

amount computed by using the straight line method shall be determined under § 1.167(b)-1 without regard to this section.

(ii) *Examples.* The principles of this subparagraph may be illustrated by the following example:

*Example.* (a) Corporation X places a new asset in service to which it elects to apply this section. The cost of the asset is \$200,000 and the estimated salvage value is zero. The taxpayer selects 9 years from the applicable asset depreciation range of 8 to 12 years. Corporation X adopts the double declining balance method of depreciation and thus the rate of depreciation is 22.2 percent (twice the applicable straight line rate). The depreciation allowance in the first year would be \$44,400, that is, 22.2 percent of \$200,000.

(b) Assume that the provisions of section 57(a)(3) apply to the property. The amount of the tax preference would be \$22,200, that is, the excess of the depreciation allowed under this section (\$44,400) over the depreciation which would have been allowable if the taxpayer had used the period selected from the asset depreciation range and the straight line rate (\$22,200).

(Secs. 167(m), 85 Stat. 508 (26 U.S.C. 167(m) and 7805, 68A Stat. 917, (26 U.S.C. 7805))

[T.D. 7272, 38 FR 9967, Apr. 23, 1973]

EDITORIAL NOTE: For FEDERAL REGISTER citations affecting § 1.167(a)-11, see the List of CFR Sections Affected, which appears in the Finding Aids section of the printed volume and on GPO Access.

**§ 1.167(a)-12 Depreciation based on class lives for property first placed in service before January 1, 1971.**

(a) *In general*—(1) *Summary.* This section provides an elective class life system for determining the reasonable allowance for depreciation of certain classes of assets for taxable years ending after December 31, 1970. The system applies only to assets placed in service before January 1, 1971. Depreciation for such assets during periods prior to January 1, 1971, may have been determined in accordance with Revenue Procedure 62-21. Accordingly, rules are provided which permit taxpayers to apply the system in taxable years ending after December 31, 1970, to such assets without the necessity of changing or regrouping their depreciation accounts other than as previously required by Revenue Procedure 62-21. The system is designed to minimize disputes between taxpayers and the Internal Revenue

Service as to the useful life of assets, salvage value, and repairs. See § 1.167(a)-11 for a similar system for property placed in service after December 31, 1970. See paragraph (d)(2) of § 1.167(a)-11 for treatment of expenditures for the repair, maintenance, rehabilitation or improvement of certain property. The system provided by this section is optional with the taxpayer. An election under this section applies only to qualified property in an asset guideline class for which an election is made and only for the taxable year of election. The taxpayer's election is made with the income tax return for the taxable year. This section also revokes the reserve ratio test for taxable years ending after December 31, 1970, and provides transitional rules for taxpayers who after January 11, 1971, adopt Revenue Procedure 62-21 for a taxable year ending prior to January 1, 1971.

(2) *Revocation of reserve ratio test and other matters.* Except as otherwise expressly provided in this section and in paragraph (b)(5)(vi) of § 1.167(a)-11, the provisions of Revenue Procedure 62-21 shall not apply to any property for any taxable year ending after December 31, 1970, whether or not the taxpayer elects to apply this section to any property. See paragraph (f) of this section for rules for the adoption of Revenue Procedure 62-21 for taxable years ending prior to January 1, 1971.

(3) *Definition of qualified property.* The term "qualified property" means tangible property which is subject to the allowance for depreciation provided by section 167(a), but only if—

(i) An asset guideline class and asset guideline period are in effect for such property for the taxable year, and

(ii) The property is first placed in service by the taxpayer before January 1, 1971,

(iii) The property is placed in service before January 1, 1971, but first placed in service by the taxpayer after December 31, 1970, and is not includible in an election under § 1.167(a)-11 by reason of § 1.167(a)-11(b)(7) (property acquired as a result of a mere change in form) or § 1.167(a)-11(e)(3)(i) (certain property acquired in a transaction to which section 381(a) applies), or

(iv) The property is acquired and first placed in service by the taxpayer after December 31, 1970, pursuant to a binding written contract entered into prior to January 1, 1971, and is excluded in accordance with paragraph (b)(5)(iv) of § 1.167(a)-11 from an election to apply § 1.167(a)-11.

The provisions of paragraph (e)(1) of § 1.167(a)-11 apply in determining whether property is first placed in service before January 1, 1971. See subparagraph (4)(ii) of this paragraph for special rules for the exclusion of property from the definition of qualified property.

(4) *Requirements of election*—(i) *In general.* An election to apply this section to qualified property must be made within the time and in the manner specified in paragraph (e) of this section. The election must specify that the taxpayer consents to and agrees to apply all the provisions of this section. The election may be made separately for each asset guideline class. Thus, a taxpayer may for the taxable year elect to apply this section to one, more than one, or all asset guideline classes in which he has qualified property. An election to apply this section for a taxable year must include all qualified property in the asset guideline class for which the election is made.

(ii) *Special rules for exclusion of property from application of this section.* (a) If for the taxable year of election, the taxpayer computes depreciation under section 167(k) or computes amortization under sections 169, 185, 187, 188, or paragraph (b) of § 1.162-11 with respect to property, such property is not qualified property for such taxable year. If for the taxable year of election, the taxpayer computes depreciation under any method of depreciation (other than a method described in the preceding sentence) not permitted by subparagraph (5)(v) of this paragraph for any property in an asset guideline class (other than subsidiary assets excluded from an election under (b) of this subdivision), no property in such asset guideline class is qualified property for such taxable year.

(b) The taxpayer may exclude from an election to apply this section all (but not less than all) subsidiary assets. Subsidiary assets so excluded are

not qualified property for such taxable year. For purposes of this subdivision the term “subsidiary assets” includes jigs, dies, molds, returnable containers, glassware, silverware, textile mill cam assemblies, and other equipment includable in Group One, Class 5, of Revenue Procedure 62-21 which is usually and properly accounted for separately from other property and under a method of depreciation not expressed in terms of years.

(iii) *Special rule for certain public utility property.* (a) In the case of public utility property described in section 167(1)(3)(A)(iii) for which no guideline life was prescribed in Revenue Procedure 62-21 (or for which reference was made in Revenue Procedure 62-21 to lives or rates established by governmental regulatory agencies) of a taxpayer which—

(1) Is entitled to use a method of depreciation other than a “subsection (1) method” of depreciation (as defined in section 167(1)(3)(F)) only if it uses the “normalization method of accounting” (as defined in section 167(1)(3)(G)) with respect to such property, or

(2) Is entitled for the taxable year to use only a “subsection (1) method” of depreciation,

such property shall be qualified property (as defined in subparagraph (3) of this paragraph) only if the taxpayer normalizes the tax deferral resulting from the election to apply this section.

