multiplied by the annual depreciation rate of .32 for recovery year 2 × ½ year).

(iv) Pursuant to paragraph (f)(5)(iii)(A) of this section, the additional first year depreciation deduction allowable for Canopy W1 equals \$44,800 (.50 of Canopy W1's remaining carryover basis at the time of replacement of \$89,600 (Canopy V1's remaining adjusted depreciable basis of \$140,000 minus 2002 regular MACRS depreciation deduction of \$28,000 minus 2003 regular MACRS depreciation deduction of \$22,400).

*Example 2.* (i) Same facts as in *Example 1*, except EE elected not to deduct the additional first year depreciation for 5-year property placed in service in 2002. EE deducted the additional first year depreciation for 5-year property placed in service in 2003.

(ii) For 2002, EE is allowed a regular MACRS depreciation deduction of \$40,000 for Canopy V1 (the unadjusted depreciable basis of \$200,000 multiplied by the annual depreciation rate of .20 for recovery year 1).

(iii) For 2003, EE is allowed a regular MACRS depreciation deduction of \$32,000 for Canopy V1 (the unadjusted depreciable basis of \$200,000 multiplied by the annual depreciation rate of .32 for recovery year 2 × ½ year).

(iv) Pursuant to paragraph (f)(5)(iii)(A) of this section, the additional first year depreciation deduction allowable for Canopy W1 equals \$64,000 (.50 of Canopy W1's remaining carryover basis at the time of replacement of \$128,000 (Canopy V1's unadjusted depreciable basis of \$200,000 minus 2002 regular MACRS depreciation deduction of \$40,000 minus 2003 regular MACRS depreciation deduction of \$32,000)).

*Example 3.* (i) In December 2001, FF, a calendar-year corporation, acquired for \$10,000 and placed in service Computer X2. Computer X2 is qualified property under section 168(k)(1) and is 5-year property under section 168(e). FF depreciated Computer X2 under the general depreciation system of section 168(a) by using the 200-percent declining balance method of depreciation, a 5-year recovery period, and the half-year convention. FF elected to use the optional depreciation tables to compute the depreciation allowance for Computer X2. On January 1, 2002, FF acquired new Computer Y2 by exchanging Computer X2 and \$1,000 cash in a like-kind exchange. Computer Y2 is qualified property under section 168(k)(1) and is 5-year property under section 168(e). Pursuant to paragraph (g)(3)(ii) of this section and §1.168(i)-6(k)(2)(i), FF decided to apply §1.168(i)-6 to the exchange of Computer X2 for Computer Y2, the acquired MACRS property.

(ii) For 2001, FF is allowed a 30-percent additional first year depreciation deduction of \$3,000 for Computer X2 (unadjusted basis of \$10,000 multiplied by .30), and a regular MACRS depreciation deduction of \$1,400 for Computer X2 (the remaining adjusted depreciable basis of \$7,000 multiplied by the annual depreciation rate of .20 for recovery year 1).

(iii) For 2002, FF is allowed a regular MACRS depreciation deduction of \$1,120 for Computer X2 (the remaining adjusted depreciable basis of \$7,000 multiplied by the annual depreciation rate of .32 for recovery year 2 × ½ year).

(iv) Pursuant to paragraph (f)(5)(iii)(A) of this section, the 30-percent additional first year depreciation deduction for Computer Y2 is allowable for the remaining carryover basis at the time of replacement of \$4,480 (Computer X2's unadjusted depreciable basis of \$10,000 minus additional first year depreciation deduction allowable of \$3,000 minus 2001 regular MACRS depreciation deduction of \$1,400 minus 2002 regular MACRS depreciation deduction of \$1,120) and for the remaining excess basis at the time of replacement of \$1,000 (cash paid for Computer Y2). Thus, the 30-percent additional first year depreciation deduction for the remaining carryover basis at the time of replacement equals \$1,344 (\$4,480 multiplied by .30) and for the remaining excess basis at the time of replacement equals \$300 (\$1,000 multiplied by .30), which totals \$1,644.

