

shall be declared when a claim is made about them. Any other vitamins or minerals listed in § 101.9(c)(8)(iv) or (c)(9) may be declared, but they shall be declared when they are added to the product for purposes of supplementation, or when a claim is made about them. Any (b)(2)-dietary ingredients that are not present, or that are present in amounts that can be declared as zero in § 101.9(c), shall not be declared (e.g., amounts corresponding to less than 2 percent of the RDI for vitamins and minerals). Protein shall not be declared on labels of products that, other than ingredients added solely for technological reasons, contain only individual amino acids.

\* \* \* \* \*

Dated: August 25, 2006.

**Jeffrey Shuren,**

*Assistant Commissioner for Policy.*

[FR Doc. 06-7306 Filed 8-30-06; 8:45 am]

BILLING CODE 4160-01-S

## DEPARTMENT OF HEALTH AND HUMAN SERVICES

### Food and Drug Administration

#### 21 CFR Part 529

#### Certain Other Dosage Form New Animal Drugs; Gentamicin Sulfate Intrauterine Solution

**AGENCY:** Food and Drug Administration, HHS.

**ACTION:** Final rule.

**SUMMARY:** The Food and Drug Administration (FDA) is amending the animal drug regulations to reflect approval of an abbreviated new animal drug application (ANADA) filed by Sparhawk Laboratories, Inc. The ANADA provides for use of a generic gentamicin sulfate solution as an intrauterine infusion for the control of bacterial metritis and as an aid in improving conception in mares.

**DATES:** This rule is effective August 31, 2006.

**FOR FURTHER INFORMATION CONTACT:** John K. Harshman, Center for Veterinary Medicine (HFV-104), Food and Drug Administration, 7500 Standish Pl., Rockville, MD 20855, 301-827-0169, e-mail: [john.harshman@fda.hhs.gov](mailto:john.harshman@fda.hhs.gov).

**SUPPLEMENTARY INFORMATION:** Sparhawk Laboratories, Inc., 12340 Santa Fe Trail Dr., Lenexa, KS 66215, filed ANADA 200-395 for the use of Gentamicin Sulfate Solution for the control of bacterial infections of the uterus (metritis) and as an aid in improving conception in mares with uterine

infections caused by bacteria sensitive to gentamicin. Sparhawk Laboratories, Inc.'s gentamicin sulfate solution is approved as a generic copy of Schering-Plough Animal Health Corp.'s GENTOCIN (gentamicin sulfate) solution veterinary, approved under NADA 46-724. The ANADA is approved as of July 31, 2006, and the regulations in 21 CFR 529.1044a are amended to reflect the approval and a current format. The basis of approval is discussed in the freedom of information summary.

In accordance with the freedom of information provisions of 21 CFR part 20 and 21 CFR 514.11(e)(2)(ii), a summary of safety and effectiveness data and information submitted to support approval of this application may be seen in the Division of Dockets Management (HFA-305), Food and Drug Administration, 5630 Fishers Lane, rm. 1061, Rockville, MD 20852, between 9 a.m. and 4 p.m., Monday through Friday.

FDA has determined under 21 CFR 25.33(a)(1) that this action is of a type that does not individually or cumulatively have a significant effect on the human environment. Therefore, neither an environmental assessment nor an environmental impact statement is required.

This rule does not meet the definition of "rule" in 5 U.S.C. 804(3)(A) because it is a rule of "particular applicability." Therefore, it is not subject to the congressional review requirements in 5 U.S.C. 801-808.

#### List of Subjects in 21 CFR Part 529

Animal drugs.

■ Therefore, under the Federal Food, Drug, and Cosmetic Act and under authority delegated to the Commissioner of Food and Drugs and redelegated to the Center for Veterinary Medicine, 21 CFR part 529 is amended as follows:

#### PART 529—CERTAIN OTHER DOSAGE FORM NEW ANIMAL DRUGS

■ 1. The authority citation for 21 CFR part 529 continues to read as follows:

**Authority:** 21 U.S.C. 360b.

■ 2. Revise § 529.1044a to read as follows:

#### § 529.1044a Gentamicin sulfate intrauterine solution.

(a) *Specifications.* Each milliliter of solution contains 50 or 100 milligrams gentamicin sulfate.

(b) *Sponsors.* See Nos. 000010, 000061, 000856, 057561, 058005, 059130, and 061623 in § 510.600(c) of this chapter.

(c) *Conditions of use in horses—(1) Amount.* Infuse 2 to 2.5 grams per day for 3 to 5 days during estrus.

(2) *Indications for use.* For control of bacterial infections of the uterus (metritis) and as an aid in improving conception in mares with uterine infections caused by bacteria sensitive to gentamicin.

(3) *Limitations.* Do not use in horses intended for human consumption. Federal law restricts this drug to use by or on the order of a licensed veterinarian.

Dated: August 11, 2006.

**Stephen F. Sundlof,**

*Director, Center for Veterinary Medicine.*

[FR Doc. 06-7307 Filed 8-30-06; 8:45 am]

BILLING CODE 4160-01-S

## DEPARTMENT OF THE TREASURY

### Internal Revenue Service

#### 26 CFR Part 1

[TD 9283]

RIN 1545-BB57

#### Special Depreciation Allowance

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Final and temporary regulations.

**SUMMARY:** This document contains final regulations relating to the depreciation of property subject to section 168 of the Internal Revenue Code (MACRS property) and the depreciation of computer software subject to section 167. Specifically, these final regulations provide guidance regarding the additional first year depreciation allowance provided by sections 168(k) and 1400L(b) for certain MACRS property and computer software. The regulations reflect changes to the law made by the Job Creation and Worker Assistance Act of 2002, the Jobs and Growth Tax Relief Reconciliation Act of 2003, the Working Families Tax Relief Act of 2004, the American Jobs Creation Act of 2004, and the Gulf Opportunity Zone Act of 2005.

**DATES:** *Effective Dates:* These regulations are effective August 31, 2006.

*Applicability Dates:* For dates of applicability, see §§ 1.167(a)-14(e), 1.168(d)-1(d), 1.168(d)-1T(d), 1.168(k)-1(g), 1.169-3(g), and 1.1400L(b)-1(g).

**FOR FURTHER INFORMATION CONTACT:** Douglas Kim, (202) 622-3110 (not a toll-free number).

**SUPPLEMENTARY INFORMATION:**

## Background

This document contains amendments to 26 CFR part 1. On September 8, 2003, the IRS and Treasury Department published temporary regulations (TD 9091) in the **Federal Register** (68 FR 52986) relating to the additional first year depreciation deduction provisions of sections 168(k) and 1400L(b) of the Internal Revenue Code (Code). On the same date, the IRS published a notice of proposed rulemaking (REG-157164-02) cross-referencing the temporary regulations in the **Federal Register** (68 FR 53008). On March 1, 2004, the temporary regulations (TD 9091) were amended by the temporary regulations (TD 9115) published by the IRS and Treasury Department in the **Federal Register** (69 FR 9529) relating to the depreciation of property acquired in a like-kind exchange or as a result of an involuntary conversion, and the notice of proposed rulemaking (REG-157164-02) was amended by the notice of proposed rulemaking (REG-106590-00, REG-138499-02) published by the IRS in the **Federal Register** (69 FR 9560) cross-referencing TD 9115. No public hearing was requested or held. Several comments responding to the notice of proposed rulemaking (REG-157164-02) were received. After consideration of all the comments, the proposed regulations (REG-157164-02) as amended by this Treasury decision are adopted as final, and the corresponding temporary regulations (TD 9091) are removed. The revisions are discussed below. Additionally, minor changes are made to the temporary regulations (TD 9115) to reflect the proper cites of the final regulations.

Section 1400N(d), which was added to the Code by section 101(a) of the Gulf Opportunity Zone Act of 2005, Public Law 109-135 (119 Stat. 2577), generally allows a 50-percent additional first year depreciation deduction (GO Zone additional first year depreciation deduction) for qualified Gulf Opportunity Zone property. Notice 2006-67 (2006-33 I.R.B. 248) provides guidance with respect to the GO Zone additional first year depreciation deduction. Because Notice 2006-67 contains citations to the temporary regulations under section 168(k) (TD 9091), the IRS intends to update Notice 2006-67 to change these citations to this Treasury decision.

## Explanation of Provisions

Section 167 allows as a depreciation deduction a reasonable allowance for the exhaustion, wear, and tear of property used in a trade or business or held for the production of income. The

depreciation allowable for tangible, depreciable property placed in service after 1986 generally is determined under section 168 (MACRS property). The depreciation allowable for computer software that is placed in service after August 10, 1993, and is not an amortizable section 197 intangible is determined under section 167(f)(1).

Section 168(k)(1) allows a 30-percent additional first year depreciation deduction for qualified property acquired after September 10, 2001, and, in most cases, placed in service before January 1, 2005. Section 168(k)(4) allows a 50-percent additional first year depreciation deduction for 50-percent bonus depreciation property acquired after May 5, 2003, and, in most cases, placed in service before January 1, 2005. Section 1400L(b) allows a 30-percent additional first year depreciation deduction for qualified New York Liberty Zone property (Liberty Zone property) acquired after September 10, 2001, and placed in service before January 1, 2007 (January 1, 2010, in the case of qualifying nonresidential real property and residential rental property).

The final regulations provide the requirements that must be met for depreciable property to qualify for the additional first year depreciation deduction provided by sections 168(k) and 1400L(b). Further, the final regulations instruct taxpayers how to determine the additional first year depreciation deduction and the amount of depreciation otherwise allowable for eligible depreciable property. Unless specifically stated, references to the temporary regulations are to TD 9091.

### *Property Eligible for the Additional First Year Depreciation Deduction*

The final regulations retain the rules contained in the temporary regulations providing that depreciable property must meet four requirements to be qualified property under section 168(k)(2) (property for which the 30-percent additional first year depreciation deduction is allowable) or 50-percent bonus depreciation property under section 168(k)(4) (property for which the 50-percent additional first year depreciation deduction is allowable). These requirements are: (1) The depreciable property must be of a specified type; (2) the original use of the depreciable property must commence with the taxpayer after September 10, 2001, for qualified property or after May 5, 2003, for 50-percent bonus depreciation property; (3) the depreciable property must be acquired by the taxpayer within a specified time period; and (4) the depreciable property

must be placed in service by a specified date.

Several commentators questioned whether these requirements must be met in the year in which the depreciable property is placed in service by the taxpayer. The statute is clear that additional first year depreciation is allowed in the taxable year in which qualified property or 50 percent bonus depreciation property is placed in service by the taxpayer for use in its trade or business or for production of income. Therefore, only property that meets all of these requirements in the year in which placed in service by the taxpayer for use in its trade or business or for production of income is allowed additional first year depreciation in the year the property is placed in service by the taxpayer for use in its trade or business or for production of income. In response to this comment, the final regulations state more explicitly that all of the requirements must be met in the first taxable year in which the property is subject to depreciation by the taxpayer whether or not depreciation deductions are allowable.

