Internal Revenue bulletin

Bulletin No. 2004-14
April 5, 2004

HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 2004–39, page 700.

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for April 2004.

T.D. 9115, page 680.
REG–106590–00, page 704.

Final, temporary, and proposed regulations under section 168 of the Code provide guidance on how to depreciate MACRS property that is acquired in a like-kind exchange or as a result of an involuntary conversion. These regulations explain how a taxpayer should determine depreciation in the year of the exchange or involuntary conversion and subsequent years. A public hearing on the proposed regulations is scheduled for June 3, 2004. Notice 2000–4 obsoleted. REG–138499–02 partially withdrawn.

T.D. 9116, page 674.
REG–115471–03, page 706.

Temporary and proposed regulations under section 45D of the Code amend temporary regulations (T.D. 8971, 2002–1 C.B. 308) and proposed regulations (REG–119436–01, 2002–1 C.B. 377). These regulations provide revised rules relating to the new markets tax credit. A taxpayer making a qualified equity investment in a qualified community development entity that has received a new markets tax credit allocation may claim a 5-percent tax credit with respect to the qualified equity investment on each of the first 3 credit allowance dates and a 6-percent tax credit with respect to the qualified equity investment on each of the remaining 4 credit allowance dates. A public hearing is scheduled for June 2, 2004.

Rev. Proc. 2004–21, page 702.

This procedure modifies the final withholding foreign partnership (WP) and withholding foreign trust (WT) agreements contained in Rev. Proc. 2003–64, 2003–32 I.R.B. 306, by eliminating the $200,000 cap on eligibility for certain pooled reporting. This procedure also makes a conforming change to the portion of the Qualified Intermediary (QI) withholding agreement contained in Rev. Proc. 2003–64. Rev. Proc. 2003–64 modified.

EMPLOYEE PLANS

REG–149752–03, page 707.

Proposed regulations under section 410(b) of the Code allow employees of a tax-exempt organization who are eligible to make salary reduction contributions to a section 403(b) plan to be treated as excludable employees for the purpose of testing whether a section 401(k) plan or a section 401(m) plan meets the minimum coverage requirements contained in section 410(b) if two conditions are met. This modification was directed by Congress in section 664 of the Economic Growth and Tax Relief Reconciliation Act of 2001.

EXEMPT ORGANIZATIONS

Announcement 2004–22, page 709.

A list is provided of organizations now classified as private foundations.

(Continued on the next page)

Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

Announcement 2004–27, page 714.
Innovative Horizons, Inc., of Bartlesville, OK, no longer qualifies as an organization to which contributions are deductible under section 170 of the Code.

ADMINISTRATIVE

Announcement 2004–24, page 714.
The Service announces that an updated edition of Publication 971, *Innocent Spouse Relief (And Separation of Liability and Equitable Relief)*, revised March 2004, is now available. It replaces the July 2003 revision.

The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The last Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the last Bulletin of each semiannual period.*

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*** Beginning with Internal Revenue Bulletin 2003–43**, we are publishing the index at the end of the month, rather than at the beginning.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of April 2004. See Rev. Rul. 2004-39, page 700.

Section 45D.—New Markets Tax Credit

26 CFR 1.45D–1T: New markets tax credit (temporary).

T.D. 9116

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

New Markets Tax Credit Amendments

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains amendments to temporary regulations for the new markets tax credit under section 45D. The regulations revise and clarify certain aspects of those regulations and affect a taxpayer making a qualified equity investment in a qualified community development entity that has received a new markets tax credit allocation. The text of these temporary regulations also serves as the text of the proposed regulations (REG–115471–03) set forth in the notice of proposed rulemaking on this subject in this issue of the Bulletin.

DATES: *Effective Date:* These regulations are effective March 11, 2004.

Applicability Date: For date of applicability, see §1.45D–1T(h).