*Example 4.* (i) In September 2002, GG, a June 30 year-end corporation, acquired for \$20,000 and placed in service Equipment X3. Equipment X3 is qualified property under section 168(k)(1) and is 5-year property under section 168(e). GG depreciated Equipment X3 under the general depreciation system of section 168(a) by using the 200-percent declining balance method of depreciation, a 5-year recovery period, and the half-year convention. GG elected to use the optional depreciation tables to compute the depreciation allowance for Equipment X3. In December 2002, GG acquired new Equipment Y3 by exchanging Equipment X3 and \$5,000 cash in a like-kind exchange. Equipment Y3 is qualified property under section 168(k)(1) and is 5-year property under section 168(e). Pursuant to paragraph (g)(3)(ii) of this section and §1.168(i)-6(k)(2)(i), GG decided to apply §1.168(i)-6 to the exchange of Equipment X3 for Equipment Y3, the acquired MACRS property.



(ii) Pursuant to paragraph (f)(5)(iii)(B) of this section, no additional first year depreciation deduction is allowable for Equipment X3 and, pursuant to §1.168(d)-1T(b)(3)(ii), no regular depreciation deduction is allowable for Equipment X3, for the taxable year ended June 30, 2003.

(iii) Pursuant to paragraph (f)(5)(iii)(A) of this section, the 30-percent additional first year depreciation deduction for Equipment Y3 is allowable for the remaining carryover basis at the time of replacement of \$20,000 (Equipment X3's unadjusted depreciable basis of \$20,000) and for the remaining excess basis at the time of replacement of \$5,000 (cash paid for Equipment Y3). Thus, the 30-percent additional first year depreciation deduction for the remaining carryover basis at the time of replacement equals \$6,000 (\$20,000 multiplied by .30) and for the remaining excess basis at the time of replacement equals \$1,500 (\$5,000 multiplied by .30), which totals \$7,500.

*Example 5.* (i) Same facts as in *Example 4*. GG depreciated Equipment Y3 under the general depreciation system of section 168(a) by using the 200-percent declining balance method of depreciation, a 5-year recovery period, and the half-year convention. GG elected to use the optional depreciation tables to compute the depreciation allowance for Equipment Y3. On July 1, 2003, GG acquired new Equipment Z1 by exchanging Equipment Y3 in a like-kind exchange. Equipment Z1 is 50-percent bonus depreciation property under section 168(k)(4) and is 5-year property under section 168(e). Pursuant to paragraph (g)(3)(ii) of this section and §1.168(i)-6(k)(2)(i), GG decided to apply §1.168(i)-6 to the exchange of Equipment Y3 for Equipment Z1, the acquired MACRS property.

(ii) For the taxable year ending June 30, 2003, the regular MACRS depreciation deduction allowable for the remaining carryover basis at the time of replacement (after taking into account the additional first year depreciation deduction) of Equipment Y3 is \$2,800 (the remaining carryover basis at the time of replacement of \$20,000 minus the additional first year depreciation deduction of \$6,000, multiplied by the annual depreciation rate of .20 for recovery year 1) and for the remaining excess basis at the time of replacement (after taking into account the additional first year depreciation deduction) of Equipment Y3 is \$700 (the remaining excess basis at the time of replacement of \$5,000 minus the additional first year depreciation deduction of \$1,500, multiplied by the annual depreciation rate of .20 for recovery year 1), which totals \$3,500.

(iii) For the taxable year ending June 30, 2004, the regular MACRS depreciation deduction allowable for the remaining carryover basis (after taking into account the additional first year depreciation deduction) of Equipment Y3 is \$2,240 (the remaining carryover basis at the time of replacement of \$20,000 minus the additional first year depreciation deduction of \$6,000, multiplied by the annual depreciation rate of .32 for recovery year 2  $\times$   $\frac{1}{2}$  year) and for the remaining excess basis (after taking into account the additional first year depreciation deduction) of Equipment Y3 is \$560 (the remaining excess basis at the time of replacement of \$5,000 minus the additional first year depreciation deduction of \$1,500, multiplied by the annual depreciation rate of .32 for recovery year 2  $\times$   $\frac{1}{2}$  year), which totals \$2,800.

(iv) For the taxable year ending June 30, 2004, pursuant to paragraph (f)(5)(iii)(A) of this section, the 50-percent additional first year depreciation deduction for Equipment Z1 is allowable for the remaining carryover basis at the time of replacement of \$11,200 (Equipment Y3's unadjusted depreciable basis of \$25,000 minus the total additional first year depreciation deduction of \$7,500 minus the total 2003 regular MACRS depreciation deduction of \$3,500 minus the total 2004 regular depreciation deduction (taking into account the half-year convention) of \$2,800). Thus, the 50-percent additional first year depreciation deduction for the remaining carryover basis at the time of replacement equals \$5,600 (\$11,200 multiplied by .50).