### *Property of a Specified Type*

The final regulations retain the rules contained in the temporary regulations providing that qualified property or 50-percent bonus depreciation property must be one of the following: (1) MACRS property that has a recovery period of 20 years or less; (2) computer software as defined in, and depreciated under, section 167(f)(1); (3) water utility property as defined in section 168(e)(5) and depreciated under section 168; or (4) qualified leasehold improvement property depreciated under section 168.

The final regulations also retain the rules contained in the temporary regulations providing that qualified property or 50-percent bonus depreciation property does not include: (1) Property excluded from the application of section 168 as a result of section 168(f); (2) property that is required to be depreciated under the alternative depreciation system of section 168(g) (ADS); (3) any class of property for which the taxpayer elects not to deduct the 30-percent or 50-percent additional first year depreciation; or (4) qualified New York Liberty Zone leasehold improvement property as defined in section 1400L(c).

Property is required to be depreciated under the ADS if the property is described under section 168(g)(1)(A) through (D) or if other provisions of the Code require depreciation for the property to be determined under the ADS (for example, section 263A(e)(2)(A) or section 280F(b)(1)). A commentator

questioned whether depreciable property held by taxpayers that made the election under section 263A(d)(3) should be excluded from eligibility for the additional first year depreciation deduction. Section 263A(e)(2)(A) provides that if a taxpayer (or a related person) makes an election under section 263A(d)(3) (relating to an election not to apply section 263A to any plant produced in any farming business carried on by the taxpayer), the ADS applies to all property of the taxpayer used predominantly in the farming business and placed in service in any taxable year during which any such election is in effect. Section 168(k) does not exclude property for which the section 263A(d)(3) election was made from the application of section 168(k)(2)(D)(i), which provides that property required to be depreciated under the ADS is not qualified property and 50-percent bonus depreciation property. For this reason, the final regulations do not adopt the suggestion that depreciable property held by taxpayers that made the election under section 263A(d)(3) is eligible for the additional first year depreciation deduction. Another commentator requested clarification as to whether the reference to "property described in section 263A(e)(2)(A)" in § 1.168(k)-1T(b)(2)(ii)(A)(2) includes only property held by a taxpayer that has made an election under section 263A(d)(3). In response to this comment, the final regulations clarify that if the taxpayer (or a related person) has made the election under section 263A(d)(3), the property described in section 263A(e)(2)(A) is not eligible for the additional first year depreciation deduction.

#### Original Use

The final regulations clarify and make conforming changes to the original use rules in the temporary regulations in several respects. First, a commentator inquired whether the rule providing that the cost of reconditioned or rebuilt property acquired by the taxpayer does not satisfy the original use requirement also applies to self-constructed property. A few commentators inquired whether the 20-percent test for determining whether property is reconditioned or rebuilt applies to self-constructed property. The IRS and Treasury Department intended that these rules apply to the cost of any reconditioned or rebuilt property, whether the taxpayer originally acquired the property or self-constructed the property. Accordingly, the final regulations clarify that the cost of reconditioned or rebuilt property

does not satisfy the original use requirement and that the 20-percent test applies to acquired or self-constructed property.

Second, *Example 2* of § 1.168(k)-1T(b)(3)(v) provides that property held primarily for sale to customers in the ordinary course of a person's business (inventory) does not constitute a use for purposes of the original use requirement. A commentator noted that this rule is not in the operative rules of the temporary regulations. In response to this comment, the final regulations make the rule explicit and provide that if a person initially acquires new property and holds the property as inventory 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. The final regulations also provide that if a taxpayer initially acquires new property and holds the property as inventory and then 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. In both situations, the final regulations provide that 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.

A commentator questioned whether *Example 2* in § 1.168(k)-1T(b)(3)(v) is the appropriate place to resolve the issue of the tax treatment of demonstrator automobiles for depreciation and other purposes when the issue may have a potential broader scope and significance that may continue to arise long after the additional first year depreciation under section 168(k) has ceased to be available. The IRS and Treasury Department believe that this example illustrates only the concept that if property is held by a person as inventory and then sold to a taxpayer for use in the taxpayer's trade or business, the taxpayer is the original user of the property, and, therefore, that this example is in the appropriate place.

Third, the final regulations retain the special rules contained in the temporary regulations for certain sale-leaseback transactions and syndication transactions. A commentator suggested that the title of § 1.168(k)-1T(b)(3)(iii)(B), "Syndication transaction," should be changed in the

final regulations to reflect that this rule, by its terms, can apply to any sale of property within three months after the date on which it is placed in service, regardless of whether that sale constitutes a syndication. The final regulations adopt this suggestion and modify the titles of, and make conforming changes to, the applicable paragraphs. Similar changes also are made to the paragraphs relating to the placed-in-service date requirement.

Fourth, the final regulations modify the provision in the temporary regulations to implement section 403(a) of the Working Families Tax Relief Act of 2004, (Pub. L. 108-311, 118 Stat. 1166) (October 4, 2004) (WFTRA) and section 337 of the American Jobs Creation Act of 2004 (Pub. L. 108-357, 118 Stat. 1418) (October 22, 2004) (AJCA). Section 403(a) of the WFTRA amended section 168(k) by adding the provision in section 168(k)(2)(E)(iii). Section 403(f) of the WFTRA provides that this amendment is effective as if included in the provisions of the Job Creation and Worker Assistance Act of 2002 (Pub. L. 107-147, 116 Stat. 21) (March 9, 2002) (JCWAA). Section 337(a) of the AJCA amended the syndication transaction provision in section 168(k)(2)(E)(iii)(II) by adding at the end the following: "(or, in the case of multiple units of property subject to the same lease, within 3 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)." Section 337(b) of the AJCA provides that this amendment is effective for property sold after June 4, 2004.

Fifth, if property placed in service by a person is sold and leased back within three months, and a syndication transaction occurs within three months after the sale-leaseback, a commentator questioned whether the purchaser of the property in the syndication transaction is considered the original user of the property and whether the property is treated as having been placed in service by the purchaser in the syndication transaction. Pursuant to §§ 1.168(k)-1T(b)(3)(iii)(C) and (5)(ii)(C), the purchaser of the property in the syndication transaction is considered the original user of the property and the property is treated as having been placed in service by the purchaser in the syndication transaction. The final regulations retain this rule and provide an example illustrating both the original use and the placed in service aspects of this situation.

Finally, the final regulations retain the rule contained in the temporary regulations providing that if, in the ordinary course of its business, a taxpayer sells fractional interests in qualified property or 50-percent bonus depreciation property to unrelated third parties, each first fractional owner of the property is considered as the original user of its proportionate share of the property. A commentator questioned whether the rule requiring the sale to be to unrelated third parties means that the purchasers must be unrelated to the seller, the purchasers must be unrelated to each other, or both. The IRS and Treasury Department intended that the purchasers be unrelated to the seller. Accordingly, the final regulations clarify this point.

A commentator questioned whether there are circumstances when the placed-in-service year of property is before the taxable year of original use. Pursuant to § 1.46-3(d)(1)(ii), property is considered placed in service in the taxable year in which the property is placed in a condition or state of readiness and availability for a specifically assigned function, whether in a trade or business, in the production of income, in a tax-exempt activity, or in a personal activity. Original use begins when new property is placed in service. Consequently, the placed-in-service year of new property cannot be before the taxable year in which original use of the property occurs.

#### *Acquisition of Property*

The final regulations modify the acquisition dates in the temporary regulations to reflect section 405 of the Gulf Opportunity Zone Act of 2005 (Pub. L. 109-135, 119 Stat. 2577) (December 21, 2005) (GOZA). Section 405(a)(1) of the GOZA amended section 168(k)(4)(B)(ii) to provide that 50-percent bonus depreciation property is property (I) 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 (II) acquired by the taxpayer pursuant to a written binding contract which was entered into after May 5, 2003, and before January 1, 2005. Section 405(b) provides that this amendment is effective as if included in section 201 of the Jobs and Growth Tax Relief and Reconciliation Act of 2003 (Pub. L. 108-27, 117 Stat. 752) (May 28, 2003).

#### *Binding Contracts*

The final regulations also modify in three respects the rules contained in the temporary regulations defining a

binding contract. First, the temporary regulations provide that if a contract provides for a full refund of the purchase price in lieu of any damages allowable by law in the event of breach or cancellation by the seller, the contract is not considered binding. A commentator suggested that this rule should apply to a breach or cancellation by the buyer, not the seller. However, the IRS and Treasury Department believe that this rule relates to a breach or cancellation by either party. Accordingly, the final regulations provide that if a contract provides 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.

Second, with respect to a contract subject to a condition, the temporary regulations provide that a contract that imposes significant obligations on the taxpayer or a predecessor will be treated as binding notwithstanding the fact that insubstantial terms remain to be negotiated by the parties to the contract. A commentator questioned whether this rule implies that a contract that imposes significant obligations will not be treated as binding if substantial terms remain to be negotiated. The IRS and Treasury Department believe that this implication was not intended. As a consequence, the final regulations clarify this rule by providing that 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.

Third, with respect to a supply agreement, a commentator suggested that the existence of agreed pricing terms should not be relevant in determining whether or not a supply agreement is a binding contract, except to the extent that their absence causes the contract not to be enforceable under local law. The commentator further suggested that if the existence of pricing terms is considered relevant to the result in the example of the operative rule and in some of the examples that illustrate the application of the rule, that requirement should be stated in the operative rule, and if not relevant, the references to pricing terms should be deleted. Pricing terms are not relevant in determining whether a supply agreement is a binding contract for purposes of these regulations. Accordingly, the final regulations adopt the suggestion by eliminating the reference to agreed pricing terms in the example of the operative rule. While the examples that illustrate the application of the rule continue to contain the

agreed price as a fact, the conclusions in these examples depend upon only whether or not the quantity and the design specification of the property to be purchased are specified.

#### *Self-Constructed Property*

With respect to self-constructed property, the final regulations clarify the rules in the temporary regulations in several respects. First, with respect to property described in section 168(k)(2)(B) (longer production period property) or section 168(k)(2)(C) (certain aircraft), the final regulations clarify that if a taxpayer enters into a written binding contract after September 10, 2001, and before January 1, 2005, with another person to manufacture, construct, or produce such property and the manufacture, construction, or production begins after December 31, 2004, the taxpayer has acquired the property pursuant to a written binding contract entered into after September 10, 2001, and before January 1, 2005 (for qualified property) or after May 5, 2003, and before January 1, 2005 (for 50-percent bonus depreciation property).

Second, a commentator asked whether the rules in the temporary regulations providing for when construction begins are intended also to apply to manufacture and production because self-constructed property can be manufactured, constructed, or produced for purposes of the additional first year depreciation deduction. The IRS and Treasury Department intended these rules to apply to manufacture, construction, or production. Accordingly, the final regulations make this clarification.