(b) The taxpayer will be considered to normalize the tax deferral resulting from the election to apply this section only if it computes its tax expense for purposes of establishing its cost of service for ratemaking purposes and for reflecting operating results in its regulated books of account using a period for depreciation no less than the period used for computing its depreciation expense for ratemaking purposes and for reflecting operating results in its regulated books of account for the taxable year, and the taxpayer makes adjustments to a reserve to reflect the deferral of taxes resulting from the use of a period for depreciation under section 167 in accordance with an election to apply this section different from the period used for computing its depreciation expense for ratemaking purposes and for reflecting operating results in

its regulated books of account for the taxable year. A determination whether the taxpayer is considered to normalize under this subdivision the tax deferral resulting from the election to apply this section shall be made in a manner consistent with the principles for determining whether a taxpayer is using the "normalization method of accounting" (within the meaning of section 167(l)(3)(G)). See § 1.167(l)-1(h).

(c) If a taxpayer, which has elected to apply this section to any qualified public utility property and is required under (a) of this subdivision to normalize the tax deferral resulting from the election to apply this section to such property, fails to normalize such tax deferral, the election to apply this section to such property shall terminate as of the beginning of the taxable year for which the taxpayer fails to normalize such tax deferral. Application of this section to such property for any period prior to the termination date will not be affected by this termination.

(5) *Determination of reasonable allowance for depreciation*—(i) *In general*. The allowance for depreciation of qualified property to which the taxpayer elects to apply this section shall be determined in accordance with this section. The annual allowance for depreciation is determined by using the method of depreciation adopted by the taxpayer and a rate based upon a life permitted by this section. In the case of the straight-line method of depreciation, the rate of depreciation shall be based upon the class life (or individual life if the taxpayer assigns individual depreciable lives in accordance with subdivision (iii) of this subparagraph) used by the taxpayer with respect to the assets in the asset guideline class. Such rate will be applied to the unadjusted basis of the asset guideline class (individual assets or depreciation accounts if the taxpayer assigns individual depreciable lives). In the case of the sum of the years-digits method of depreciation, the rate of depreciation will be determined based upon the remaining life of the class (or individual remaining lives if the taxpayer assigns such lives in accordance with subdivision (iii) of this subparagraph) and is applied to the adjusted basis of the class (or individual

accounts or assets) as of the beginning of the taxable year of election. The remaining life of a depreciation account is determined by dividing the unrecovered cost or other basis of the account, as computed by straight-line depreciation, by the gross cost or unadjusted basis of the account, and multiplying the result by the class life used with respect to the account. In the case of the declining balance method of depreciation, the rate of depreciation for the asset guideline class shall be based upon the class life (or individual life if the taxpayer assigns such lives in accordance with subdivision (iii) of this subparagraph). Such rate is applied to the adjusted basis of the class (or individual accounts or assets) as of the beginning of the taxable year of election.

(ii) *Reasonable allowance by reference to class lives*. The amount of depreciation for all qualified property in an asset guideline class to which the taxpayer elects to apply this section will constitute the reasonable allowance provided by section 167(a) and the depreciation for the asset guideline class will not be adjusted if—

(a) The taxpayer's qualified property is accounted for in one or more depreciation accounts which conform to the asset guideline class, and the depreciation for each such account is determined by using a rate based upon a life not less than the class life, or

(b) The taxpayer's qualified property is accounted for in one or more depreciation accounts (whether or not conforming to the asset guideline class) for which depreciation is determined at a rate based upon the taxpayer's estimate of the lives of the assets (instead of the class life) and the total amount of depreciation so determined for the asset guideline class for the taxable year of election is not more than would be permitted under (a) of this subdivision for such year using the method of depreciation adopted by the taxpayer for the property.

See subdivision (vii) of this subparagraph for determination of reasonable allowance if depreciation exceeds the amount permitted by this subdivision. See paragraph (b) of this section for rules regarding the determination of "class life". For rules for regrouping

depreciation accounts to conform to the asset guideline class, see subdivision (iv) of this subparagraph.

(iii) *Consistency when individual lives are used.* If the taxpayer assigns individual depreciable lives to assets in accordance with subdivision (ii) (b) of this subparagraph, even though the total amount of depreciation for the asset guideline class will not be adjusted, the lives assigned to the various assets in the asset guideline class must be reasonably in proportion to their relative expected periods of use in the taxpayer's business. Thus, although the taxpayer who uses individual asset lives normally has latitude in thereby allocating the depreciation for the asset guideline class among the assets, if the lives are grossly disproportionate (as where a short life is assigned to one asset and a long life to another even though the expected periods of use are the same), the taxpayer's allocation of depreciation to particular assets or depreciation accounts may be adjusted. For example, the taxpayer's allocation may be adjusted for purposes of determining adjusted basis under section 1016(a) or in allocating depreciation to the 50-percent limitation on percentage depletion provided by section 613(a). See paragraph (d) of this section for rules regarding the use of individual asset lives for purposes of classifying retirements as normal or abnormal.

(iv) *Regrouping depreciation accounts.* Without the consent of the Commissioner, the taxpayer may for any taxable year for which he elects to apply this section to an asset guideline class, regroup his accounts for that and all succeeding taxable years to conform to the asset guideline class. Other changes in accounting, including a change from item accounts to multiple-asset accounting, may be made with the consent of the Commissioner. No depreciation accounts for which the straight line or sum of the years-digits method of depreciation is adopted may be combined under this section which would not be permitted to be combined under part III of Revenue Procedure 65-13, as in effect on January 1, 1971. Accordingly, whether or not the taxpayer adopted the guideline system of Revenue Procedure 62-21 for a taxable year to which part III of Revenue Procedure

65-13 is applicable, the depreciation allowance for any taxable year of election under this section may not exceed that amount which would have been allowed for such year if the taxpayer had used item accounts or year of acquisition accounts. Thus, for example, if a calendar year taxpayer acquired a \$90 asset on the first day of each year from 1966 through 1970, placed such assets in a single multiple asset account, adopted the sum of the years-digits method of depreciation and used a 5-year depreciable life for such assets, and in 1971 uses the 5-year class life determined under paragraph (b) of this section, the depreciation allowance for such assets in 1971 under this section may not exceed \$60, that is, the amount which would be allowed if the taxpayer had used year of acquisition accounts for the assets for the years 1966 through 1970.

For purposes of this subparagraph, a taxpayer's depreciation accounts conform to the asset guideline class if each depreciation account includes only assets of the same asset guideline class.