*Example 6.* (i) In April 2004, SS, a calendar year-end corporation, acquired and placed in service Equipment K89. Equipment K89 is 50-percent bonus depreciation property under section 168(k)(4). In November 2004, SS acquired and placed in service used Equipment N78 by exchanging Equipment K89 in a like-kind exchange.

(ii) Pursuant to paragraph (f)(5)(iii)(B) of this section, no additional first year deduction is allowable for Equipment K89 and, pursuant to §1.168(d)-1T(b)(3)(ii), no regular depreciation deduction is allowable for Equipment K89, for the taxable year ended December 31, 2004.

(iii) Equipment N78 is not qualified property under section 168(k)(1) or 50-percent bonus depreciation property under section 168(k)(4) because the original use requirement of paragraph (b)(3) of this section is not met. Accordingly, no additional first year depreciation deduction is allowable for Equipment N78.

## **(6) Change in use**

**(i) Change in use of depreciable property.**— The determination of whether the use of depreciable property changes is made in accordance with section 168(i)(5) and regulations thereunder.

**(ii) Conversion to personal use.**— If qualified property or 50-percent bonus depreciation property is converted from business or income-producing use to personal use in the same taxable year in which the property is placed in service by a taxpayer, the additional first year depreciation deduction is not allowable for the property.

### **(iii) Conversion to business or income-producing use**

**(A) During the same taxable year.**— If, during the same taxable year, property is acquired by a taxpayer for personal use and is converted by the taxpayer from personal use to business or income-producing use, the additional first year depreciation deduction is allowable for the property in the taxable year the property is converted to business or income-producing use (assuming all of the requirements in paragraph (b) of this section are met). See paragraph (b)(3)(ii) of this section relating to the original use rules for a conversion of property to business or income-producing use.

**(B) Subsequent to the acquisition year.**— If property is acquired by a taxpayer for personal use and, during a subsequent taxable year, is converted by the taxpayer from personal use to business or income-producing use, the additional first year depreciation deduction is allowable for the property in the taxable year the property is converted to business or income-producing use (assuming all of the requirements in paragraph (b) of this section are met). For purposes of paragraphs (b)(4) and (5) of this section, the property must be acquired by the taxpayer for personal use after September 10, 2001 (for qualified property), or after May 5, 2003 (for 50-percent bonus depreciation property), and converted by the taxpayer from personal use to business or income-producing use by January 1, 2005. See paragraph (b)(3)(ii) of this section relating to the original use rules for a conversion of property to business or income-producing use.

### **(iv) Depreciable property changes use subsequent to the placed-in-service year**

**(A)** If the use of qualified property or 50-percent bonus depreciation property changes in the hands of the same taxpayer subsequent to the taxable year the qualified property or the 50-percent bonus depreciation property, as applicable, is placed in service and, as a result of the change in use, the property is no longer qualified property or 50-percent bonus depreciation property, as applicable, the additional first year depreciation deduction allowable for the qualified property or the 50-percent bonus depreciation property, as applicable, is not redetermined.

**(B)** If depreciable property is not qualified property or 50-percent bonus depreciation property in the taxable year the property is placed in service by the taxpayer, the additional first year depreciation deduction is not allowable for the property even if a change in the use of the property subsequent to the taxable year the property is placed in service results in the property being qualified property or 50-percent bonus depreciation property in the taxable year of the change in use.

**(v) Examples.**— The application of this paragraph (f)(6) is illustrated by the following examples:

**Example 1.** (i) On January 1, 2002, *HH*, a calendar year corporation, purchased and placed in service several new computers at a total cost of \$100,000. *HH* used these computers within the United States for 3 months in 2002 and then moved and used the computers outside the United States for the remainder of 2002. On January 1, 2003, *HH* permanently returns the computers to the United States for use in its business.

(ii) For 2002, the computers are considered as used predominantly outside the United States in 2002 pursuant to §1.48-1(g)(1)(i). As a result, the computers are required to be depreciated under the alternative depreciation system of section 168(g). Pursuant to paragraph (b)(2)(ii)(A)(2) of this section, the computers are not qualified property in 2002, the placed-in-service year. Thus, pursuant to (f)(6)(iv)(B) of this section, no additional first year depreciation deduction is allowed for these computers, regardless of the fact that the computers are permanently returned to the United States in 2003.