FOR FURTHER INFORMATION CONTACT: Paul F. Handleman or Lauren R. Taylor, (202) 622–3040 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document amends 26 CFR part 1 to provide amended rules (the revised regulations) relating to the new markets tax credit under section 45D of the Internal Revenue Code (Code). On December 26, 2001, the IRS published temporary (T.D. 8971, 2002–1 C.B. 308) and proposed regulations (REG–119436–01, 2002–1 C.B. 377) (the 2001 temporary regulations) in the **Federal Register** (66 FR 66307, 66 FR 66376). Written and electronic comments responding to the 2001 temporary regulations were received. The IRS and Treasury Department have reviewed the comments on the 2001 temporary regulations and decided to revise and clarify certain aspects of those regulations. The IRS and Treasury Department continue to consider comments on the 2001 temporary regulations that are not addressed in the revised regulations.

Explanation of Provisions

General Overview

Taxpayers may claim a new markets tax credit on a credit allowance date in an amount equal to the applicable percentage of the taxpayer's qualified equity investment in a qualified community development entity (CDE). The credit allowance date for any qualified equity investment is the date on which the investment is initially made and each of the 6 anniversary dates thereafter. The applicable percentage is 5 percent for the first 3 credit allowance dates and 6 percent for the remaining credit allowance dates.

A CDE is any domestic corporation or partnership if: (1) the primary mission of the entity is serving or providing investment capital for low-income communities or low-income persons; (2) the entity maintains accountability to residents of low-income communities through their representation on any governing board of the entity or on any advisory board to the entity; and (3) the entity is certified by the Secretary for purposes of section 45D as being a CDE.

The new markets tax credit may be claimed only for a qualified equity investment in a CDE. A qualified equity investment is any equity investment in a CDE for which the CDE has received an allocation from the Secretary if, among other things, the CDE uses substantially all of the cash from the investment to make qualified low-income community investments. Under a safe harbor, the substantially-all requirement is treated as met if at least 85 percent of the aggregate gross assets of the CDE are invested in qualified low-income community investments.

Qualified low-income community investments consist of: (1) any capital or equity investment in, or loan to, any qualified active low-income community business; (2) the purchase from another CDE of any loan made by such entity that is a qualified low-income community investment; (3) financial counseling and other services to businesses located in, and residents of, low-income communities; and (4) certain equity investments in, or loans to, a CDE.

In general, a qualified active low-income community business is a corporation or a partnership if for the taxable year: (1) at least 50 percent of the total gross income of the entity is derived from the active conduct of a qualified business within any low-income community; (2) a substantial portion of the use of the tangible property of the entity is within any low-income community; (3) a substantial portion of the services performed for the entity by its employees is performed in any low-income community; (4) less than 5 percent of the average of the aggregate unadjusted bases of the property of the entity is attributable to certain collectibles; and (5) less than 5 percent of the average of the aggregate unadjusted bases of the property of the entity is attributable to certain nonqualified financial property.

Substantially All

As indicated above, a CDE must use substantially all of the cash from a qualified equity investment to make qualified low-income community investments. Section 1.45D–1T(c)(5)(i) provides that the substantially-all requirement is treated as satisfied for an annual period if either the direct-tracing calculation under §1.45D–1T(c)(5)(ii), or the safe harbor calculation under §1.45D–1T(c)(5)(iii), is performed every six months and the average of the two calculations for the annual period is at least 85 percent. Commentators have suggested that the use of the direct-tracing calculation (or the safe harbor calculation) for an annual period should not preclude the use of the safe harbor calculation (or the direct-tracing calculation) for another annual period. The revised regulations adopt this suggestion.

Commentators have suggested that, if a CDE makes a qualified low-income community investment from a source of funds other than a qualified equity investment (for example, a line of credit from a bank), and later uses proceeds of an equity investment in the CDE to reimburse or repay the other source of funds, the equity investment should be treated as financing the qualified low-income community investment on a direct-tracing basis. The revised regulations do not adopt this suggestion because, in these circumstances, the proceeds of the equity investment are not "used...to make" the qualified low-income community investment as required by section 45D(b)(1)(B). However, the revised regulations provide an example demonstrating that, in this situation, the substantially-all requirement may be satisfied under the safe harbor calculation.