(v) *Method of depreciation.* The same method of depreciation must be applied to all property in a single depreciation account. The method of depreciation is subject to the limitations of section 167 (c), (j), and (l). Except as otherwise provided in this subdivision, the taxpayer must apply a method of depreciation described in section 167(b) (1), (2), or (3) for qualified property to which the taxpayer elects to apply this section. A method of depreciation permitted under section 167(b)(4) may be used under this section if the method was used by the taxpayer with respect to the property for his last taxable year ending before January 1, 1971, the method is expressed in terms of years, the taxpayer establishes to the satisfaction of the Commissioner that the method is both a reasonable and consistent method, and if the taxpayer applies paragraph (b)(2) of this section (relating to class lives in special situations) to determine a classlife, that the method of determining such class life is consistent with the principles of Revenue Procedure 62-21 as applied to

such a method. If the taxpayer has applied a method of depreciation with respect to the property which is not described in section 167(b) (1), (2), (3), or (4) (as permitted under the preceding sentence), he must change under this section to a method of depreciation described in section 167(b) (1), (2), or (3) for the first taxable year for which an election is made under this section. Other changes in depreciation method may be made with the consent of the Commissioner (see sec. 446 and the regulations thereunder). (See also sec. 167(e).)

(vi) *Salvage value.* In applying the method of depreciation adopted by the taxpayer, the annual allowance for depreciation is determined without adjustment for the salvage value of the property, except that no depreciation account may be depreciated below a reasonable salvage value for the account. See paragraph (c) of this section for definition and treatment of salvage value.

(vii) *Reasonable allowance when depreciation exceeds amount based on class life.* In the event that the total amount of depreciation claimed by the taxpayer on his income tax return, in a claim for refund, or otherwise, for an asset guideline class with respect to which an election is made under this section for the taxable year, exceeds the maximum amount permitted under subdivision (ii)(a) of this subparagraph—

(a) If the excess is established to the satisfaction of the Commissioner to be the result of a good faith mistake by the taxpayer in determining the maximum amount permitted under subdivision (ii) (a) of this subparagraph, the taxpayer's election to apply this section will be treated as valid and only such excess will be disallowed, and

(b) In all other cases, the taxpayer's election to apply this section to the asset guideline class for the taxable year is invalid and the reasonable allowance for depreciation will be determined without regard to this section. (See § 1.167(a)-1 (b) for rules regarding the estimated useful life of property.)

(b) *Determination of class lives—(1) Class lives in general.* The class life determined under this paragraph (with-out regard to any range or variance permitted with respect to class lives

under § 1.167(a)-11) will be applied for purposes of determining whether the allowance for depreciation for qualified property included in an election under this section is subject to adjustment. The taxpayer is not required to use the class life determined under this paragraph for purposes of determining the allowance for depreciation. Except as provided in subparagraph (2) of this paragraph, the class life of qualified property to which the taxpayer elects to apply this section is the shorter of—

(i) The asset guideline period for the asset guideline class as set forth in Revenue Procedure 72-10 as in effect on March 1, 1972 (applied without regard to any special provision therein with respect to property predominantly used outside the United States), or

(ii) The asset guideline period for the asset guideline class as set forth in any supplement or revision of Revenue Procedure 72-10, but only if and to the extent by express reference in such supplement or revision made applicable for the purpose of changing the asset guideline period or classification of qualified property to which this section applies.

See paragraph (e)(3)(iii) of this section for requirement that the election for the taxable year specify the class life for each asset guideline class. Generally, the applicable asset guideline class and asset guideline period for qualified property to which the taxpayer has elected to apply this section will not be changed for the taxable year of election to reflect any supplement or revision thereof after the taxable year. However, if expressly provided in such a supplement or revision, the taxpayer may, at his option in the manner specified therein, apply the revised or supplemented asset guideline classes or periods to such property for such taxable year and succeeding taxable years. The principles of this subparagraph may be illustrated by the following example:

*Example.* (i) Corporation X, a calendar year taxpayer, has assets in asset guideline class 20.4 of Revenue Procedure 72-10 which were placed in service by corporation X in 1967, 1968, and 1970. Corporation X also has assets in asset guideline class 22.1 of Revenue Procedure 72-10 which were placed in service at various times prior to 1971. Corporation X has no other qualified property. Corporation

X elects to apply this section for 1971 to both classes. Assume that the class lives are determined under this subparagraph and not under subparagraph (2) of this paragraph.

(ii) The class lives for asset guideline classes 20.4 and 22.1 are their respective asset guideline periods of 12 years and 9 years in Revenue Procedure 72-10.

(iii) Accordingly, in the election for the taxable year, in accordance with paragraph (e)(3)(iii) of this section, corporation X specifies a class life of 12 years for asset guideline class 20.4 and a class life of 9 years for asset guideline class 22.1

(2) *Class lives in special situations.* Notwithstanding subparagraph (1) of this paragraph, for the purposes of this section the class life for the asset guideline class determined under this subparagraph shall be used if such class life is shorter than the class life determined under subparagraph (1) of this paragraph. If property described in paragraph (a)(2)(iii) of this section in an asset guideline class is acquired by the taxpayer in a transaction to which section 381(a) applies, for purposes of this subparagraph such property shall be segregated from other property in the class and treated as in a separate asset guideline class, and the class life for that asset guideline class under this subparagraph shall be the shortest class life the transferor was entitled to use under this section for such property on the date of such transfer. In all other cases, the class life for the asset guideline class for purposes of this subparagraph shall be the shortest class life (within the meaning of sec. 4, part II, of Revenue Procedure 62-21) which can be justified by application of secs. 3.02(a), 3.03(a), or 3.05, part II, of Revenue Procedure 62-21 (other than the portion of such sec. 3.05 dealing with justification of a class life by reference to facts and circumstances) for the taxpayer's last taxable year ending prior to January 1, 1971.