**Example 2.** (i) On February 8, 2002, *II*, a calendar year corporation, purchased and placed in service new equipment at a cost of \$1,000,000 for use in its California plant. The equipment is 5-year property under section 168(e) and is qualified property under section 168(k). *II* depreciates its 5-year property placed in service in 2002 using the optional depreciation table that corresponds with the general depreciation system, the 200-percent declining balance method, a 5-year recovery period, and the half-year convention. On June 4, 2003, due to changes in *II*'s business circumstances, *II* permanently moves the equipment to its plant in Mexico.

(ii) For 2002, *II* is allowed a 30-percent additional first year depreciation deduction of \$300,000 (the adjusted depreciable basis of \$1,000,000 multiplied by .30). In addition, *II*'s depreciation deduction allowable in 2002 for the remaining adjusted depreciable basis of \$700,000 (the unadjusted depreciable basis of \$1,000,000 reduced by the additional first year depreciation deduction of \$300,000) is \$140,000 (the remaining adjusted depreciable basis of \$700,000 multiplied by the annual depreciation rate of .20 for recovery year 1).

(iii) For 2003, the equipment is considered as used predominantly outside the United States pursuant to §1.48-1(g)(1)(i). As a result of this change in use, the adjusted depreciable basis of \$560,000 for the equipment is required to be depreciated under the alternative depreciation system of section 168(g) beginning in 2003. However, the additional first year depreciation deduction of \$300,000 allowed for the equipment in 2002 is not redetermined.

**(7) Earnings and profits.**— The additional first year depreciation deduction is not allowable for purposes of computing earnings and profits.

**(8) Limitation of amount of depreciation for certain passenger automobiles.**— For a passenger automobile as defined in section 280F(d)(5), the limitation under section 280F(a)(1)(A)(i) is increased by—

(i) \$4,600 for qualified property acquired by a taxpayer after September 10, 2001, and before May 6, 2003; and

(ii) \$7,650 for qualified property or 50-percent bonus depreciation property acquired by a taxpayer after May 5, 2003.

**(9) Section 754 election.**— In general, for purposes of section 168(k) any increase in basis of qualified property or 50-percent bonus depreciation property due to a section 754 election is not eligible for the additional first year depreciation deduction. However, if qualified property or 50-percent bonus depreciation property is placed in service by a partnership in the taxable year the partnership terminates under section 708(b)(1)(B), any increase in basis of the qualified property or the 50-percent bonus depreciation property due to a section 754 election is eligible for the additional first year depreciation deduction.

## **(10) Coordination with section 47**

**(i) In general.**— If qualified rehabilitation expenditures (as defined in section 47(c)(2) and §1.48-12(c)) incurred by a taxpayer with respect to a qualified rehabilitated building (as defined in section 47(c)(1) and §1.48-12(b)) are qualified property or 50-percent bonus depreciation property, the taxpayer may claim the rehabilitation credit provided by section 47(a) (provided the requirements of section 47 are met)—

**(A)** With respect to the portion of the basis of the qualified rehabilitated building that is attributable to the qualified rehabilitation expenditures if the taxpayer makes the applicable election under paragraph (e)(1)(i) or (e)(1)(ii)(B) of this section not to deduct any additional first year depreciation for the class of property that includes the qualified rehabilitation expenditures; or

**(B)** With respect to the portion of the remaining rehabilitated basis of the qualified rehabilitated building that is attributable to the qualified rehabilitation expenditures if the taxpayer claims the additional first year depreciation deduction on the unadjusted depreciable basis (as defined in paragraph (a)(2)(iii) of this section but before the reduction in basis for the amount of the rehabilitation credit) of the qualified rehabilitation expenditures and the taxpayer depreciates the remaining adjusted depreciable basis (as defined in paragraph (d)(2)(i) of this section) of such expenditures using straight line cost recovery in accordance with section 47(c)(2)(B)(i) and §1.48-12(c)(7)(i). For purposes of this paragraph (f)(10)(i)(B), the remaining rehabilitated basis is equal to the unadjusted depreciable basis (as defined in paragraph (a)(2)(iii) of this section but before the reduction in basis for the amount of the rehabilitation credit) of the qualified rehabilitation expenditures that are qualified property or 50-percent bonus depreciation property reduced by the additional first year depreciation allowed or allowable, whichever is greater.