Qualified Low-Income Community Investments

Under section 45D(d)(1)(B), a qualified low-income community investment includes the purchase from another CDE of any loan made by such entity that is a qualified low-income community investment. Commentators have suggested that, for purposes of section 45D(d)(1)(B), a loan by an entity should be treated as made by a CDE, even if the entity is not a CDE at the time it makes the loan, so long as the entity is a CDE at the time it sells the loan. The revised regulations adopt this suggestion, in accordance with Notice 2003–68, 2003–41 I.R.B. 824.

Commentators also have suggested that the phrase "made by such entity" for purposes of section 45D(d)(1)(B) should include any loans held or purchased by such entity. The revised regulations do not adopt this suggestion because it would treat loan purchases as qualified low-income community investments even if the originator or a prior seller of the loan were not a CDE. However, the revised regulations do contain a special rule, as set forth in Notice 2003–68, that applies to the purchase of a loan by a CDE (the ultimate CDE) from a second CDE if the loan was made by a third CDE (the originating CDE). Specifically, the revised regulations provide that, for purposes of section 45D(d)(1)(B): (1) The purchase of a loan by the ultimate CDE from a second CDE that purchased the loan from the originating CDE (or from another CDE) is treated as a purchase of the loan by the ultimate CDE from the originating CDE, provided that each entity that sold the loan was a CDE at the time it sold the loan; and (2) a loan purchased by the ultimate CDE from another CDE is a qualified low-income community investment if it qualifies as a qualified low-income community investment either (A) at the time the loan was made or (B) at the time the ultimate CDE purchases the loan.

Commentators have suggested that, in certain circumstances in which a CDE purchases a loan from another entity under an advance commitment agreement, the loan should be treated as made by the CDE and therefore eligible to be a qualified low-income community investment. The revised regulations provide that, for these purposes, a loan is treated as made by a CDE to the extent the CDE purchases the loan from the originator (whether or not the originator is a CDE) within 30 days after the date the originator makes the loan if, at the time the loan is made, there is a legally enforceable written agreement between the originator and the CDE which (A) requires the CDE to approve the making of the loan either directly or by imposing specific written loan underwriting criteria and (B) requires the CDE to purchase the loan within 30 days after the date the loan is made.

Section 1.45D–1T(d)(1)(iv) provides that a qualified low-income community investment includes an equity investment in, or loan to, another CDE, but only to the extent that the recipient CDE uses the proceeds: (1) for either an investment in, or a loan to, a qualified active low-income community business, or financial counseling and other services; and (2) in a manner that would constitute a qualified low-income community investment if it were made directly by the CDE making the equity investment or loan. Commentators have suggested that this provision should be amended to permit investments through multiple tiers of CDEs. For example, commentators have indicated that some CDEs have reasons relating to bank regulatory requirements for lending to bank holding company CDEs that invest in bank subsidiary CDEs. The revised regulations amend this provision, in accordance with Notice 2003–64, 2003–39 I.R.B. 646, to permit investments through two additional CDEs.

Qualified Active Low-Income Community Business

Section 45D(d)(2)(A)(i) provides that a corporation (including a nonprofit corporation) or a partnership is a qualified active low-income community business only if, among other things, at least 50 percent of the total gross income of the entity is derived from the active conduct of a qualified business within any low-income community. Commentators have requested clarification of the meaning of "active conduct". Some commentators have suggested that the term should include start-up businesses, including the development of commercial rental property. Other commentators have suggested defining active conduct by focusing on the economic effect of a particular business activity. The revised regulations provide a special rule that makes clear that an entity will be treated as engaged in the active conduct of a trade or business if, at the time the CDE makes a capital or equity investment in, or loan to, the entity, the CDE reasonably expects that the entity will generate revenues (or, in the case of a nonprofit corporation, receive donations) within 3 years after the date the investment or loan is made.