A class life justified by application of section 3.03(a), Part II, of Revenue Procedure 62-21 shall not be shorter than can be justified under the Adjustment Table for Class Lives in Part III of such Revenue Procedure. For purposes of this subparagraph and paragraph (f)(1)(iii) of this section, the reserve ratio test is met only if the taxpayer's reserve ratio does not exceed the upper limit of the appropriate reserve ratio

range or in the alternative during the transitional period there provided does not exceed the appropriate "transitional upper limit" in section 3, Part II, of Revenue Procedure 65-13. References to Revenue Procedure 62-21 include all modifications, amendments, and supplements thereto as of January 1, 1971. The guideline form of the reserve ratio test, as described in Revenue Procedure 65-13, may be applied for purposes of this subparagraph in a manner consistent with the rules contained in section 7, Part II, of Revenue Procedure 65-13 and sections 3.02, 3.03, and 3.05, Part II, of Revenue Procedure 62-21. The principles of this subparagraph may be illustrated by the following examples:

*Example (1).* Corporation X, a calendar year taxpayer, has all its assets in asset guideline class 20.4 of Revenue Procedure 72-10 which were placed in service by corporation X prior to 1971. Corporation X elects to apply this section for 1971. For taxable years 1967 through 1969, corporation X had used a class life (within the meaning of section 4, Part II, of Revenue Procedure 62-21) for asset guideline class 20.4 of 12 years. The asset guideline period in Revenue Procedure 72-10 in effect for 1971 is also 12 years. Assume that for 1969 corporation X's reserve ratio was below the appropriate reserve ratio lower limit. However, corporation X could not justify a class life shorter than the asset guideline period of 12 years for 1970 since corporation X had not used the 12-year class life for a period at least equal to one-half of 12 years. (See section 3.03(a), Part II, of Revenue Procedure 62-21.) Accordingly, the class life for asset guideline class 20.4 in 1971 is the asset guideline period of 12 years in accordance with subparagraph (1) of this paragraph.

*Example (2).* The facts are the same as in example (1) except that corporation X had used a class life of 10 years for guideline class 20.4 since 1967. Corporation X had not used the class life of 10 years for a period at least equal to one-half of 10 years. However, in 1968 corporation X's 10-year class life was accepted on audit by the Internal Revenue Service and corporation X met the reserve ratio test in 1970 for guideline class 20.4 using a test life of 10 years. (See section 3.05, Part II, of Revenue Procedure 62-21.) Accordingly, the class life of 10 years is justified for 1970 and the class life for 1971 is 10 years in accordance with this subparagraph. If the taxpayer's class life had not been audited and accepted for 1968, and in the absence of other circumstances, the taxpayer could not justify a class life shorter than the asset guideline period of 12 years since it had not used the 10-year class life for a period at

least equal to one-half of 10 years. (See section 3.02, Part II, of Revenue Procedure 62-21.)

*Example (3).* Corporation Y, a calendar year taxpayer, has all its assets in asset guideline class 13.3 of Revenue Procedure 72-10 which were placed in service from 1960 through 1970. Corporation Y elects to apply this section for 1971. The asset guideline period in Revenue Procedure 72-10 in effect for 1971 is 16 years. Since 1963 corporation Y had used a class life of 16 years for asset guideline 13.3. At the end of 1969 corporation Y's reserve ratio for guideline class 13.3 was 36 percent. With a growth rate of 8 percent and a test life of 16 years the appropriate reserve ratio lower limit was 37 percent. Corporation Y's reserve ratio of 36 percent was below the lower limit of the appropriate reserve ratio range. Corporation Y had used the 16-year class life for at least eight years. A class life of 13.5 years for 1970 was justified by application of section 3.03(a), Part II, of Revenue Procedure 62-21 and the Adjustment Table for Class Lives in Part III, of Revenue Procedure 62-21. The class life for 1971 is 13.5 years in accordance with this subparagraph.

(3) *Classification of property*—(i) *In general.* Property to which this section applies shall be included in the asset guideline class for the activity in which the property is primarily used in the taxable year of election. See paragraph (d)(5) of this section for rule regarding the classification of leased property.

(ii) *Insubstantial activity.* The provisions of Revenue Procedure 62-21 with respect to classification of assets used in an activity which is insubstantial may be applied under this section.

(iii) *Special rule for certain public utilities.* An electric or gas utility which in accordance with Revenue Procedure 64-21 used a composite guideline class basis for applying Revenue Procedure 62-21 for its last taxable year prior to January 1, 1971, may apply Revenue Procedure 72-10 and this section on the basis of such composite asset guideline class determined as provided in Revenue Procedure 64-21. For the purposes of this section all property in the composite guideline class shall be treated as included in a single asset guideline class.

(c) *Salvage value*—(1) *In general*—(i) *Definition of gross salvage value.* "Gross salvage" value is the amount (determined at or as of the time of acquisition but without regard to the application of Revenue Procedure 62-21) which

is estimated will be realized upon a sale or other disposition of qualified property when it is no longer useful in the taxpayer's trade or business or in the production of his income and is to be retired from service, without reduction for the cost of removal, dismantling, demolition, or similar operations. "Net salvage" is gross salvage reduced by the cost of removal, dismantling, demolition, or similar operations. If a taxpayer customarily sells or otherwise disposes of property at a time when such property is still in good operating condition, the gross salvage value of such property is the amount expected to be realized upon such sale or disposition, and under certain circumstances, as where such property is customarily sold at a time when it is still relatively new, the gross salvage value may constitute a relatively large proportion of the unadjusted basis of such property.

(ii) *Definition of salvage value.* "Salvage value" for purposes of this section means gross or net salvage value less the amount, if any, by which reduced by application of section 167(f). Generally, as provided in section 167(f), a taxpayer may reduce the gross or net salvage value for an account by an amount which does not exceed 10 percent of the unadjusted basis of the personal property (as defined in section 167(f)(2)) in the account.

(2) *Estimation of salvage value*—(i) *In general.* For the first taxable year for which he elects to apply this section, the taxpayer must (in accordance with paragraph (e)(3)(iv)(c) of this section) establish salvage value for all qualified property to which the election applies. The taxpayer may (in accordance with subparagraph (1) of this paragraph) determine either gross or net salvage, but an election under this section does not constitute permission to change the manner of estimating salvage. Permission to change the manner of estimating salvage must be obtained by filing form 3115 with the Commissioner of Internal Revenue, Washington, D.C. 20224, within the time otherwise permitted for the taxable year or before September 6, 1973. Salvage value in succeeding taxable years of election will be determined by adjustments of such initial salvage value for the account, as

retirements occur. This salvage value established by the taxpayer for the first taxable year of election will not be redetermined merely as a result of fluctuations in price levels or as a result of other circumstances occurring after the close of such taxable year. See paragraph (e)(3)(iv) of this section for requirements that the taxpayer specify in his election the aggregate amount of salvage value for an asset guideline class and that the taxpayer maintain records reasonably sufficient to identify the salvage value established for each depreciation account in the class.

(ii) *Salvage as limitation on depreciation.* In no case may an account be depreciated under this section below a reasonable salvage value, after taking into account any reduction in gross or net salvage value permitted by section 167(f). For example, if the salvage value of an account for 1971 is \$75, the unadjusted basis of the account is \$500, and the depreciation reserve is \$425, no depreciation is allowable for 1971.