Third, the temporary regulations provide that construction of property begins when physical work of a significant nature begins and the determination of when physical work of a significant nature begins depends on the facts and circumstances. The temporary regulations also provide that physical work of a significant nature will not be considered to begin before the taxpayer incurs or pays more than 10 percent of the total cost of the property (excluding the cost of any land and preliminary activities). Several commentators questioned whether this 10-percent test is a safe harbor. The preamble to the temporary regulations (68 FR 52987) states that the 10-percent test is a safe harbor. Consequently, the final regulations are clarified to provide that the 10-percent test is a safe harbor. Further, when another party manufactures, constructs, or produces property for the taxpayer, the final regulations clarify that the safe harbor test must be met by the taxpayer. Thus,

under the final regulations, a taxpayer can determine when manufacture, construction, or production of the property begins either (1) by using the 10 percent safe harbor or (2) by using its own facts and circumstances.

Fourth, the final regulations retain the rules contained in the temporary regulations relating to components of self-constructed property. One of these rules is that if the binding contract to acquire a component is entered into, or 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 begins after December 31, 2004, the component qualifies for the additional first year depreciation deduction (assuming all other requirements are met) but the larger self-constructed property does not. In the case of a self-constructed component that is to be incorporated into a larger self-constructed property, some commentators noted that the applicability of this rule is limited. Specifically, one commentator stated that if the 10 percent test mentioned in the preceding paragraph is not a safe harbor test, then the only case in which self-constructed components could qualify for the additional first year depreciation deduction is one in which the taxpayer's pre-January 1, 2005, costs are 10 percent or less of the total cost of the larger self-constructed property (but more than 10 percent of the total cost of the component). Another commentator stated that a self-constructed component that is to be incorporated into a larger self-constructed property may not be placed in service before the larger self-constructed property. The IRS and Treasury Department agree that the rule has limited applicability. The rule applies when the larger self-constructed property is property that is manufactured, constructed, or produced by the taxpayer for its own use and that is described in section 168(k)(2)(B) (longer production period property) or section 168(k)(2)(C) (certain aircraft) and, therefore, the property is eligible for the extended placed-in-service date of January 1, 2006.

#### *Disqualified Transactions*

The final regulations clarify the disqualified transaction rules in the temporary regulations to reflect section 403(a) of the WFTRA. This section amended section 168(k) by adding section 168(k)(2)(E)(iv), which provides

limitations related to users and related parties (disqualified transactions). Section 168(k)(2)(E)(iv) provides that the term *qualified property* does not include any property if: (I) the user of such property (as of the date on which the property is originally placed in service) or a person that is related (within the meaning of section 267(b) or 707(b)) to such user or to the taxpayer had a written binding contract in effect for the acquisition of the property at any time on or before September 10, 2001; or (II) in the case of property manufactured, constructed, or produced for such user's or person's own use, the manufacture, construction, or production of the property began at any time on or before September 10, 2001. Section 403(f) of the WFTRA provides that this amendment is effective as if included in the provisions of the JCWAA.

Finally, the IRS and Treasury Department decided to add new examples to illustrate the above rules. Further, in *Example 10* of § 1.168(k)-1T(b)(4)(v), a commentator inquired whether the taxpayer (S) is considered to be self-constructing the property, acquiring the property, or both. The IRS and Treasury Department intended to have the taxpayer both self-constructing and acquiring the property. The final regulations make this clarification.

A commentator questioned whether the result in *Example 10* of § 1.168(k)-1T(b)(4)(v) also would apply if before September 11, 2001, a partnership began construction of a power plant for its own use, then after September 10, 2001, and before completion of the plant, there is a technical termination of the partnership under section 708(b)(1)(B), and then subsequently the new partnership incurred additional expenditures to complete the construction of the power plant and placed the power plant in service before January 1, 2005. Assuming the terminated partnership and the new partnership are not related parties, the new partnership is considered to have acquired the uncompleted power plant and completed the construction of the power plant and, thus, the result in *Example 10* of § 1.168(k)-1T(b)(4)(v) will apply to the new partnership in this case. While the additional first year depreciation deduction for Liberty Zone property requires the property to be acquired by purchase, the same result would apply because for purposes of that requirement, § 1.1400L(b)-1T(c)(5)(ii) treats the new partnership as acquiring the property by purchase and the final regulations retain this rule.

#### *Placed-in-Service Date*

The final regulations retain the rule contained in the temporary regulations providing, pursuant to section 168(k)(2)(A)(iv) and section 168(k)(4)(B)(iii), that qualified property or 50-percent bonus depreciation property is property that is placed in service by the taxpayer before January 1, 2005. The temporary regulations also provide that property described in section 168(k)(2)(B) (longer production period property) must be placed in service before January 1, 2006. The final regulations modify this extended placed-in-service date requirement in two respects. First, the final regulations reflect that the extended placed-in-service date of before January 1, 2006, also applies to property described in section 168(k)(2)(C) (certain aircraft), which was added to section 168(k) by section 336 of the AJCA. Second, the final regulations reflect that the extended placed-in-service date of before January 1, 2006, is extended for one year to before January 1, 2007, for property to which Announcement 2006-29 (2006-19 IRB 879) applies. Announcement 2006-29 applies to property described in section 168(k)(2)(B) or (C) that is either placed in service by the taxpayer or manufactured by a person in the Gulf Opportunity (GO) Zone, the Rita GO Zone, or the Wilma GO Zone, provided the taxpayer was unable to meet the December 31, 2005, placed-in-service date deadline for such property as a result of Hurricane Katrina, Hurricane Rita, or Hurricane Wilma.

#### *Qualified Leasehold Improvement Property*

The final regulations retain the rules contained in the temporary regulations relating to qualified leasehold improvement property. The temporary regulations provide that 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, among other things, 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. A commentator questioned whether this rule means an improvement that is permitted or required by a lease. The IRS and Treasury Department believe that the improvement must be made under or pursuant to a lease, regardless of whether the improvement is permitted or required under the lease.

### *Computation of Additional First Year Depreciation Deduction and Otherwise Allowable Depreciation*

The final regulations retain the rules contained in the temporary regulations for determining the amount of the additional first year depreciation deduction and otherwise allowable depreciation deduction. In addition, the final regulations clarify that the additional first year depreciation deduction generally 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.

### *Election Not To Claim Additional First Year Depreciation Deduction*

With respect to the election not to claim the additional first year depreciation deduction, the final regulations retain the rules contained in the temporary regulations for making this election and for defining what is a class of property for purposes of the election. For any class of property that is qualified property, a taxpayer may elect out of the 30-percent additional first year depreciation deduction for any class of qualified property. For any class of property that is 50-percent bonus depreciation property, a taxpayer may elect either to deduct the 30-percent, instead of the 50-percent, additional first year depreciation or to deduct no additional first year depreciation. A commentator asked whether a taxpayer with 50-percent bonus depreciation property must make two elections to elect not to deduct any additional first year depreciation. The final regulations clarify that only one election is needed to elect not to deduct both the 30-percent and 50-percent additional first year depreciation for 50-percent bonus depreciation property.

If a taxpayer elects not to deduct any additional first year depreciation for a class of property, another commentator asked whether the depreciation adjustments under section 56 apply to property included in such class for purposes of computing the taxpayer's alternative minimum taxable income. The non-applicability of the depreciation adjustments under section 56 provided by section 168(k)(2)(G) applies only to qualified property or 50-percent bonus depreciation property. If a taxpayer elects not to deduct any additional first year depreciation for a class of property, the property included in such class is not qualified property or 50-percent bonus depreciation property. Accordingly, the final regulations

provide that if a taxpayer elects not to deduct any additional first year depreciation for a class of property, the depreciation adjustments under section 56 apply to that property for purposes of computing the taxpayer's alternative minimum taxable income.

The final regulations also include the procedures provided by section 3.04 of Rev. Proc. 2002-33 (2002-1 C.B. 963) for revoking an election not to deduct the additional first year depreciation for a class of property. These procedures provide that this election is revocable only with the prior written consent of the Commissioner of Internal Revenue and, to seek the Commissioner's consent, the taxpayer must submit a request for a letter ruling. However, the final regulations also provide an automatic 6-month extension from the due date of the taxpayer's Federal tax return (excluding extensions) for the placed-in-service year to revoke the election, provided the taxpayer timely filed its Federal tax return for the placed-in-service year.

### *Liberty Zone Property*

Generally, the requirements for determining the eligibility of property for the additional first year depreciation deduction for Liberty Zone property provided by section 1400L(b) are similar to the requirements for the 30-percent additional first year depreciation deduction for qualified property provided by section 168(k)(1) in the final regulations. The final regulations made several changes to the temporary regulations with respect to the Liberty Zone property, which are discussed below.

The final regulations retain the rule contained in the temporary regulations providing that Liberty Zone property includes the same property that is described as qualified property or 50-percent bonus depreciation property for purposes of section 168(k). In addition, Liberty Zone property includes nonresidential real property or residential rental property to the extent such property rehabilitates real property damaged, or replaces real property destroyed or condemned, as a result of the terrorist attacks of September 11, 2001. Real property is considered to have been destroyed or condemned only if an entire building or structure was destroyed or condemned as a result of the terrorist attacks of September 11, 2001. Property is treated as replacing destroyed or condemned property if, as part of an integrated plan, the property replaces real property that is included in a continuous area that includes real property destroyed or condemned. A commentator noted that the temporary

regulations simply reiterate the statute but do not define the word *continuous*. The IRS and Treasury Department believe that the common meaning of *continuous* applies.

The temporary regulations define *real property* as a building or its structural components, or other tangible real property except: (1) Property described in section 1245(a)(3)(B) (relating to depreciable property used as an integral part of a specified activity or as a specified facility); (2) property described in section 1245(a)(3)(D) (relating to a single purpose agricultural or horticultural structure); and (3) property described in section 1245(a)(3)(E) (relating to storage facility used in connection with the distribution of petroleum or any primary product of petroleum). A commentator suggested that these exclusions to the definition of real property should be deleted in the final regulations. As a result of this definition, nonresidential real property or residential rental property that rehabilitates or replaces any of the excluded properties that were damaged, destroyed, or condemned, is not eligible for the Liberty Zone additional first year depreciation deduction. For this reason, the IRS and Treasury Department agree. Accordingly, the final regulations provide that real property is a building or its structural components, or other tangible real property.

The temporary regulations provide that Liberty Zone property does not include property that is described as qualified property or 50-percent bonus depreciation property for purposes of section 168(k), or property that is described in § 1.168(k)-1T(b)(2)(ii). The property described in § 1.168(k)-1T(b)(2)(ii) is property that is: (1) Described in section 168(f); (2) required to be depreciated under the alternative depreciation system; (3) included in any class of property for which the taxpayer elects out of the additional first year depreciation deduction under section 168(k); or (4) qualified Liberty Zone leasehold improvement property. Instead of providing a cross-reference to § 1.168(k)-1(b)(2)(ii), the final regulations list the property that is described in § 1.168(k)-1(b)(2)(ii) with one modification to the exclusion for property that is included in any class of property for which the taxpayer elects out of the additional first year depreciation deduction under section 168(k). In this regard, a commentator stated that while section 1400L(b)(2)(C)(iv) provides that the election out rules for purposes of section 1400L(b) are to be similar to the election out rules under section 168(k), section 1400L(b)(2)(C)(iv) does not mean

that the same election must be made with respect to both sections 168(k) and 1400L(b). Accordingly, the commentator suggested that a taxpayer be permitted to elect not to apply section 168(k) to its property of a particular class of property to the extent that such property is not located within the Liberty Zone, while still being entitled to the benefits of section 1400L(b) for its property of the same class that is located within the Liberty Zone. The IRS and Treasury Department agree with this suggestion. Accordingly, the final regulations make clear that Liberty Zone property is not property included in any class of property for which the taxpayer elects out of the additional first year depreciation deduction under section 1400L(b).