Section 45D(d)(2)(A)(iii) provides that a corporation or a partnership is a qualified active low-income community business only if, among other things, a substantial portion of the services performed for such entity by its employees are performed in a low-income community (the services test). Section 1.45D–1T(d)(4)(i)(C) defines substantial portion for this purpose as 40 percent. Commentators have requested guidance on compliance with the services test if an entity has no employees. One commentator has suggested that, if the entity is a partnership and has no employees, the test should be applied to the general partners or managing members. The revised regulations provide that, if an entity has no employees, the entity is deemed to satisfy the services test (as well as the requirement in §1.45D–1T(d)(4)(i)(A) that at least 50 percent of the total gross income of the entity be derived from the active conduct of a qualified business within a low-income community) if at least 85 percent of the use of the tangible property of the entity (whether owned or leased) is within a low-income community.

Control

Under §1.45D–1T(d)(6)(i), an entity is treated as a qualified active low-income community business if the CDE reasonably expects, at the time the CDE makes the capital or equity investment in, or loan to, the entity, that the entity will satisfy the requirements to be a qualified active low-income community business throughout the entire period of the investment or loan. However, under §1.45D–1T(d)(6)(ii)(A), if the CDE controls or obtains control of the entity at any time during the 7-year credit period, the entity will be treated as a qualified active low-income community business only if the entity satisfies the applicable requirements throughout the entire period the CDE controls the entity. Section 1.45D–1T(d)(6)(ii)(B) generally defines control with respect to an entity as direct or indirect ownership (based on value) or control (based on voting or management rights) of 33 percent or more of the entity. Commentators have suggested that this definition should be revised to increase the threshold for control. The revised regulations amend the definition of control to mean direct or indirect ownership (based on value) or control (based on voting or management rights) of more than 50 percent of the entity.

Commentators have suggested that if a CDE obtains control of an entity subsequent to making an investment in the entity, the CDE should be granted a reasonable period (such as 12 months) either to cause the entity to satisfy the requirements to be a qualified active low-income community business or to find a replacement investment. The revised regulations provide a 12-month period during which a CDE's acquisition of control of an entity is disregarded if, among other things, the CDE's investment in the entity met the reasonable expectations test of §1.45D–1T(d)(6)(i) when initially made and the acquisition of control is due to unforeseen financial difficulties of the entity.

Other Issues

Commentators have suggested that taxpayers should be able to claim the new markets tax credit in the event the CDE in which the qualified equity investment is made becomes bankrupt. The revised regulations adopt this suggestion.

The revised regulations incorporate Notice 2003–9, 2003–1 C.B. 369, which permits certain equity investments made on or after April 20, 2001, to be designated as qualified equity investments, and Notice 2003–56, 2003–34 I.R.B. 396, which permits certain equity investments made on or after the date the Treasury Department publishes a Notice of Allocation Availability to be designated as qualified equity investments. The revised regulations also incorporate Notice 2002–64, 2002–2 C.B. 690, which provides guidance on Federal tax benefits that do not limit the availability of the new markets tax credit. The IRS and Treasury Department continue to study how the low-income housing credit under section 42 may limit the availability of the new markets tax credit.

Special Analysis

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. For applicability of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*), refer to the cross-reference notice of proposed rulemaking published elsewhere in this issue of the Bulletin. Pursuant to section 7805(f) of the Code, these amendments to the 2001 temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

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

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Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

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

Par. 2. Section 1.45D–1T is amended by:

1. Revising the section heading.

2. Amending paragraph (a) by:

(a) Amending the entry for (c)(3)(ii) by removing the word "Exception" and by adding the word "Exceptions" in its place.

(b) Adding new entries for (c)(3)(ii)(A) and (B).

(c) Redesignating the entry for (c)(3)(iii) as (c)(3)(iv).

(d) Adding a new entry for (c)(3)(iii).

(e) Adding a new entry for (c)(5)(vi).

(f) Adding new entries for (d)(1)(ii)(A), (d)(1)(ii)(B), (d)(1)(ii)(C), and (d)(1)(ii)(D).

(g) Adding new entries for (d)(1)(iv)(A) and (d)(1)(iv)(B).

(h) Adding new entries for (d)(4)(iv), (d)(4)(iv)(A), and (d)(4)(iv)(B).

(i) Adding a new entry for (d)(6)(ii)(C).

(j) Adding new entries for (d)(8), (d)(8)(i), and (d)(8)(ii).

(k) Adding new entries for (g)(3), (g)(3)(i), (g)(3)(ii), and (g)(4).