(iii) *Special rule for first taxable year.* If for a taxable year ending prior to January 1, 1971, the taxpayer had adopted Revenue Procedure 62-21 prior to January 12, 1971 (see paragraph (f)(2) of this section), no adjustment in the amount of depreciation allowable for any taxable year ending prior to January 1, 1971, shall be made solely by reason of establishing salvage value under this paragraph for any taxable year ending after December 31, 1970. The principles of this subdivision may be illustrated by the following example:

*Example.* Taxpayer A had adopted Revenue Procedure 62-21 prior to January 12, 1971, for taxable years prior to 1971. Taxpayer A had not taken into account any salvage value for account No. 1 which is one of four depreciation accounts A has in the class. The reserve ratio test has been met for all years prior to 1971 and in accordance with Revenue Procedure 62-21 no adjustments in depreciable lives or salvage values were made. At the end of A's taxable year 1970, the unadjusted basis of account No. 1 was \$10,000 and the reserve for depreciation was \$9,800. Pursuant to this paragraph, A establishes a salvage value of \$400 for account No. 1 (determined at or as of the time of acquisition). This salvage value is determined to be correct. No depreciation is allowable for account No. 1 in 1971. No depreciation is disallowed for any taxable year

prior to 1971, solely by reason of establishing salvage value under this paragraph.

(3) *Limitation on adjustment of reasonable salvage value.* The salvage value established by the taxpayer for a depreciation account will not be redetermined if it is reasonable. Since the determination of salvage value is a matter of estimation, minimal adjustments will not be made. The salvage value established by the taxpayer will be deemed to be reasonable unless there is sufficient basis for a determination of an amount of salvage value for the account which exceeds the salvage value established by the taxpayer for the account by an amount greater than 10 percent of the unadjusted basis of the account at the close of such taxable year. If the salvage value established by the taxpayer for the account is not within the 10-percent range or if the taxpayer follows the practice of understating his estimates of salvage to take advantage of this subdivision, and if there is a determination of an amount of salvage value for the account for the taxable year which exceeds the salvage value established by the taxpayer for the account for such taxable year, an adjustment will be made by increasing the salvage value established by the taxpayer for the account by an amount equal to the difference between the salvage value as determined and the salvage value established by the taxpayer for the account. For the purposes of this subdivision, a determination of salvage value shall include all determinations at all levels of audit and appellate proceedings, and as well as all final determinations within the meaning of section 1313(a)(1). This subparagraph shall apply to each such determination.

(4) *Examples.* The principles of this paragraph may be illustrated by the following examples in which it is assumed that the taxpayer has established salvage value in accordance with this paragraph and has not followed a practice of understating his estimates of salvage value:

*Example (1).* Taxpayer B elects to apply this section for 1971. Assets Y and Z are the only assets in a multiple asset account of 1967, the year in which the assets were acquired. The unadjusted basis of asset Y is \$50,000 and the unadjusted basis of asset Z is



\$30,000. B estimated a gross salvage value of \$55,000 at the time of acquisition. The property qualified under section 167(f)(2) and B reduced the amount of salvage taken into account by \$8,000 (that is, 10 percent of \$80,000, under sec. 167(f)). Thus, in accordance with this paragraph and paragraph (e)(3)(iv)(c) of this section, B establishes a salvage value of \$47,000 for the account for 1971. Assume that there is not sufficient basis for determining a salvage value for the account greater than \$52,000 (that is \$60,000 minus the \$8,000 reduction under sec. 167(f)). Since the salvage value of \$47,000 established by B for the account is within the 10 percent range, it is reasonable. Salvage value for the account will not be redetermined.

*Example (2).* The facts are the same as in example (1) except that B estimated a gross salvage value of \$50,000 and establishes a salvage value of \$42,000 for the account (that is, \$50,000 minus the \$8,000 reduction under section 167(f)). There is sufficient basis for determining an amount of salvage value greater than \$50,000 (that is, \$58,000 minus the \$8,000 reduction under section 167(f)). The salvage value of \$42,000 established by B for the account can be redetermined without regard to the limitation in subparagraph (3) of this paragraph, since it is not within the 10 percent range. Upon audit of B's tax return for 1971 (a year in which the redetermination would affect the amount of depreciation allowable for the account), salvage value is determined to be \$52,000 after taking into account the reduction under section 167(f). Salvage value for the account will be adjusted to \$52,000.

*Example (3).* The facts are the same as in example (1) except that upon audit of B's tax return for 1971 the examining officer determines the salvage value to be \$58,000 (that is, \$66,000 minus the \$8,000 reduction under section 167(f)), and proposes to adjust salvage value for the account to \$58,000 which will result in disallowing an amount of depreciation for the taxable year. B does not agree with the finding of the examining officer. After receipt of a "30-day letter," B waives a district conference and initiates proceedings before the Appellate Division. In consideration of the case by the Appellate Division it is concluded that there is not sufficient basis for determining an amount of salvage value for the account in excess of \$55,000 (that is, \$63,000 minus the \$8,000 reduction under section 167(f)). Since the salvage value of \$47,000 established by B for the account is within the 10 percent range, it is reasonable. Salvage value for the account will not be redetermined.

*Example (4).* For 1971, taxpayer C elects to apply this section to factory building X which is in an item account of 1965, the year in which the building was acquired. The unadjusted basis of factory building X is \$90,000. C estimated a gross salvage value for

the account of \$10,000. The property did not qualify under section 167(f)(2). Thus, C establishes a salvage value of \$10,000 for the account for 1971. Assume that there is not sufficient basis for determining a salvage value for the account greater than \$14,000. Since the salvage value of \$10,000 established by C for the account is within the 10-percent range, it is reasonable. Salvage value for the account will not be redetermined.

(d) *Accounting for qualified property—*  
(1) *In general.* Qualified property for which the taxpayer elects to apply this section may be accounted for in any number of item or multiple asset accounts.

(2) *Retirements of qualified property—*  
(i) *In general.* The provisions of this subparagraph and § 1.167(a)-8 apply to retirements of qualified property to which the taxpayer elects to apply this section for the taxable year. See subdivision (iii) of this subparagraph for special rule for normal retirements.

(ii) *Adjusted basis of assets retired.* In the case of a taxpayer who depreciates qualified property in a multiple-asset account conforming to the asset guideline class at a rate based on the class life in accordance with paragraph (a)(5)(ii)(a) of this section, § 1.167(a)-8(c) (relating to basis of assets retired) shall be applied by assuming that the class life is the average expected useful life of the assets in the account. See § 1.167(a)-8, generally, for the basis of assets retired.