The final regulations retain the rule contained in the temporary regulations providing that Liberty Zone property is property that is acquired by the taxpayer by purchase after September 10, 2001, but only if no written binding contract for the acquisition of the property was in effect before September 10, 2001. The term *by purchase* is defined in section 179(d) and § 1.179-4(c). The final regulations also retain the rule contained in the temporary regulations providing that the new partnership resulting from a technical termination under section 708(b)(1)(B) or a transferee in section 168(i)(7) transactions is deemed to acquire the depreciable property by purchase. A commentator suggested that the rule should apply only if the old transferor partnership had itself acquired the property by purchase, as the mere existence of a technical termination does not provide sufficient reason to deem the statutory purchase requirement to have been met. The final regulations do not adopt this suggestion. The rule is the result of the rules provided in the temporary regulations regarding the additional first year depreciation deduction under sections 168(k) and 1400L(b) that allow the new partnership resulting from a technical termination to be entitled to the additional first year depreciation deduction for eligible property that was placed in service by the terminated partnership during the taxable year of termination. As a result, the IRS and Treasury Department determined that the rule should not be changed.

The final regulations also retain the rules contained in the temporary regulations for electing not to deduct the Liberty Zone additional first year depreciation deduction for a class of property. In addition, the final regulations for this election include provisions similar to those previously

discussed relating to the alternative minimum tax and the revocation of the election with respect to the election not to deduct the additional first year depreciation deduction under section 168(k).

#### *Special Rules*

Similar to the temporary regulations, the final regulations provide special rules for the following situations: (1) Qualified property, 50-percent bonus depreciation property, or Liberty Zone property placed in service and disposed of in the same taxable year; (2) redetermination of basis of qualified property, 50-percent bonus depreciation property, or Liberty Zone property; (3) recapture of additional first year depreciation for purposes of section 1245 and section 1250; (4) a certified pollution control facility that is qualified property, 50-percent bonus depreciation property, or Liberty Zone property; (5) like-kind exchanges and involuntary conversions of qualified property, 50-percent bonus depreciation property, or Liberty Zone property; (6) a change in use of qualified property, 50-percent bonus depreciation property, or Liberty Zone property; (7) the computation of earnings and profits; (8) the increase in the limitation of the amount of depreciation for passenger automobiles; and (9) the step-up in basis due to a section 754 election. For some of these situations, the final regulations modify or clarify the rules contained in the temporary regulations. In addition, the final regulations provide rules for two new situations: the rehabilitation credit under section 47 and the computation of depreciation for purposes of section 514(a)(3).

#### *Property Placed in Service and Disposed of in the Same Taxable Year*

With respect to qualified property, 50-percent bonus depreciation property, or Liberty Zone property placed in service and disposed of in the same taxable year, the final regulations retain the rules contained in the temporary regulations. In general, the regulations provide that the additional first year depreciation deduction is not allowed. If qualified property or 50-percent bonus depreciation property is placed in service and disposed of by a taxpayer in the same taxable year and then, in a subsequent taxable year, is reacquired and again placed in service by the taxpayer, a commentator inquired whether the additional first year depreciation deduction is allowable in the subsequent taxable year. Because the property is used property in the subsequent taxable year, the additional first year depreciation deduction is not

allowable for the property in the subsequent taxable year. Accordingly, in this situation, the final regulations clarify that the additional first year depreciation deduction is not allowable for the property in the subsequent taxable year.

The temporary regulations provide two exceptions to the general rule. First, the additional first year depreciation deduction is allowable for qualified property, 50-percent bonus depreciation property, or Liberty Zone property placed in service by a terminated partnership in the same taxable year in which a technical termination of the partnership occurs. In this case, the new partnership, and not the terminated partnership, claims the additional first year depreciation deduction. Second, the additional first year depreciation deduction is allowable for qualified property, 50-percent bonus depreciation property, or Liberty Zone property placed in service by a transferor in the same taxable year in which the property is transferred in a transaction described in section 168(i)(7). In this case, the additional first year depreciation deduction 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. The 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. If the transferee has a different taxable year than the transferor, a commentator questioned whether the allocation of the additional first year depreciation deduction would be made between the transferor and the transferee in accordance with the above rules. Because the allocation rules in § 1.168(d)-1(b)(7)(ii) cover this situation, the IRS and Treasury Department did not modify the rule in the final regulations.

#### *Redetermination of Basis*

The final regulations also retain the rules contained in the temporary regulations with respect to a redetermination of basis of qualified property, 50-percent bonus depreciation property, or Liberty Zone property (for example, due to a contingent purchase price or a discharge of indebtedness). These rules apply to a redetermination of the unadjusted depreciable basis of the property occurring before January 1, 2005 (January 1, 2006, for the extended placed-in-service date property) for qualified property or 50-percent bonus depreciation property, or before January 1, 2007 (January 1, 2010, in the case of nonresidential real property and

residential rental property) for Liberty Zone property. A commentator suggested that the rules should be expanded to include redeterminations of basis occurring on or after these dates. The commentator pointed out that the rule results in additional first year depreciation not being allowable for additional purchase price paid on or after January 1, 2005, with respect to qualified property or 50-percent bonus depreciation property acquired before 2005. The final regulations do not adopt this suggestion. While the current rule may be unfavorable when, for example, a redetermination of basis results in an increase of basis on or after January 1, 2005, for qualified property or 50-percent bonus depreciation property acquired before 2005, the current rule may be favorable when, for example, a redetermination of basis results in a decrease of basis on or after January 1, 2005, with respect to qualified property or 50-percent bonus depreciation property acquired before 2005. Further, the IRS and Treasury Department limited the rules to redeterminations occurring before the dates mentioned above to be consistent with the dates on which property must be placed in service to be eligible for the additional first year depreciation deduction. For this reason, the IRS and Treasury Department determined not to change the rule in the final regulations.

In the case of a redetermination of basis that results in a decrease in basis, a commentator noted that the operative rule provides that the taxpayer includes in the taxpayer's income the excess additional first year depreciation deduction previously claimed for the qualified property, the 50-percent bonus depreciation property, or the Liberty Zone property but the example illustrating the application of this rule allows the taxpayer to reduce current year depreciation deductions by the amount of the excess additional first year depreciation deduction previously claimed for the qualified property, the 50-percent bonus depreciation property, or Liberty Zone property. Because the IRS and Treasury Department recognize that the lump-sum inclusion in income approach provided in the operative rule of the temporary regulation may adversely affect real estate investment trusts and similar entities, the final regulations provide that the excess additional first year depreciation deduction offsets the amount otherwise allowable for depreciation for the taxable year. Even if the amount of the offset exceeds the amount otherwise allowable for depreciation for the taxable year, the taxpayer takes into

account a negative depreciation deduction in computing taxable income.

The final regulations retain the rule contained in the temporary regulations providing that, for purposes of the redetermination of basis rules: (1) an increase in basis occurs in the taxable year an amount is taken into account under section 461; and (2) a decrease in basis occurs in the taxable year an amount is taken into account under section 451. A commentator questioned whether because the event in question is giving rise to a basis adjustment, rather than to an item of income or deduction, it is appropriate for the rule to tie the timing of the adjustment to accounting method rules concerning the timing of income and deductions. The commentator also noted that one apparent effect of applying the accounting method rules is to override the basis reduction rule of section 1017(a) as illustrated in *Example 2* of § 1.168(k)-1T(f)(2)(iv). The IRS and Treasury Department did not intend to change the section 1017(a) rules. While the IRS and Treasury Department continue to believe that the current rule is appropriate, the final regulations have been modified for cases in which the Code, the regulations under the Code, or other published guidance expressly provides an exception to such rule (for example, section 1017(a)). Therefore, *Example 2* of § 1.168(k)-1T(f)(2)(iv) in the final regulations reflects the basis adjustment rules of section 1017(a).

#### *Like-Kind Exchanges and Involuntary Conversions*

With respect to MACRS property or computer software acquired in a like-kind exchange under section 1031 or as a result of an involuntary conversion under section 1033, the final regulations change the rules contained in the temporary regulations (TD 9091 as amended by TD 9115) in several respects. First, the final regulations modify the scope of this provision to include property described in section 168(k)(2)(C) (certain aircraft), which was added to section 168(k) by section 336 of the AJCA, and to include property to which Announcement 2006-29 (2006-19 IRB 879) applies if the time of replacement is after September 10, 2001, and before January 1, 2007. As previously noted, Announcement 2006-29 applies to property described in section 168(k)(2)(B) or (C) that is either placed in service by the taxpayer or manufactured by a person in the Gulf Opportunity (GO) Zone, the Rita GO Zone, or the Wilma GO Zone, provided the taxpayer was unable to meet the December 31, 2005, placed-in-service date deadline for such property as a

result of Hurricane Katrina, Hurricane Rita, or Hurricane Wilma. Similar changes also are made to the paragraph relating to the computation of the additional first year depreciation deduction for MACRS property or computer software acquired in a like-kind exchange or as a result of an involuntary conversion.

A commentator inquired whether the rules should be expanded to include exchanged or involuntarily converted property that is subject to former section 168 (the accelerated cost recovery system or ACRS) or that is pre-1981 depreciation property. The current rules apply only to exchanged or involuntarily converted property that is MACRS property in order to conform with § 1.168(i)-6T (relating to depreciation of property acquired in like-kind exchanges or as a result of involuntary conversions). Accordingly, the IRS and Treasury Department believe that this issue is outside the scope of these regulations and should be addressed when the temporary regulations under § 1.168(i)-6T are finalized.