(l) Amending the entry for (h) by removing the word "Date" and by adding the word "Dates" in its place.

(m) Adding new entries for (h)(1) and (h)(2).

3. Amending paragraph (c)(3)(ii) by removing the word "Exception" and by adding the word "Exceptions" in its place.

4. Revising paragraphs (c)(3)(ii)(A) and (c)(3)(ii)(B).

5. Removing paragraph (c)(3)(ii)(C) and (c)(3)(ii)(D).

6. Redesignating paragraph (c)(3)(iii) as paragraph (c)(3)(iv).

7. Adding a new paragraph (c)(3)(iii), a sentence after the third sentence in paragraph (c)(5)(i), a new paragraph (c)(5)(vi).

8. Revising paragraphs (d)(1)(ii) and (iv).

9. Adding a sentence at the end of paragraph (d)(4)(i)(A), a sentence at the end of paragraph (d)(4)(i)(C), a new paragraph (d)(4)(iv).

10. Revising paragraph (d)(6)(ii)(B).

11. Adding new paragraph (d)(6)(ii)(C), a new paragraph (d)(8), new paragraphs (g)(3) and (g)(4).

12. Revising paragraph (h).

The additions and revisions read as follows:

§1.45D–1T New markets tax credit (temporary).

(a) * * *

* * * * *

(c) * * *

(3) * * *

(ii) Exceptions.

(A) Allocation applications submitted by August 29, 2002.

(B) Other allocation applications.

(iii) Failure to receive allocation.

(iv) Initial investment date.

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(5) * * *

(vi) Examples.

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(d) * * *

(1) * * *

(ii) * * *

(A) In general.

(B) Certain loans made before CDE certification.

(C) Intermediary CDEs.

(D) Examples.

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(iv) * * *

(A) In general.

(B) Examples.

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(4) * * *

(iv) Active conduct of a trade or business.

(A) Special rule.

(B) Example.

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(6) * * *

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(ii) * * *

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(C) Disregard of control.

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(8) Special rule for certain loans.

(i) In general.

(ii) Example.

* * * * *

(g) * * *

(3) Other Federal tax benefits.

(i) In general.

(ii) Low-income housing credit.

(4) Bankruptcy of CDE.

(h) Effective dates.

(1) In general.

(2) Exception for certain provisions.

* * * * *

* * * * *

(c) * * *

(3) * * *

(ii) *Exceptions*. * * *

(A) *Allocation applications submitted by August 29, 2002*.

(*1*) The equity investment is made on or after April 20, 2001;

(*2*) The designation of the equity investment as a qualified equity investment is made for a credit allocation received pursuant to an allocation application submitted to the Secretary no later than August 29, 2002; and

(*3*) The equity investment otherwise satisfies the requirements of section 45D and this section; or

(B) *Other allocation applications*.

(*1*) The equity investment is made on or after the date the Secretary publishes a Notice of Allocation Availability (NOAA) in the **Federal Register**;

(*2*) The designation of the equity investment as a qualified equity investment is made for a credit allocation received pursuant to an allocation application submitted to the Secretary under that NOAA; and

(*3*) The equity investment otherwise satisfies the requirements of section 45D and this section.

(iii) *Failure to receive allocation*. For purposes of paragraph (c)(3)(ii)(A) of this section, if the entity in which the equity investment is made does not receive an allocation pursuant to an allocation application submitted no later than August 29, 2002, the equity investment will not be eligible to be designated as a qualified equity investment. For purposes of paragraph (c)(3)(ii)(B) of this section, if the entity in which the equity investment is made does not receive an allocation under the NOAA described in paragraph (c)(3)(ii)(B)(*1*) of this section, the equity investment will not be eligible to be designated as a qualified equity investment.