**(ii) Example.**— The application of this paragraph (f)(10) is illustrated by the following example.

*Example.* (i) Between February 8, 2004, and June 4, 2004, UU, a calendar-year taxpayer, incurred qualified rehabilitation expenditures of \$200,000 with respect to a qualified rehabilitated building that is nonresidential real property under section 168(e). These qualified rehabilitation expenditures are 50-percent bonus depreciation property and qualify for the 10-percent rehabilitation credit under section 47(a)(1). UU's basis in the qualified rehabilitated building is zero before incurring the qualified rehabilitation expenditures and UU placed the qualified rehabilitated building in service in July 2004. UU depreciates its nonresidential real property placed in service in 2004 under the general depreciation system of section 168(a) by using the straight line method of depreciation, a 39-year recovery period, and the mid-month convention. UU elected to use the optional depreciation tables to compute the depreciation allowance for its depreciable property placed in service in 2004. Further, for 2004, UU did not make any election under paragraph (e) of this section.

(ii) Because UU did not make any election under paragraph (e) of this section, UU is allowed a 50-percent additional first year depreciation deduction of \$100,000 for the qualified rehabilitation expenditures for 2004 (the unadjusted depreciable basis of \$200,000 (before reduction in basis for the rehabilitation credit) multiplied by .50). For 2004, UU also is allowed to claim a rehabilitation credit of \$10,000 for the remaining rehabilitated basis of \$100,000 (the unadjusted depreciable basis (before reduction in basis for the rehabilitation credit) of \$200,000 less the additional first year depreciation deduction of \$100,000). Further, UU's depreciation deduction for 2004 for the remaining adjusted depreciable basis of \$90,000 (the unadjusted depreciable basis (before reduction in basis for the rehabilitation credit) of \$200,000 less the additional first year depreciation deduction of \$100,000 less the rehabilitation credit of \$10,000) is \$1,059.30 (the remaining adjusted depreciable basis of \$90,000 multiplied by the depreciation rate of .01177 for recovery year 1, placed in service in month 7).

**(11) Coordination with section 514(a)(3).**— The additional first year depreciation deduction is not allowable for purposes of section 514(a)(3).

### **(g) Effective date**

**(1) In general.**— Except as provided in paragraphs (g)(2), (3), and (5) of this section, this section applies to qualified property under section 168(k)(2) acquired by a taxpayer after September 10, 2001, and to 50-percent bonus depreciation property under section 168(k)(4) acquired by a taxpayer after May 5, 2003.

**(2) Technical termination of a partnership or section 168(i)(7) transactions.**— If qualified property or 50 percent bonus depreciation property is transferred in a technical termination of a partnership under section 708(b)(1)(B) or in a transaction described in section 168(i)(7) for a taxable year ending on or before September 8, 2003, and the additional first year depreciation deduction allowable for the property was not determined in accordance with paragraph (f)(1)(ii) or (iii) of this section, as applicable, the Internal Revenue Service will allow any reasonable method of determining the additional first year depreciation deduction allowable for the property in the year of the transaction that is consistently applied to the property by all parties to the transaction.

### **(3) Like-kind exchanges and involuntary conversions**

**(i)** If a taxpayer did not claim on a federal tax return for a taxable year ending on or before September 8, 2003, the additional first year depreciation deduction for the remaining carryover basis of qualified property or 50-percent bonus depreciation property acquired in a transaction described in section 1031(a), (b), or (c), or in a transaction to which section 1033 applies and the taxpayer did not make an election not to deduct the additional first year depreciation deduction for the class of property applicable to the remaining carryover basis, the Internal Revenue Service will treat the taxpayer's method of not claiming the additional first year depreciation deduction for the remaining carryover basis as a permissible method of accounting and will treat the amount of the additional first year depreciation deduction allowable for the remaining carryover basis as being equal to zero, provided the taxpayer does not claim the additional first year depreciation deduction for the remaining carryover basis in accordance with paragraph (g)(4)(ii) of this section.

**(ii)** Paragraphs (f)(5)(ii)(F)(2) and (f)(5)(v) of this section apply to a like-kind exchange or an involuntary conversion of MACRS property and computer software for which the time of disposition and the time of replacement both occur after February 27, 2004. For a like-kind exchange or an involuntary conversion of MACRS property for which the time of disposition, the time of replacement, or both occur on or before February 27, 2004, see §1.168(i)-6(k)(2)(ii). For a like-kind exchange or involuntary conversion of computer software for which the time of disposition, the time of replacement, or both occur on or before February 27, 2004, a taxpayer may rely on prior guidance issued by the Internal Revenue Service for determining the depreciation deductions of the acquired computer software and the exchanged or involuntarily converted computer software (for further guidance, see §1.168(k)-1T(f)(5) published in the **Federal Register** on September 8, 2003 (68 FR 53000)). In relying on such guidance, a taxpayer may use any reasonable, consistent method of determining depreciation in the year of disposition and the year of replacement.