Second, the temporary regulations define the time of replacement as the later of when the acquired MACRS property or acquired computer software is placed in service, or the time of disposition of the exchanged or involuntarily converted property. A commentator expressed concern that in the case of an involuntary conversion under section 1033, the final regulations may confer an unintended benefit in the case of taxpayers who acquired property prior to September 11, 2001, in order to replace property that was ultimately requisitioned or condemned after September 10, 2001, but as to which the threat or imminence of condemnation existed prior to that date. The IRS and Treasury Department acknowledge that the rule confers a benefit under such circumstances, but continue to believe that the rule is appropriate. Additionally, the IRS and Treasury Department decided to provide rules in the final regulations to address how the additional first year depreciation deduction is treated when § 1.168(i)-6T(d)(4) applies. Section 1.168(i)-6T(d)(4) applies when, in an involuntary conversion, a taxpayer acquires and places in service acquired MACRS property before the time of disposition of the involuntarily converted MACRS property. If the time of disposition of the involuntarily converted MACRS property 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 Announcement 2006–29 applies), the final regulations provide that the time of replacement is when the acquired MACRS property is placed in service, provided the threat or imminence of requisition or condemnation of the converted property existed prior to 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 Announcement 2006–29 applies). In this case, the final regulations also modify the income inclusion rule in § 1.168(i)–6T(d)(4) to allow the additional first year depreciation deduction on the remaining carryover basis of the acquired MACRS property that is qualified property, 50-percent bonus depreciation property, or Liberty Zone property.

Third, the final regulations clarify the rules contained in the temporary regulations relating to the computation of the additional first year depreciation deduction for property described in section 168(k)(2)(B) (longer production period property) and for alternative minimum tax purposes. In both cases, the temporary regulations provide a cross-reference to § 1.168(k)–1T(d) (computation of depreciation deduction for qualified property or 50-percent bonus depreciation property). A commentator suggested that the purpose of the reference to § 1.168(k)–1T(d) should be clarified. The final regulations adopt this suggestion by deleting the cross-reference and providing rules for computing the additional first year depreciation deduction for property described in section 168(k)(2)(B) (longer production period property) and for alternative minimum tax purposes.

Also, a commentator questioned whether the rule that the additional first year depreciation is calculated separately with respect to the carryover basis and the excess basis is appropriate, and suggested that the rule should be simplified by eliminating the requirement of separate calculations. The IRS and Treasury Department believe that the rule is appropriate because it conforms with § 1.168(i)–6T, which requires separate calculations of depreciation for the carryover basis and the excess basis.

Fourth, the final regulations clarify the rules contained in the temporary regulations relating to exchanged or involuntarily converted MACRS property or exchanged or involuntarily

converted computer software that is placed in service and disposed of in an exchange or involuntary conversion in the same taxable year. In this case, the temporary regulations provide that 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 MACRS property or computer software is placed in service and disposed of in an exchange or involuntary conversion in the same taxable year. A commentator suggested that the final regulations clarify that the reference in the above rule to the MACRS property or computer software that is placed in service and disposed of in the same taxable year is the exchanged or involuntarily converted MACRS property or exchanged or involuntarily converted computer software. The final regulations adopt this suggestion.

Finally, a new example is added and the facts in several of the examples are clarified to reflect that the acquired property must be new property in order to meet the original use requirement and, therefore, qualify for the additional first year depreciation deduction.

#### *Change in Use*

The final regulations retain the rules contained in the temporary regulations providing when the use of qualified property, 50-percent bonus depreciation property, or Liberty Zone property changes in the hands of the same taxpayer during the placed-in-service year or a subsequent taxable year. One of these rules provide that 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 the requirements for the additional first year depreciation deduction are met). Another rule provides that if depreciable property is not qualified property, 50-percent bonus depreciation property, or Liberty Zone property in the placed-in-service year, 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 placed-in-service year results in the property being qualified property, 50-percent bonus depreciation property, or Liberty Zone property in the taxable year of the change in use. A commentator questioned whether these two rules are

inconsistent. The commentator further noted that under § 1.167(a)–11(e)(1)(i), property that is ready for use in a personal activity is considered to be placed in service. The IRS and Treasury Department do not believe that the two rules are inconsistent. Property is eligible for the additional first year depreciation deduction if in the first year in which the property is subject to depreciation, the property meets all the requirements to qualify for the additional first year depreciation deduction. In the case of property that changes from personal use to a business or income-producing use, the first year such property is subject to depreciation is the year of conversion to business or income-producing use. But in the case of property that changes from a depreciable use not eligible for the additional first year depreciation deduction to a depreciable use that is eligible for the additional first year depreciation deduction, such property did not meet the requirements to qualify for the additional first year depreciation deduction in the first year in which the property is subject to depreciation.

#### *Earnings and Profits*

The final regulations retain the rule contained in the temporary regulations providing that the additional first year depreciation deduction is not allowable for purposes of computing earnings and profits. A commentator suggested that because this provision interprets section 312(k), the regulations under section 312 should include a cross-reference to the regulations under section 168(k). The IRS and Treasury Department agree and, accordingly, the final regulations adopt this suggestion.

#### *280F(a)(1) Limitation*

The final regulations also retain the rules contained in the temporary regulations providing the increase in the limitation under section 280F(a)(1) of the amount of depreciation for certain passenger automobiles that are qualified property or 50-percent bonus depreciation property. A commentator had three inquiries about this increase in the limitation under section 280F(a)(1). First, the commentator asked whether the increase in the limitation can be taken as a section 179 expense. The increase in the limitation under section 280F(a)(1) that is provided in the final regulations may be taken as a section 179 expense. Second, the commentator asked whether the increase in the limitation of amount of depreciation for certain passenger automobiles needs to be prorated in a short taxable year. Because the additional first year depreciation

deduction is not prorated for a short taxable year, the increase in the limitation under section 280F(a)(1) that is provided in the final regulations also is not prorated. Third, when calculating depreciation for an asset with less than 100 percent business use, the commentator asked whether the business use percentage is applied to the increase in the limitation of amount of depreciation for certain passenger automobiles. If a taxpayer's business use of the automobile is less than 100 percent, the business use percentage is applied to the automobile's depreciation deduction, including the additional first year depreciation deduction, for the taxable year. The IRS and Treasury Department believe that these issues are outside the scope of these regulations and, accordingly, the final regulations do not address these issues.

#### *Section 754 Election*

Finally, the final regulations retain the rules contained in the temporary regulations relating to any increase in basis of qualified property, 50-percent bonus depreciation property, or Liberty Zone property due to a section 754 election. Under these rules, such increase in basis generally is not eligible for the additional first year depreciation deduction. However, if qualified property, 50-percent bonus depreciation property, or Liberty Zone property is placed in service by a partnership in the taxable year the partnership terminates under section 708(b)(1)(B), any increase of basis of the qualified property, 50-percent bonus depreciation property, or Liberty Zone property due to a section 754 election is eligible for the additional first year depreciation deduction. A commentator requested that we expand this terminating partnership rule to any increase in basis due to a section 754 election that arises before or during the placed-in-service year of the property. The IRS and Treasury Department decided not to do so. The rule for a termination of a partnership under section 708(b)(1)(B) was made to be consistent with the special rule allowing the new partnership, instead of the terminated partnership, to claim the additional first year depreciation deduction for property placed in service during the taxable year of termination and contributed by the terminated partnership to a new partnership. The IRS and Treasury Department believe that these rules should not be expanded to cover any other situations.

A commentator also suggested that we clarify the regulation to provide that any increase in basis due to a section 754 election that arises before or during the year in which the qualified property, 50-

percent bonus depreciation property, or Liberty Zone property is placed in service will be taken into account for the additional first year depreciation deduction. The IRS and Treasury Department did not adopt this suggestion in the final regulations. The additional first year depreciation deduction rules provide for the accelerated recovery of a taxpayer's cost of qualified property, 50-percent bonus depreciation property, or Liberty Zone property. Many basis increases resulting from a section 754 election bear no relation whatsoever to the cost of qualified property, 50-percent bonus depreciation property, or Liberty Zone property. For example, if a partnership with a section 754 election in effect made a liquidating distribution of high-basis property to a partner with low basis in his partnership interest, the basis of the partnership's undistributed property would be increased under section 734(b) by an amount equal to the decrease in basis to the distributed property under section 732(b). The amount of the section 734(b) basis increase allocable to qualified property under section 755 would have no correlation to the taxpayer's cost of the property. The IRS and Treasury Department believe that the rules regarding any basis increase due to a section 754 election should remain limited to those provided in the temporary regulations.

#### *Rehabilitation Credit*

Several commentators asked whether property that is qualified property, 50-percent bonus depreciation property, or Liberty Zone property qualifies for the rehabilitation credit under section 47. Section 47 allows a rehabilitation credit for qualified rehabilitation expenditures for certain buildings. Section 47(c)(2) defines the term *qualified rehabilitation expenditure* as meaning, in general, any amount properly chargeable to capital account for property for which depreciation is allowable under section 168 and that is nonresidential real property, residential rental property, real property that has a class life of more than 12.5 years, or an addition or improvement thereof. However, a qualified rehabilitation expenditure does not include any expenditure with respect to which the taxpayer does not use the straight line method over a recovery period determined under section 168(c) or (g). Because the additional first year depreciation deduction is not a straight line method, the IRS and Treasury Department have decided to provide in the final regulations that if qualified rehabilitation expenditures (as defined

in section 47(c)(2) and § 1.48-12(c)) are qualified property, 50-percent bonus depreciation property, or Liberty Zone property, the taxpayer may claim the additional first year depreciation deduction for the unadjusted depreciable basis of the qualified rehabilitation expenditures and may claim the rehabilitation credit (provided the requirements of section 47 are met) for the remaining basis of the qualified rehabilitation expenditures (unadjusted depreciable basis less the additional first year depreciation deduction allowed or allowable, whichever is greater) provided the taxpayer depreciates the remaining adjusted depreciable basis of such expenditures using the straight line method over a recovery period determined under section 168(c) or (g). The taxpayer may also claim the rehabilitation credit for the portion of the basis of the qualified rehabilitated building that is attributable to the qualified rehabilitation expenditures if the taxpayer elects not to deduct the additional first year depreciation for the class of property that includes the qualified rehabilitated expenditures.

#### *Depreciation Under Section 514(a)(3)*

Finally, a few commentators questioned whether a tax-exempt partner in a partnership that has debt-financed property may take advantage of the additional first year depreciation deduction. In computing under section 512 the unrelated business taxable income for any taxable year, section 514 provides the rules for determining the amount of unrelated business taxable income related to debt-financed property. Under section 514(a)(3), the deductions allowable with respect to each debt-financed property is the sum of the deductions under chapter 1 of the Code that are directly connected with the debt-financed property or the income therefrom, except that if the debt-financed property is depreciable property, the allowance must be computed only by use of the straight-line method. The final regulations provide that the additional first year depreciation deduction is not allowable for purposes of section 514(a)(3).

#### *Changes in Method of Accounting*

The IRS and Treasury Department intend to issue administrative guidance providing procedures for automatic consent for taxpayers that wish to seek a change in method of accounting to comply with these final regulations.

#### *Effective Date*

In general, the final regulations apply to qualified property or Liberty Zone

property acquired by a taxpayer after September 10, 2001, and for 50-percent bonus depreciation property acquired by a taxpayer after May 5, 2003. Modifications to § 1.168(k)-1(b)(3)(iii)(B) and (5)(ii)(B) relating to syndication and other lease transactions that provide a special rule for multiple units of property subject to the same lease apply to property sold after June 4, 2004.

### Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because these regulations do not impose on small entities a collection of information requirement, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking was previously submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

### Drafting Information

The principal author of these regulations is Douglas H. Kim, Office of Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

### List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

### Adoption of Amendments to the Regulations

■ Accordingly, 26 CFR part 1 is amended as follows:

#### PART 1—INCOME TAXES

■ **Paragraph 1.** The authority for part 1 continues to read, in part, as follows:

**Authority:** 26 U.S.C. 7805 \* \* \*

■ **Par. 2.** Section 1.48-12 is amended by adding a new sentence at the end of paragraph (a)(2)(i) and adding a new sentence at the end of paragraph (c)(8)(i) to read as follows:

**§ 1.48-12 Qualified rehabilitated building; expenditures incurred after December 31, 1981.**

- (a) \* \* \*  
(2) \* \* \*

(i) \* \* \* The last sentence of paragraph (c)(8)(i) of this section applies to qualified rehabilitation expenditures that are qualified property under section 168(k)(2) or qualified New York Liberty Zone property under section 1400L(b) acquired by a taxpayer after September 10, 2001, and to qualified rehabilitation expenditures that are 50 percent bonus depreciation property under section 168(k)(4) acquired by a taxpayer after May 5, 2003.

\* \* \* \* \*

(c) \* \* \*

(8) \* \* \*

(i) \* \* \* However, see § 1.168(k)-1(f)(10) if the qualified rehabilitation expenditures are qualified property or 50-percent bonus depreciation property under section 168(k) and see § 1.1400L(b)-1(f)(9) if the qualified rehabilitation expenditures are qualified New York Liberty Zone property under section 1400L(b).

\* \* \* \* \*

■ **Par. 3.** Section 1.167(a)-14 is amended by revising paragraphs (b)(1), (e)(2), and (e)(3) to read as follows:

**§ 1.167(a)-14 Treatment of certain intangible property excluded from section 197.**

\* \* \* \* \*

(b) \* \* \* (1) *In general.* The amount of the deduction for computer software described in section 167(f)(1) and § 1.197-2(c)(4) is determined by amortizing the cost or other basis of the computer software using the straight line method described in § 1.167(b)-1 (except that its salvage value is treated as zero) and an amortization period of 36 months beginning on the first day of the month that the computer software is placed in service. Before determining the amortization deduction allowable under this paragraph (b), the cost or other basis of computer software that is section 179 property, as defined in section 179(d)(1)(A)(ii), must be reduced for any portion of the basis the taxpayer properly elects to treat as an expense under section 179. In addition, the cost or other basis of computer software that is qualified property under section 168(k)(2) or § 1.168(k)-1, 50-percent bonus depreciation property under section 168(k)(4) or § 1.168(k)-1, or qualified New York Liberty Zone property under section 1400L(b) or § 1.1400L(b)-1, must be reduced by the amount of the additional first year depreciation deduction allowed or allowable, whichever is greater, under section 168(k) or section 1400L(b) for the computer software. If costs for developing computer software that the taxpayer properly elects to defer under

section 174(b) result in the development of property subject to the allowance for depreciation under section 167, the rules of this paragraph (b) will apply to the unrecovered costs. In addition, this paragraph (b) applies to the cost of separately acquired computer software if the cost to acquire the software is separately stated and the cost is required to be capitalized under section 263(a).

\* \* \* \* \*

(e) \* \* \*

(2) *Change in method of accounting.* See § 1.197-2(l)(4) for rules relating to changes in method of accounting for property to which § 1.167(a)-14 applies. However, see § 1.168(k)-1(g)(4) or 1.1400L(b)-1(g)(4) for rules relating to changes in method of accounting for computer software to which the third sentence in § 1.167(a)-14(b)(1) applies.

(3) *Qualified property, 50-percent bonus depreciation property, qualified New York Liberty Zone property, or section 179 property.* This section also applies to computer software that is qualified property under section 168(k)(2) or qualified New York Liberty Zone property under section 1400L(b) acquired by a taxpayer after September 10, 2001, and to computer software that is 50-percent bonus depreciation property under section 168(k)(4) acquired by a taxpayer after May 5, 2003. This section also applies to computer software that is section 179 property placed in service by a taxpayer in a taxable year beginning after 2002 and before 2010.

**§ 1.167(a)-14T [Removed]**

■ **Par. 4.** Section 1.167(a)-14T is removed.

■ **Par. 5.** Section 1.168(d)-1 is amended by revising paragraph (d)(2) to read as follows:

**§ 1.168(d)-1 Applicable conventions—half-year and mid-quarter convention.**

\* \* \* \* \*

(d) \* \* \*

(2) *Qualified property, 50-percent bonus depreciation property, or qualified New York Liberty Zone property.* This section also applies to qualified property under section 168(k)(2) or qualified New York Liberty Zone property under section 1400L(b) 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.

\* \* \* \* \*

■ **Par. 6.** In § 1.168(d)-1T, paragraphs (b)(3)(ii) and (d)(2) are amended as follows:

■ 1. The last sentence in paragraph (b)(3)(ii) is amended by removing the language “§ 1.168(k)–1T(f)(1)” and adding “§ 1.168(k)–1(f)(1)” in its place.

■ 2. The last sentence in paragraph (b)(3)(ii) is amended by removing the language “§ 1.1400L(b)–1T(f)(1)” and adding “§ 1.1400L(b)–1(f)(1)” in its place.

■ 3. Paragraph (d)(2) is revised. The revision reads as follows:

**§ 1.168(d)–1T Applicable conventions—half-year and mid-quarter conventions (temporary).**

\* \* \* \* \*

(d) \* \* \*

(2) *Qualified property, 50-percent bonus depreciation property, or qualified New York Liberty Zone property.* For further guidance, see § 1.168(d)–1(d)(2).

\* \* \* \* \*

■ **Par. 7.** Section 1.168(i)–6T is amended by adding a new sentence at the end of paragraph (d)(4) to read as follows:

**§ 1.168(i)–6T Like-kind exchanges and involuntary conversions (temporary).**

\* \* \* \* \*

(d) \* \* \*

(4) \* \* \* However, see § 1.168(k)–1(f)(5)(v) for replacement MACRS property that is qualified property or 50-percent bonus depreciation property and § 1.1400L(b)–1(f)(5) for replacement MACRS property that is qualified New York Liberty Zone property.

\* \* \* \* \*

■ **Par. 8.** Section 1.168(k)–0T is redesignated as § 1.168(k)–0 and newly designated § 1.168(k)–0 is amended as follows:

■ 1. The word “temporary” is removed from the section heading.

■ 2. The introductory text and the table of contents heading are revised.

■ 3. The entries for § 1.168(k)–1(b)(3)(ii)(A) and (B) are added.

■ 4. The entries for § 1.168(k)–1(b)(3)(iii), (iii)(B), and (iii)(C) are revised.

■ 5. The entry for § 1.168(k)–1(b)(4)(iii)(B) is revised.

■ 6. The entries for § 1.168(k)–1(b)(4)(iii)(B)(1) and (2) are added.

■ 7. The entries for § 1.168(k)–1(b)(5)(ii), (ii)(B), and (ii)(C) are revised.

■ 8. The entry for § 1.168(k)–1(b)(5)(v) is added.

■ 9. The entries for § 1.168(k)–1(e)(6), (7), (7)(i), and (7)(ii) are added.

■ 10. The entries for § 1.168(k)–1(f)(5)(iii)(C) and (D) are added.

■ 11. The entry for § 1.168(k)–1(f)(5)(v) is redesignated as § 1.168(k)–1(f)(5)(vi).

■ 12. The entries for § 1.168(k)–1(f)(5)(v), (v)(A), and (v)(B) are added.

■ 13. The entries for § 1.168(k)–1(f)(10) and (11) are added.

■ 14. The entries for § 1.168(k)–1(g)(5) and (6) are added.

The additions and revisions read as follows:

**§ 1.168(k)–0 Table of contents.**

This section lists the headings that appear in § 1.168(k)–1.

**§ 1.168(k)–1 Additional first year depreciation deduction.**

\* \* \* \* \*

(b) \* \* \*

(3) \* \* \*

(ii) \* \* \*

(A) Personal use to business or income-producing use.

(B) Inventory to business or income-producing use.

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

\* \* \* \* \*

(B) Syndication transaction and certain other transactions.

(C) Sale-leaseback transaction followed by a syndication transaction and certain other transactions.

\* \* \* \* \*

(4) \* \* \*

(iii) \* \* \*

(B) When does manufacture, construction, or production begin.

(1) In general.

(2) Safe harbor.

\* \* \* \* \*

(5) \* \* \*

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

(B) Syndication transaction and certain other transactions.

(C) Sale-leaseback transaction followed by a syndication transaction and certain other transactions.

\* \* \* \* \*

(v) Example.

\* \* \* \* \*

(e) \* \* \*

(6) Alternative minimum tax.

(7) Revocation.

(i) In general.

(ii) Automatic 6-month extension.

\* \* \* \* \*

(f) \* \* \*

(5) \* \* \*

(iii) \* \* \*

(C) Property having a longer production period.

(D) Alternative minimum tax.

\* \* \* \* \*

(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.

(A) Time of replacement.

(B) Depreciation of acquired MACRS property or acquired computer software.

\* \* \* \* \*

(10) Coordination with section 47.

(11) Coordination with section 514(a)(3).

(g) \* \* \*

(5) Revisions to paragraphs (b)(3)(ii)(B) and (b)(5)(ii)(B).

(6) Rehabilitation credit.

■ **Par. 9.** Section 1.168(k)–1T is redesignated as § 1.168(k)–1 and newly designated § 1.168(k)–1 is amended as follows:

■ 1. The word “temporary” is removed from the section heading.

■ 2. Paragraph (a)(2)(iii) is revised.

■ 3. Paragraph (a)(2)(iv) is amended by removing the language “§ 1.168(k)–1T(a)(2)(iii)” and adding “§ 1.168(k)–1(a)(2)(iii)” in its place.

■ 4. Paragraph (b)(1) is revised.

■ 5. Paragraph (b)(2)(i)(A) is amended by removing the language “§ 1.168(k)–1T(a)(2)(ii)” and adding “§ 1.168(k)–1(a)(2)(ii)” in its place.

■ 6. Paragraphs (b)(2)(ii)(A)(2), (b)(3)(i), and (b)(3)(ii) are revised.

■ 7. The heading of paragraph (b)(3)(iii) is revised.

■ 8. Paragraphs (b)(3)(iii)(B) and (C) are revised.

■ 9. The first and second sentences of paragraph (b)(3)(iv) are revised.

■ 10. Paragraph (b)(3)(v) is amended by revising the fourth sentence in *Example 4* and by adding new *Example 5*.

■ 11. Paragraph (b)(4)(i)(B) is revised.

■ 12. The last sentences of paragraphs (b)(4)(ii)(A), (B), and (D) are revised.

■ 13. Paragraph (b)(4)(iii)(A) is amended by adding a new sentence at the end.

■ 14. Paragraphs (b)(4)(iii)(B) and (b)(4)(iv)(A) are revised.