* * * * *

(5) * * *

(i) * * * The use of the direct-tracing calculation under paragraph (c)(5)(ii) of this section (or the safe harbor calculation under paragraph (c)(5)(iii) of this section) for an annual period does not preclude the use of the safe harbor calculation under paragraph (c)(5)(iii) of this section (or the direct-tracing calculation under paragraph (c)(5)(ii) of this section) for another annual period. * * *

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(vi) *Examples*. The following examples illustrate an application of this paragraph (c)(5):

Example 1. X is a partnership and a CDE that has received a $1 million new markets tax credit allocation from the Secretary. On September 1, 2004, X uses a line of credit from a bank to fund a $1 million loan to Y. The loan is a qualified low-income community investment under paragraph (d)(1) of this section. On September 5, 2004, A pays $1 million to acquire a capital interest in X. X uses the proceeds of A's equity investment to pay off the $1 million line of credit that was used to fund the loan to Y. X's aggregate gross assets consist of the $1 million loan to Y and $100,000 in other assets. A's equity investment in X does not satisfy the substantially-all requirement under paragraph (c)(5)(i) of this section using the direct-tracing calculation under paragraph (c)(5)(ii) of this section because the cash from A's equity investment is not used to make X's loan to Y. However, A's equity investment in X satisfies the substantially-all requirement using the safe harbor calculation under paragraph (c)(5)(iii) of this section because at least 85 percent of X's aggregate gross assets are invested in qualified low-income community investments.

Example 2. X is a partnership and a CDE that has received a new markets tax credit allocation from the Secretary. On August 1, 2004, A pays $100,000 for a capital interest in X. On August 5, 2004, X uses the proceeds of A's equity investment to make an equity investment in Y. X controls Y within the meaning of paragraph (d)(6)(ii)(B) of this section. For the annual period ending July 31, 2005, Y is a qualified active low-income community business (as defined in paragraph (d)(4) of this section). Thus, for that period, A's equity investment satisfies the substantially-all requirement under paragraph (c)(5)(i) of this section using the direct-tracing calculation under paragraph (c)(5)(ii) of this section. For the annual period ending July 31, 2006, Y no longer is a qualified active low-income community business. Thus, for that period, A's equity investment does not satisfy the substantially-all requirement using the direct-tracing calculation. However, during the entire annual period ending July 31, 2006, X's remaining assets are invested in qualified low-income community investments with an aggregate cost basis of $900,000. Consequently, for the annual period ending July 31, 2006, at least 85 percent of X's aggregate gross assets are invested in qualified low-income community investments. Thus, for the annual period ending July 31, 2006, A's equity investment satisfies the substantially-all requirement using the safe harbor calculation under paragraph (c)(5)(iii) of this section.

Example 3. X is a partnership and a CDE that has received a new markets tax credit allocation from the Secretary. On August 1, 2004, A and B each pay $100,000 for a capital interest in X. X does not treat A's and B's equity investments as one qualified equity investment under paragraph (c)(6) of this section. On September 1, 2004, X uses the proceeds of A's equity investment to make an equity investment in Y and X uses the proceeds of B's equity investment to make an equity investment in Z. X has no assets other than its investments in Y and Z. X controls Y and Z within the meaning of paragraph (d)(6)(ii)(B) of this section. For the annual period ending July 31, 2005, Y and Z are qualified active low-income community businesses (as defined in paragraph (d)(4) of this section). Thus, for the annual period ending July 31, 2005, A's and B's equity investments satisfy the substantially-all requirement under paragraph (c)(5)(i) of this section using either the direct-tracing calculation under paragraph (c)(5)(ii) of this section or the safe harbor calculation under paragraph (c)(5)(iii) of this section. For the annual period ending July 31, 2006, Y, but not Z, is a qualified active low-income community business. Thus, for the annual period ending July 31, 2006: (1) X does not satisfy the substantially-all requirement using the safe harbor calculation under paragraph (c)(5)(iii) of this section; (2) A's equity investment satisfies the substantially-all requirement using the direct-tracing calculation because A's equity investment is directly traceable to Y; and (3) B's equity investment does not satisfy the substantially-all requirement because B's equity investment is traceable to Z.

* * * * *

(d) * * *

(1) * * *

(ii) *Purchase of certain loans from CDEs*—(A) *In general*. The purchase by a CDE (the ultimate CDE) from another CDE (whether or not that CDE has received an allocation from the Secretary under section 45D(f)(2)) of any loan made by such entity that is a qualified low-income community investment. A loan purchased by the ultimate CDE from another CDE is a qualified low-income community investment if it qualifies as a qualified low-income community investment either—

(*1*) At the time the loan was made; or

(*2*) At the time the ultimate CDE purchases the loan.