(iii) *Definition of normal retirements.* Notwithstanding § 1.167(a)-8(b), the determination whether a retirement of qualified property is normal or abnormal shall be made in light of all the facts and circumstances, primarily with reference to the expected period of use of the asset in the taxpayer's business without regard to paragraph (a)(5)(ii) of this section. A retirement is not abnormal unless the taxpayer can show that the withdrawal of the asset was not due to a cause which would customarily be contemplated (in light of the taxpayer's practice and experience) in setting a depreciation rate for the assets without regard to paragraph (a)(5)(ii) of this section. Thus, for example, a retirement is normal if made within the range of years which would customarily be taken into account in setting such depreciation rate and if the asset has reached a condition at

which, in the normal course of events, the taxpayer customarily retires similar assets from use in his business. A retirement may be abnormal if the asset is withdrawn at an earlier time or under other circumstances, as, for example, when the asset has been damaged by casualty or has lost its usefulness suddenly as the result of extraordinary obsolescence.

(3) *Special rules*—(i) *In general.* The provisions of this subparagraph shall apply to qualified property in a taxable year for which an election to apply this section is made.

(ii) *Repairs.* For the purpose of sections 162 and 263 and the regulations thereunder, whether an expenditure prolongs the life of an asset shall be determined by reference to the expected period of use of the asset in the taxpayer's business without regard to paragraph (a)(5)(ii) of this section.

(iii) *Sale and lease.* For the purpose of comparison with the term of a lease of such property, the remaining life of qualified property shall be determined by reference to the expected period of use of the asset in the taxpayer's business without regard to paragraph (a)(5)(ii) of this section.

(4) *Expected period of use.* For the purposes of subparagraphs (2) and (3) of this paragraph, the determination of the expected period of use of an asset shall be made in light of all the facts and circumstances. The expected period of use of a particular asset will not necessarily coincide with the class life used for depreciation (or with the individual asset life for depreciation under the alternative method in paragraph (a)(5)(ii) (b) of this section for applying the class life). Thus, for example, if the question is whether an asset has been leased for a period less than, equal to or greater than its remaining life, the determination shall be based on the remaining expected period of use of the individual asset without regard to the fact that the asset is depreciated at a rate based on the class life in accordance with paragraph (a)(5)(ii) (a) of this section.

(5) *Leased property.* In the case of a lessor of qualified property, unless there is an asset guideline class in effect for such lessors, the asset guideline class for such property shall be de-

termined by reference to the activity in which such property is primarily used by the lessee. See paragraph (b)(3) of this section for general rule for classification of qualified property according to primary use. However, in the case of an asset guideline class based upon the type of property (such as trucks or railroad cars), as distinguished from the activity in which used, the property shall be classified without regard to the activity of the lessee.

(e) *Election under this section*—(1) *Consent to change in method of accounting.* An election to apply this section for a taxable year ending after December 31, 1970, is a method of accounting but the consent of the Commissioner will be deemed granted to make an annual election.

(2) *Election for taxable years ending after December 31, 1976.* For taxable years ending after December 31, 1976, the election to apply this section for a taxable year shall be made by attaching to the income tax return a statement that an election under this section is being made. If the taxpayer does not file a timely return (taking into account extensions of time for filing) for the taxable year, the election shall be made at the time the taxpayer files his first return for the taxable year. The election may be made with an amended return only if such amended return is filed no later than the time prescribed by law (including extensions thereof) for filing the return for the taxable year. A taxpayer who makes an election under this subparagraph must maintain books and records reflecting the information described in paragraph (e)(3) (ii) and (iii) of this section.

(3) *Election for taxable years ending on or before December 31, 1976.* (i) For taxable years ending on or before December 31, 1976, the election to apply this section for a taxable year may be made by filing Form 5006 with the income tax return for the taxable year. If the taxpayer does not file a timely return (taking into account extensions of time for filing) for the taxable year, the election shall be filed at the time the taxpayer files his first return for the taxable year. The election may be made with an amended return only if such amended return is filed no later

than the later of (a) the time prescribed by law (including extensions thereof) for filing the return for the taxable year, or (b) November 5, 1973.

(ii) The election to apply this section for a taxable year ending on or before December 31, 1976, will be deemed to be made if the tax return (filed within the periods referred to in paragraph (e)(3)(i) of this section) contains information sufficient to establish the following:

(a) Each asset guideline class for which the election is intended to apply;

(b) The class life for each such asset guideline class and whether the class life is determined under paragraph (b)(1) or (2) of this section;

(c) For each asset guideline class, as of the end of the taxable year of election, (1) the total unadjusted basis of all qualified property, (2) the aggregate of the reserves for depreciation of all accounts in the asset guideline class, and (3) the aggregate of the salvage value established for all accounts in the asset guideline class; and

(d) Whether the taxpayer is an electric or gas utility using a composite asset guideline class basis in accordance with paragraph (b)(3)(iii) of this section.

If an election is deemed to be made under this subdivision (ii), the taxpayer will be deemed to have consented to apply all the provisions of this section.

(iii) A taxpayer to whom the election applies shall maintain books and records for each asset guideline class reasonably sufficient to identify the unadjusted basis, reserve for depreciation and salvage value established for each depreciation account in such asset guidelines class.

(f) *Depreciation for taxable years ending before January 1, 1971*—(1) *Adoption of Revenue Procedure 62-21*—(i) *In general.* Except as provided in subdivision (ii) of this subparagraph, a taxpayer may elect to be examined under the provisions of Revenue Procedure 62-21 for a taxable year ending before January 1, 1971, only in accordance with the rules of this paragraph. The election must specify:

(a) That the taxpayer makes such election and consents to, and agrees to

apply, all the provisions of this paragraph;

(b) Each guideline class and taxable year for which the taxpayer elects to be examined under Revenue Procedure 62-21;

(c) The class life claimed for each such guideline class;

(d) The class life and the total amount of the depreciation for the guideline class claimed on the last income tax return for such taxable year filed prior to January 12, 1971 (or in case no income tax return was filed prior to January 12, 1971, on the first income tax return filed for such taxable year);

(e) The class life claimed and the total amount of depreciation for the guideline class under the election to apply Revenue Procedure 62-21, in accordance with this paragraph, for the taxable year; and

(f) If the class life or total amount of depreciation for the guideline class is different in (d) and (e) of this subdivision, a reasonable description of the computation of the class life in (e) of this subdivision, the amount of difference in tax liability resulting therefrom, and the amount of any refund or reduction in any deficiency in tax. The election shall be made in an amended tax return or claim for refund (or by a supplement to the tax return or claim) for the taxable year, and if the class life or total amount of depreciation for the guideline class is different in accordance with (f) of this subdivision, such difference shall be reflected in the amended tax return or claim for refund. Forms may be provided for making the election and submission of the information. In the case of an election made after issuance of such forms and more than 30 days after publication of notice thereof in the Internal Revenue Bulletin, the election may be made and the information submitted only in accordance with such forms. An election will not otherwise be invalid under this paragraph so long as there is substantial compliance, in good faith, with the requirements of this paragraph.