■ 15. Paragraph (b)(4)(v) is amended by revising the third sentence in *Example 10*, by adding a sentence at the end of *Example 11*, and by adding Examples 12, 13, and 14.

■ 16. Paragraph (b)(5)(i) is revised.

■ 17. The heading of paragraph (b)(5)(ii) is revised.

■ 18. Paragraphs (b)(5)(ii)(B) and (C) are revised.

■ 19. Paragraph (b)(5)(v) is added.

■ 20. Paragraph (d)(1)(i) is revised.

■ 21. Paragraph (d)(1)(ii) is amended by removing the language “§ 1.168(k)–1T(a)(2)(iii)” and adding “§ 1.168(k)–1(a)(2)(iii)” in its place.

■ 22. Paragraphs (d)(1)(iii) and (e)(1)(ii)(B) are revised.

■ 23. Paragraphs (e)(6) and (e)(7) are added.

■ 24. Paragraph (f)(1)(i) is amended by adding a new sentence at the end.

■ 25. The introductory text of paragraph (f)(2) is revised.

■ 26. Paragraph (f)(2)(ii) and the introductory text of paragraph (f)(2)(iii) are revised.

■ 27. Paragraph (f)(2)(iv) is amended by revising *Example 2*.

■ 28. Paragraph (f)(5)(i) is revised.

■ 29. Paragraphs (f)(5)(ii)(F) and (f)(5)(ii)(J)(2) are revised.

- 30. Paragraphs (f)(5)(ii)(K) and (L) are added.
- 31. Paragraph (f)(5)(iii)(A) is revised.
- 32. The last sentence of paragraph (f)(5)(iii)(B) is revised.
- 33. Paragraphs (f)(5)(iii)(C) and (D) are added.
- 34. Paragraph (f)(5)(v) is redesignated as paragraph (f)(5)(vi) and newly designated paragraph (f)(5)(vi) is amended by revising paragraph (i) in *Examples 1, 3, 4, and 5*, and by adding new *Example 6*.
- 35. New paragraph (f)(5)(v) is added.
- 36. Paragraphs (f)(10) and (11) are added.
- 37. Paragraph (g)(1) is revised.
- 38. The last sentence in paragraph (g)(3)(ii) is removed.
- 39. Paragraphs (g)(5) and (6) are added.

The additions and revisions read as follows:

**§ 1.168(k)-1 Additional first year depreciation deduction.**

(a) \* \* \*

(2) \* \* \*

(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).

(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) \* \* \*

(ii) \* \* \*

(A) \* \* \*

(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) \* \* \*

(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*. \* \* \*

(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.

\* \* \*  
(v) \* \* \*

*Example 4.* \* \* \* On June 1, 2003, G sells to I, an unrelated party to G, the remaining unsold 3/8 fractional interests in the aircraft.

*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) \* \* \*  
(i) \* \* \*

(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) \* \* \*

(A) \* \* \* 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) \* \* \* 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.

\* \* \* \* \*

(D) \* \* \* 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.

\* \* \* \* \*

(iii) \* \* \*

(A) \* \* \* 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).

\* \* \* \* \*

(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).

\* \* \* \* \*

(v) \* \* \*

*Example 10.* \* \* \* 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. \* \* \*

*Example 11.* \* \* \* 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 (Pub. L. 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.* \* \* \*

(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.

(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.

\* \* \* \* \*

(d) \* \* \*  
(1) \* \* \* (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.

\* \* \* \* \*

(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.

\* \* \* \* \*

(e) \* \* \*

(1) \* \* \*

(ii) \* \* \*

(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.

\* \* \* \* \*

(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) \* \* \*

(1) \* \* \*

(i) \* \* \* 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.

\* \* \* \* \*

(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 (Pub. L. 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:

\* \* \* \* \*

(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):

\* \* \* \* \*

(iv) \* \* \*

*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).

\* \* \* \* \*

(5) \* \* \* (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 (Pub. L. 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) \* \* \*

(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.

\* \* \* \* \*

(J) \* \* \*

(2) Any portion of the basis the taxpayer properly elects to treat as an expense under section 179 or section 179C;

\* \* \* \* \*

(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) \* \* \* (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 (Pub. L. 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) \* \* \* 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.

\* \* \* \* \*

(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 (Pub. L. 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 (Pub. L. 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)-6T(b)(7)) and the excess basis (as defined in § 1.168(i)-6T(b)(8)) of the acquired MACRS property and begins to depreciate the depreciable exchanged basis (as defined in § 1.168(i)-6T(b)(9)) of the acquired MACRS property in accordance with § 1.168(i)-6T(c). The depreciable excess basis (as defined in § 1.168(i)-6T(b)(10)) of the acquired MACRS property continues to be depreciated by the taxpayer in accordance with the first sentence of this paragraph. 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)-6T(k)(2)(i), EE decided to apply § 1.168(i)-6T to the involuntary conversion of Canopy V1 with the replacement of Canopy W1, the acquired MACRS property.

\* \* \* \* \*

*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)-6T(k)(2)(i), FF decided to apply § 1.168(i)-6T to the exchange of Computer X2 for Computer Y2, the acquired MACRS property.

\* \* \* \* \*

*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)-6T(k)(2)(i), GG decided to apply § 1.168(i)-6T to the exchange of Equipment X3 for Equipment Y3, the acquired MACRS property.

\* \* \* \* \*

*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)(iii) of this section and § 1.168(i)-6T(k)(2)(i), GG decided to apply § 1.168(i)-6T to the exchange of Equipment Y3 for Equipment Z3, the acquired MACRS property.

\* \* \* \* \*

*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.

\* \* \* \* \*

(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) \* \* \*

(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.

\* \* \* \* \*

(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.

■ **Par. 10.** Section 1.169-3 is amended by revising paragraphs (a), (b)(2), and (g) to read as follows:

**§ 1.169-3 Amortizable basis.**

(a) *In general.* The amortizable basis of a certified pollution control facility for the purpose of computing the amortization deduction under section 169 is the adjusted basis of the facility for purposes of determining gain (see part II (section 1011 and following), subchapter O, chapter 1 of the Internal Revenue Code), in conjunction with paragraphs (b), (c), and (d) of this section. The adjusted basis for purposes of determining gain (computed without regard to paragraphs (b), (c), and (d) of this section) of a facility that performs a function in addition to pollution control, or that is used in connection with more than one plant or other property, or both, is determined under § 1.169-2(a)(3). For rules as to additions and improvements to such a facility, see paragraph (f) of this section. Before computing the amortization deduction allowable under section 169, the adjusted basis for purposes of determining gain for a facility that is placed in service by a taxpayer after September 10, 2001, and that is qualified property under section 168(k)(2) or § 1.168(k)-1, 50-percent bonus depreciation property under section 168(k)(4) or § 1.168(k)-1, or qualified New York Liberty Zone property under section 1400L(b) or § 1.1400L(b)-1 must be reduced by the amount of the additional first year

depreciation deduction allowed or allowable, whichever is greater, under section 168(k) or section 1400L(b), as applicable, for the facility.

(b) \* \* \*

(2) If the taxpayer elects to begin the 60-month amortization period with the first month of the taxable year succeeding the taxable year in which the facility is completed or acquired and a depreciation deduction is allowable under section 167 (including an additional first-year depreciation allowance under former section 179; for a facility that is acquired by the taxpayer after September 10, 2001, and that is qualified property under section 168(k)(2) or § 1.168(k)-1 or qualified New York Liberty Zone property under section 1400L(b) or § 1.1400L(b)-1, the additional first year depreciation deduction under section 168(k)(1) or 1400L(b), as applicable; and for a facility that is acquired by the taxpayer after May 5, 2003, and that is 50-percent bonus depreciation property under section 168(k)(4) or § 1.168(k)-1, the additional first year depreciation deduction under section 168(k)(4)) with respect to the facility for the taxable year in which it is completed or acquired, the amount determined under paragraph (b)(1) of this section shall be reduced by an amount equal to the amount of the depreciation deduction allowed or allowable, whichever is greater, multiplied by a fraction the numerator of which is the amount determined under paragraph (b)(1) of this section, and the denominator of which is the facility's total cost. The additional first-year allowance for depreciation under former section 179 will be allowable only for the taxable year in which the facility is completed or acquired and only if the taxpayer elects to begin the amortization deduction under section 169 with the taxable year succeeding the taxable year in which such facility is completed or acquired. For a facility that is acquired by a taxpayer after September 10, 2001, and that is qualified property under section 168(k)(2) or § 1.168(k)-1 or qualified New York Liberty Zone property under section 1400L(b) or § 1.1400L(b)-1, see § 1.168(k)-1(f)(4) or § 1.1400L(b)-1(f)(4), as applicable, with respect to when the additional first year depreciation deduction under section 168(k)(1) or 1400L(b) is allowable. For a facility that is acquired by a taxpayer after May 5, 2003, and that is 50-percent bonus depreciation property under section 168(k)(4) or § 1.168(k)-1, see § 1.168(k)-1(f)(4) with respect to when the additional first year depreciation

deduction under section 168(k)(4) is allowable.

\* \* \* \* \*

(g) *Effective date for qualified property, 50-percent bonus depreciation property, and qualified New York Liberty Zone property.* This section applies to a certified pollution control facility. This section also applies to a certified pollution control facility that is qualified property under section 168(k)(2) or qualified New York Liberty Zone property under section 1400L(b) acquired by a taxpayer after September 10, 2001, and to a certified pollution control facility that is 50-percent bonus depreciation property under section 168(k)(4) acquired by a taxpayer after May 5, 2003.

**§ 1.169-3T [Removed]**

■ **Par. 11.** Section 1.169-3T is removed.

■ **Par. 12.** Section 1.312-15 is amended by adding a new sentence at the end of paragraph (a)(1) to read as follows:

**§ 1.312-15 Effect of depreciation on earnings and profits.**

(a) \* \* \* (1) \* \* \* See § 1.168(k)-1(f)(7) with respect to the treatment of the additional first year depreciation deduction allowable under section 168(k) for qualified property or 50-percent bonus depreciation property, and § 1.1400L(b)-1(f)(7) with respect to the treatment of the additional first year depreciation deduction allowable under section 1400L(b) for qualified New York Liberty Zone property, for purposes of computing the earnings and profits of a corporation.

\* \* \* \* \*

■ **Par. 13.** Section 1.1400L(b)-1T is redesignated as § 1.1400L(b)-1 and newly designated § 1.1400L(b)-1 is amended as follows:

■ 1. The word “(temporary)” is removed from the section heading.

■ 2. Paragraph (b) is amended by removing the language “§ 1.168(k)-1T(a)(2)” and adding “§ 1.168(k)-1(a)(2)” in its place.

■ 3. Paragraph (b)(4) is revised.

■ 4. Paragraph (c)(1) is revised.

■ 5. Paragraph (c)(2)(i)(A) is amended by removing the language “§ 1.168(k)-1T(b)(2)(i)” and adding “§ 1.168(k)-1(b)(2)(i)” in its place.