### **(4) Change in method of accounting**

**(i) Special rules for 2000 or 2001 returns.**— If a taxpayer did not claim on the Federal tax return for the taxable year that included September 11, 2001, any additional first year depreciation deduction for a class of property that is qualified property and did not make an election not to deduct the additional first year depreciation deduction for that class of property, the taxpayer should refer to the guidance provided by the Internal Revenue Service for the time and manner of claiming the additional first year depreciation deduction for the class of property (for further guidance, see section 4 of Rev. Proc. 2002-33 (2002-1 C.B. 963), Rev. Proc. 2003-50 (2003-29 I.R.B. 119), and §601.601(d)(2)(ii)(b) of this chapter).

**(ii) Like-kind exchanges and involuntary conversions.**— If a taxpayer did not claim on a federal tax return for any taxable year ending on or before September 8, 2003, the additional first year depreciation deduction allowable for the remaining carryover basis of qualified property or 50-percent bonus depreciation property acquired in a transaction described in section 1031(a), (b), or (c), or in a transaction to which section 1033 applies and the taxpayer did not make an election not

to deduct the additional first year depreciation deduction for the class of property applicable to the remaining carryover basis, the taxpayer may claim the additional first year depreciation deduction allowable for the remaining carryover basis in accordance with paragraph (f)(5) of this section either:

**(A)** by filing an amended return (or a qualified amended return, if applicable (for further guidance, see Rev. Proc. 94-69 (1994-2 C.B. 804) and §601.601(d)(2)(ii)(b) of this chapter)) on or before December 31, 2003, for the year of replacement and any affected subsequent taxable year; or,

**(B)** by following the applicable administrative procedures issued under §1.446-1(e)(3)(ii) for obtaining the Commissioner's automatic consent to a change in method of accounting (for further guidance, see Rev. Proc. 2002-9 (2002-1 C.B. 327) and §601.601(d)(2)(ii)(b) of this chapter).

**(5) Revision to paragraphs (b)(3)(iii)(B) and (b)(5)(ii)(B) of this section.**— The addition of "(or, in the case of multiple units of property subject to the same lease, within three months after the date the final unit is placed in service, so long as the period between the time the first unit is placed in service and the time the last unit is placed in service does not exceed 12 months)" to paragraphs (b)(3)(iii)(B) and (b)(5)(ii)(B) of this section applies to property sold after June 4, 2004.

**(6) Rehabilitation credit.**— If a taxpayer did not claim on a Federal tax return for any taxable year ending on or before September 1, 2006, the rehabilitation credit provided by section 47(a) with respect to the portion of the basis of a qualified rehabilitated building that is attributable to qualified rehabilitation expenditures and the qualified rehabilitation expenditures are qualified property or 50-percent bonus depreciation property, and the taxpayer did not make the applicable election specified in paragraph (e)(1)(i) or (e)(1)(ii)(B) of this section for the class of property that includes the qualified rehabilitation expenditures, the taxpayer may claim the rehabilitation credit for the remaining rehabilitated basis (as defined in paragraph (f)(10)(i)(B) of this section) of the qualified rehabilitated building that is attributable to the qualified rehabilitation expenditures (assuming all the requirements of section 47 are met) in accordance with paragraph (f)(10)(i)(B) of this section by filing an amended Federal tax return for the taxable year for which the rehabilitation credit is to be claimed. The amended Federal tax return must include the adjustment to the tax liability for the rehabilitation credit and any collateral adjustments to taxable income or to the tax liability (for example, the amount of depreciation allowed or allowable in that taxable year for the qualified rehabilitated building). Such adjustments must also be made on amended Federal tax returns for any affected succeeding taxable years. [Reg. §1.168(k)-1.]

# [T.D. 9091, 9-5-2003 (corrected 11-7-2003). Amended by T.D. 9115, 2-27-2004 (corrected 4-2-2004). Redesignated and amended by T.D. 9283, 8-28-2006. Amended by T.D. 9314, 2-26-2007.]