(ii) *Special rule.* The provisions of this subparagraph shall not apply to a guideline class in any taxable year for

which the taxpayer has prior to January 12, 1971, adopted Revenue Procedure 62-21 for such class. See subparagraph (2) of this paragraph for determination of adoption of Revenue Procedure 62-21 prior to January 12, 1971.

(iii) *Justification of class life claimed and limitations on refunds.* If the taxpayer elects for a taxable year to be examined under the provisions of Revenue Procedure 62-21 in accordance with subdivision (i) of this subparagraph, any of the provisions of Revenue Procedure 62-21 may be applied to justify a class life claimed on the income tax return filed for such year or to offset an increase in tax liability for such year. Unless it meets the reserve ratio test, no class life will be accepted on audit which (after all other adjustments in tax liability for such year) results in a reduction (or further reduction) in the amount of tax liability shown on the income tax return (specified in subdivision (i)(d) of this subparagraph) for such taxable year, or results in an amount of loss carryback or carryover to any taxable year, but if it is justified under Revenue Procedure 62-21 and meets the reserve ratio test, a class life will be accepted on audit without regard to the foregoing limitations and, for example, may produce a refund or credit against tax. For example, if a class life of 9 years is otherwise justified under Revenue Procedure 62-21 for 1969, but the taxpayer does not meet the reserve ratio test for 1969 using a test life of 9 years, a class life of 9 years (or any class life justified under Revenue Procedure 62-21) will be accepted on audit under Revenue Procedure 62-21 pursuant to an election in accordance with this paragraph provided it does not result in the reduction or further reduction in tax liability or in an amount of loss carryback or carryover as described in the preceding sentence. On the other hand, for example, if a class life of 10 years is justified under Revenue Procedure 62-21 for 1969 and the taxpayer meets the reserve ratio test for 1969 using a test life of 10 years, a class life of 10 years will be accepted on audit under Revenue Procedure 62-21 pursuant to an election in accordance with this paragraph even though it results in a reduction or further reduction in tax liability

or in an amount of loss carryback or carryover as described above and produces a refund of tax. For purposes of this section, the term "audit" includes examination of claims for refund or credit against tax.

(iv) *Definitions.* For purposes of this paragraph, the determination whether the reserve ratio test is met shall be made in accordance with that portion of paragraph (b)(2) of this section which is by express reference therein made applicable to this paragraph. In addition, the guideline form of the reserve ratio test, as described in Revenue Procedure 65-13, may be applied. For purposes of this paragraph, references to Revenue Procedure 62-21 include all modifications, amendments, and supplements thereto as of January 11, 1971. The terms "class life" and "guideline class" have the same meaning as in Revenue Procedure 62-21.

(2) *Determination whether Revenue Procedure 62-21 adopted prior to January 12, 1971—(i) In general.* For the purposes of this paragraph, a taxpayer will be treated as having adopted prior to January 12, 1971, Revenue Procedure 62-21 for a guideline class for a taxable year ending before January 1, 1971, only if—

(a) For the guideline class and taxable year, the taxpayer adopted Revenue Procedure 62-21 by expressly so indicating on the income tax return filed for such taxable year prior to January 12, 1971;

(b) For the guideline class and taxable year, the taxpayer adopted Revenue Procedure 62-21 prior to January 12, 1971, by expressly so indicating in a proceeding before the Internal Revenue Service (such as upon examination of the income tax return for such taxable year) and there is reasonable evidence to that effect; or

(c) There is other reasonable evidence that prior to January 12, 1971, the taxpayer adopted Revenue Procedure 62-21 for the guideline class and taxable year.

If not treated under (b) or (c) of this subdivision as having done so for the last taxable year ending before January 1, 1971, and if the taxpayer files his first income tax return for such taxable year after January 11, 1971, the taxpayer will be treated as having adopted Revenue Procedure 62-21 prior

to January 12, 1971, for a guideline class for such taxable year if he expressly so indicated on that return, or is treated under this subparagraph as having adopted Revenue Procedure 62-21 prior to January 12, 1971, for that guideline class for the immediately preceding taxable year.

(ii) *Examples.* The principles of this subparagraph may be illustrated by the following examples:

*Example (1).* Taxpayer A, an individual who uses the calendar year as his taxable year, has property in Group Three, Class 16(a), of Revenue Procedure 62-21. On A's income tax return for 1968, filed prior to January 12, 1971, he adopted Revenue Procedure 62-21 for the guideline class by so indicating under "Summary of Depreciation" in the appropriate schedule of Form 1040 for 1968. Under subdivision (i) (a) of this subparagraph, A is treated as having adopted Revenue Procedure 62-21 for the guideline class for 1968 prior to January 12, 1971.

*Example (2).* Taxpayer B, an individual who uses the calendar year as his taxable year, has property in Group Two, Class 5, of Revenue Procedure 62-21. B filed timely income tax returns for 1966 through 1968 but did not adopt Revenue Procedures 62-21 on any of such returns. In 1969 upon audit of B's taxable years 1966 through 1968, B exercised his option to be examined under the provisions of Revenue Procedure 62-21. The Revenue Agent's report shows that B was examined under Revenue Procedure 62-21 for taxable years 1966 through 1968. B will be treated under subdivision (ii) (b) of this subparagraph as having adopted Revenue Procedure 62-21 for such years prior to January 12, 1971.

*Example (3).* The facts are the same as in example (2) except that B did not upon examination by the Revenue Agent in 1969 exercise his option to be examined under Revenue Procedure 62-21. B has six accounts in the guideline class, Nos. 1 through 6. The Revenue Agent proposed to lengthen the depreciable lives on accounts Nos. 2 and 3 from 8 years to 12 years. In proceedings before the Appellate Division in 1970, B exercised his option to be examined under the provisions of Revenue Procedure 62-21. This is shown by correspondence between B and the Appellate Conferee as well as by other documents in the case before the Appellate Division. The case was settled on that basis before the Appellate Division without adjustment of the depreciable lives for B's accounts Nos. 2 and 3. B will be treated under subdivision (ii) (b) of this subparagraph as having adopted Revenue Procedure 62-21 for taxable years 1966 through 1968 prior to January 12, 1971.