■ 6. Paragraph (c)(2)(ii) is revised.

■ 7. Paragraph (c)(4) is amended by removing the language “§ 1.168(k)-1T(b)(3)” and adding “§ 1.168(k)-1(b)(3)” in its place.

■ 8. Paragraph (c)(5)(i) is amended by removing the language “§ 1.168(k)-1T(b)(4)(ii)” and adding “§ 1.168(k)-1(b)(4)(ii) in its place, removing the language “§ 1.168(k)-1T(b)(4)(iii)” and

adding “§ 1.168(k)-1(b)(4)(iii) in its place, and removing the language “§ 1.168(k)-1T(b)(4)(iv)” and adding “§ 1.168(k)-1(b)(4)(iv)” in its place.

■ 9. Paragraph (c)(5)(ii) is amended by removing the language “§ 1.168(k)-1T(f)(1)(ii)” and adding “§ 1.168(k)-1(f)(1)(ii)” in its place, and removing the language “§ 1.168(k)-1T(f)(1)(iii)” and adding “§ 1.168(k)-1(f)(1)(iii)” in its place.

■ 10. Paragraph (c)(6) is amended by removing the language “§ 1.168(k)-1T(b)(5)(ii)” and adding “§ 1.168(k)-1(b)(5)(ii)” in its place, removing the language “§ 1.168(k)-1T(b)(5)(iii)” and adding “§ 1.168(k)-1(b)(5)(iii)” in its place, and removing the language “§ 1.168(k)-1T(b)(5)(iv)” and adding “§ 1.168(k)-1(b)(5)(iv)” in its place.

■ 11. Paragraph (d) is amended by removing the language “§ 1.168(k)-1T(d)(1)(i)” and adding “§ 1.168(k)-1(d)(1)(i)” in its place.

■ 12. Paragraphs (e)(6) and (e)(7) are added.

■ 13. Paragraph (f)(1) is amended by removing the language “§ 1.168(k)-1T(f)(1)” and adding “§ 1.168(k)-1(f)(1)” in its place.

■ 14. Paragraph (f)(2) is amended by removing the language “§ 1.168(k)-1T(a)(2)(iii)” and adding “§ 1.168(k)-1(a)(2)(iii)” in its place, and removing the language “§ 1.168(k)-1T(f)(2)” and adding “§ 1.168(k)-1(f)(2)” in its place.

■ 15. Paragraph (f)(3) is amended by removing the language “§ 1.168(k)-1T(f)(3)” and adding “§ 1.168(k)-1(f)(3)” in its place.

■ 16. Paragraph (f)(4) is amended by removing the language “§ 1.168(k)-1T(f)(4)” and adding “§ 1.168(k)-1(f)(4)” in its place.

■ 17. Paragraph (f)(5) is amended by removing the language “§ 1.168(k)-1T(f)(5)(ii)(A)” and adding “§ 1.168(k)-1(f)(5)(ii)(A)” in its place, removing the language “§ 1.168(k)-1T(f)(5)(ii)(C)” and adding “§ 1.168(k)-1(f)(5)(ii)(C)” in its place, and removing the language “§ 1.168(k)-1T(f)(5)” and adding “§ 1.168(k)-1(f)(5)” in its place.

■ 18. Paragraph (f)(6) is amended by removing the language “§ 1.168(k)-1T(f)(6)” and adding “§ 1.168(k)-1(f)(6)” in its place.

■ 19. Paragraph (f)(7) is amended by removing the language “§ 1.168(k)-1T(f)(7)” and adding “§ 1.168(k)-1(f)(7)” in its place.

■ 20. Paragraph (f)(8) is amended by removing the language “§ 1.168(k)-1T(f)(9)” and adding “§ 1.168(k)-1(f)(9)” in its place.

■ 21. Paragraphs (f)(9) and (10) are added.

■ 22. Paragraph (g)(1) is revised.

■ 23. Paragraphs (g)(4)(iii), (g)(5), and (g)(6) are added.

The additions and revisions read as follows:

**§ 1.1400L(b)-1 Additional first year depreciation deduction for qualified New York Liberty Zone property.**

\* \* \* \* \*

(b) \* \* \*

(4) *Real property* is a building or its structural components, or other tangible real property.

(c) *Qualified New York Liberty Zone property*—(1) *In general.* Qualified New York Liberty Zone 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 § 1.1400L(b)-1(c)(2) (description of property);

(ii) The requirements in § 1.1400L(b)-1(c)(3) (substantial use);

(iii) The requirements in § 1.1400L(b)-1(c)(4) (original use);

(iv) The requirements in § 1.1400L(b)-1(c)(5) (acquisition of property by purchase); and

(v) The requirements in § 1.1400L(b)-1(c)(6) (placed-in-service date).

(2) \* \* \*

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

Depreciable property will not meet the requirements of this paragraph (c)(2) if—

(A) Section 168(k) or § 1.168(k)-1 applies to the property;

(B) The property is described in section 168(f);

(C) The property is 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) has made an election under section 263A(d)(3), or property described in section 280F(b)(1));

(D) The property is included in any class of property for which the taxpayer elects not to deduct the additional first year depreciation under paragraph (e) of this section; or

(E) The property is qualified New York Liberty Zone leasehold improvement property as described in section 1400L(c)(2).

\* \* \* \* \*

(e) \* \* \*

(6) *Alternative minimum tax.* If a taxpayer makes an election under this paragraph (e) for a class of property, the depreciation adjustments under section

56 and the regulations under section 56 apply to the property to which the 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 under this paragraph (e), 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 under this paragraph (e) 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) \* \* \*

(9) *Coordination with section 47.* Rules similar to those provided in § 1.168(k)-1(f)(10) apply for purposes of this paragraph (f)(9).

(10) *Coordination with section 514(a)(3).* Rules similar to those provided in § 1.168(k)-1(f)(11) apply for purposes of this paragraph (f)(10).

(g) \* \* \*

(1) *In general.* Except as provided in paragraphs (g)(2), (3), and (5) of this section, this section applies to qualified New York Liberty Zone property acquired by a taxpayer after September 10, 2001.

\* \* \* \* \*

(4) \* \* \*

(iii) *Revisions made in paragraphs (b)(4) and (c)(2)(ii) of this section.* If a taxpayer did not claim on a Federal tax return for a taxable year ending on or after September 11, 2001, and on or before September 1, 2006, any additional first year depreciation deduction for qualified New York Liberty Zone property because of the application of § 1.1400L(b)-1T(b)(4) or because the taxpayer made an election under § 1.168(k)-1T(e)(1) for a class of property that included such qualified New York Liberty Zone property, the taxpayer may claim the additional first year depreciation deduction for such

qualified New York Liberty Zone property under this section in accordance with the applicable administrative procedures issued under § 1.446-1(e)(3)(ii) for obtaining the Commissioner's consent to a change in method of accounting. Section 481(a) applies to a request to claim the additional first year depreciation deduction for such qualified New York Liberty Zone property under this paragraph (g)(4)(iii).

(5) *Revision to paragraphs (b)(4) and (b)(6)*. 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 § 1.168(k)-1(b)(3)(iii)(B) and § 1.168(k)-1(b)(5)(ii)(B) applies to property sold after June 4, 2004, for purposes of paragraphs (b)(4) and (b)(6) of this section.

(6) *Rehabilitation credit*. If a taxpayer did not claim on a Federal tax return for a 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 New York Liberty Zone property, and the taxpayer did not make the election specified in paragraph (e)(1) 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 § 1.168(k)-1(f)(10)(i)(B)) 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)(9) 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.

**Steven T. Miller,**

*Acting Deputy Commissioner for Services and Enforcement.*

Approved: August 25, 2006.

**Eric Solomon,**

*Acting Deputy Assistant Secretary of the Treasury (Tax Policy).*

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## DEPARTMENT OF JUSTICE

### Bureau of Prisons

#### 28 CFR Part 503

[BOP-1136-F]

RIN 1120-AB36

#### **Bureau of Prisons Central Office, Regional Offices, Institutions, and Staff Training Centers: Removal of Addresses From Rules**

**AGENCY:** Bureau of Prisons, Justice.

**ACTION:** Final rule.

**SUMMARY:** In this document, the Bureau of Prisons (Bureau) finalizes the removal of rules listing the addresses of Bureau facilities in each of its regions. We have replaced these rules with a short description of the Bureau's structure, the address of the Bureau's Central Office, and a reference to the Bureau's internet address containing current and frequently updated contact information on Bureau facilities and Regional Offices. This change enables the Bureau to more quickly and accurately provide updated contact information to members of the public, in light of frequently changing circumstances.

**DATES:** This rule is effective October 2, 2006.

**FOR FURTHER INFORMATION CONTACT:** Sarah Qureshi, Office of General Counsel, Bureau of Prisons, phone (202) 307-2105.

**SUPPLEMENTARY INFORMATION:** In this document, the Bureau of Prisons (Bureau) finalizes the removal of rules listing the addresses of Bureau facilities in each of its regions. We have replaced these rules with a short description of the Bureau's structure, the address of the Bureau's Central Office, and a reference to the Bureau's Web site containing current and frequently updated contact information on Bureau facilities and Regional Offices.

This rule was published as an interim final rule on November 4, 2005 (70 FR 67090). No comments were received

during the comment period. We therefore finalized the interim final rule without change.

### **Administrative Procedure Act**

The Administrative Procedure Act (5 U.S.C. 553(b)(3)(B)) allows exceptions to notice-and-comment rulemaking "when the agency for good cause finds \* \* \* that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest." Further, § 553(d) provides an exception to the usual requirement of a delayed effective date when an agency finds "good cause" that the rule be made immediately effective.

This rulemaking is exempt from normal notice-and-comment procedures because advance notice and public comment in this instance is unnecessary. This is an administrative rule insignificant in impact and inconsequential to the public. The rule merely eliminates a long list of non-current addresses and replaces them with a reference to a publicly accessible and more accurate source. This rulemaking makes no change to any rights or responsibilities of the agency or any regulated entities. For the same reasons, the Bureau finds that "good cause" exists to make this rule effective upon publication. Nevertheless, the Bureau did invite public comment on this interim rule, and no comments were received.

### **Executive Order 12866**

This rule falls within a category of actions that the Office of Management and Budget (OMB) has determined not to constitute "significant regulatory actions" under section 3(f) of Executive Order 12866 and, accordingly, it was not reviewed by OMB.

### **Executive Order 13132**

This regulation will not have substantial direct effects on the States, on the relationship between the national government and the States, or on distribution of power and responsibilities among the various levels of government. Therefore, under Executive Order 13132, we determine that this rule does not have sufficient federalism implications to warrant the preparation of a Federalism Assessment.

### **Regulatory Flexibility Act**

The Director of the Bureau of Prisons, under the Regulatory Flexibility Act (5 U.S.C. 605(b)), reviewed this regulation and by approving it certifies that it will not have a significant economic impact upon a substantial number of small entities for the following reasons: This rule pertains to the correctional