*Example (4).* Corporation X uses the calendar year as its taxable year and has assets in Group Two, Class 5, of Revenue Procedure

62-21. Beginning in 1964, corporation X used the guideline life of 10 years as the depreciable life for all assets in the guideline class. In 1967, corporation X's taxable years 1964 through 1966 were examined and corporation X exercised its option to be examined under the provisions of Revenue Procedure 62-21. Corporation X did not adopt Revenue Procedure 62-21 on any of its income tax returns, for the years 1964 through 1970. Corporation X has not been examined since 1967, but has continued to use the guideline life of 10 years for all property in the guideline class including additions since 1966. Corporation X will be treated under subdivision (ii) (c) and (d) of this subparagraph as having adopted Revenue Procedure 62-21 prior to January 12, 1971, for taxable years 1964 through 1970.

*Example (5).* Corporation Y uses the calendar year as its taxable year and has asset in Group Two, Class 5, of Revenue Procedure 62-21. Since 1964, corporation Y has used various depreciable lives, based on the facts and circumstances, for different accounts in the guideline class. Corporation Y was examined in 1968 for taxable years 1965 through 1967. Corporation Y was also examined in 1970 for taxable years 1968 and 1969. Corporation Y did not exercise its option to be examined under the provisions of Revenue Procedure 62-21. Corporation Y has not adopted Revenue Procedure 62-21 on any income tax return. For taxable years 1964 through 1970, corporation Y's class life (within the meaning of section 4, Part II, of Revenue Procedure 62-21) was between 12 and 14 years. In August of 1971, corporation Y filed amended income tax returns for 1968 and 1969, and an income tax return for 1970, using a depreciable life of 10 years (equal to the guideline life) for all assets in the guideline class. Corporation Y will not be treated as having adopted Revenue Procedure 62-21 prior to January 12, 1971.

*Example (6).* Corporation Z uses the calendar year as its taxable year and has assets in group 2, class 5, of Revenue Procedure 62-21. Corporation Z adopted Revenue Procedure 62-21 for this guideline class by expressly so indicating on its tax return for 1966, which was filed before January 12, 1971. Corporation Z computed its allowable depreciation for 1966 as if it adopted Revenue Procedure 62-21 for this guideline class for its taxable years 1962 through 1965, although it had earlier filed its tax returns for those years without regard to Revenue Procedure 62-21. The depreciation thus claimed in 1966 was less than what would have been allowable if corporation Z first adopted Revenue Procedure 62-21 in 1966. This was the result of certain accounts becoming fully depreciated through use of Revenue Procedure 62-21 in computing depreciation for 1962

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through 1965. In addition, in deferred tax accounting procedures employed before January 12, 1971, for financial reporting purposes, corporation Z calculated its tax deferrals on the basis that it had adopted Revenue Procedure 62-21 for the years 1962 through 1965. Corporation Z will be treated under subdivision (i) (c) of this subparagraph as having adopted Revenue Procedure 62-21 for taxable years 1962 through 1965 prior to January 12, 1971.

(Sec. 167(m), 85 Stat. 508 (26 U.S.C. 167))

[T.D. 7278, 38 FR 14923, June 7, 1973, as amended by T.D. 7315, 39 FR 20195, June 7, 1974; T.D. 7517, 42 FR 58934, Nov. 14, 1977]

### § 1.167(a)-13T Certain elections for intangible property (temporary).

For rules applying the elections under section 13261(g) (2) and (3) of the Omnibus Budget Reconciliation Act of 1993 to intangible property described in section 167(f), see § 1.197-1T.

[59 FR 11922, Mar. 15, 1994]

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

(a) *Overview.* This section provides rules for the amortization of certain intangibles that are excluded from section 197 (relating to the amortization of goodwill and certain other intangibles). These excluded intangibles are specifically described in § 1.197-2(c) (4), (6), (7), (11), and (13) and include certain computer software and certain other separately acquired rights, such as rights to receive tangible property or services, patents and copyrights, certain mortgage servicing rights, and rights of fixed duration or amount. Intangibles for which an amortization amount is determined under section 167(f) and intangibles otherwise excluded from section 197 are amortizable only if they qualify as property subject to the allowance for depreciation under section 167(a).

(b) *Computer software*—(1) *In general.* [Reserved]. For further guidance, see § 1.167(a)-14T(b)(1).

(2) *Exceptions.* Paragraph (b)(1) of this section does not apply to the cost of computer software properly and consistently taken into account under § 1.162-11. The cost of acquiring an interest in computer software that is included, without being separately stated, in the cost of the hardware or other

tangible property is treated as part of the cost of the hardware or other tangible property that is capitalized and depreciated under other applicable sections of the Internal Revenue Code.

(3) *Additional rules.* Rules similar to those in § 1.197-2 (f)(1)(iii), (f)(1)(iv), and (f)(2) (relating to the computation of amortization deductions and the treatment of contingent amounts) apply for purposes of this paragraph (b).

(c) *Certain interests or rights not acquired as part of a purchase of a trade or business*—(1) *Certain rights to receive tangible property or services.* The amount of the deduction for a right (other than a right acquired as part of a purchase of a trade or business) to receive tangible property or services under a contract or from a governmental unit (as specified in section 167(f)(2) and § 1.197-2(c)(6)) is determined as follows:

(i) *Amortization of fixed amounts.* The basis of a right to receive a fixed amount of tangible property or services is amortized for each taxable year by multiplying the basis of the right by a fraction, the numerator of which is the amount of tangible property or services received during the taxable year and the denominator of which is the total amount of tangible property or services received or to be received under the terms of the contract or governmental grant. For example, if a taxpayer acquires a favorable contract right to receive a fixed amount of raw materials during an unspecified period, the taxpayer must amortize the cost of acquiring the contract right by multiplying the total cost by a fraction, the numerator of which is the amount of raw materials received under the contract during the taxable year and the denominator of which is the total amount of raw materials received or to be received under the contract.

(ii) *Amortization of unspecified amount over fixed period.* The cost or other basis of a right to receive an unspecified amount of tangible property or services over a fixed period is amortized ratably over the period of the right. (See paragraph (c)(3) of this section regarding renewals).

(iii) *Amortization in other cases.* [Reserved]

(2) *Rights of fixed duration or amount.* The amount of the deduction for a