(B) *Certain loans made before CDE certification*. For purposes of paragraph (d)(1)(ii)(A) of this section, a loan by an entity is treated as made by a CDE, notwithstanding that the entity was not a CDE at the time it made the loan, if the entity is a CDE at the time it sells the loan.

(C) *Intermediary CDEs*. For purposes of paragraph (d)(1)(ii)(A) of this section, the purchase of a loan by the ultimate CDE from a CDE that did not make the loan (the second CDE) is treated as a purchase of the loan by the ultimate CDE from the CDE that made the loan (the originating CDE) if—

(*1*) The second CDE purchased the loan from the originating CDE (or from another CDE); and

(*2*) Each entity that sold the loan was a CDE at the time it sold the loan.

(D) *Examples*. The following examples illustrate an application of this paragraph (d)(1)(ii):

Example 1. X is a partnership and a CDE that has received a new markets tax credit allocation from the Secretary. Y, a corporation, made a $500,000 loan to Z in 1999. In January of 2004, Y is certified as a CDE. On September 1, 2004, X purchases the loan from Y. At the time X purchases the loan, Z is a qualified active low-income community business under paragraph (d)(4)(i) of this section. Accordingly, the loan purchased by X from Y is a qualified low-income community investment under paragraphs (d)(1)(ii)(A) and (B) of this section.

Example 2. The facts are the same as in *Example 1* except that on February 1, 2004, Y sells the loan to W and on September 1, 2004, W sells the loan to X. W is a CDE. Under paragraph (d)(1)(ii)(C) of this section, X's purchase of the loan from W is treated as the purchase of the loan from Y. Accordingly, the loan purchased by X from W is a qualified low-income community investment under paragraphs (d)(1)(ii)(A) and (C) of this section.

Example 3. The facts are the same as in *Example 2* except that W is not a CDE. Because W was not a CDE at the time it sold the loan to X, the purchase of the loan by X from W is not a qualified low-income community investment under paragraphs (d)(1)(ii)(A) and (C) of this section.

* * * * *

(iv) *Investments in other CDEs*—(A) *In general*. Any equity investment in, or loan to, any CDE (the second CDE) by a CDE (the primary CDE), but only to the extent that the second CDE uses the proceeds of the investment or loan—

(*1*) In a manner—

(*i*) That is described in paragraph (d)(1)(i) or (iii) of this section; and

(*ii*) That would constitute a qualified low-income community investment if it were made directly by the primary CDE;

(*2*) To make an equity investment in, or loan to, a third CDE that uses such proceeds in a manner described in paragraph (d)(1)(iv)(A)(*1*) of this section; or

(*3*) To make an equity investment in, or loan to, a third CDE that uses such proceeds to make an equity investment in, or loan to, a fourth CDE that uses such proceeds in a manner described in paragraph (d)(1)(iv)(A)(*1*) of this section.

(B) *Examples*. The following examples illustrate an application of paragraph (d)(1)(iv)(A) of this section:

Example 1. X is a partnership and a CDE that has received a new markets tax credit allocation from the Secretary. On September 1, 2004, X uses $975,000 to make an equity investment in Y. Y is a corporation and a CDE. On October 1, 2004, Y uses $950,000 from X's equity investment to make a loan to Z. Z is a qualified active low-income community business under paragraph (d)(4)(i) of this section. Of X's equity investment in Y, $950,000 is a qualified low-income community investment under paragraph (d)(1)(iv)(A)(*1*) of this section.

Example 2. W is a partnership and a CDE that has received a new markets tax credit allocation from the Secretary. On September 1, 2004, W uses $975,000 to make an equity investment in X. On October 1, 2004, X uses $950,000 from W's equity investment to make an equity investment in Y. X and Y are corporations and CDEs. On October 5, 2004, Y uses $925,000 from X's equity investment to make a loan to Z. Z is a qualified active low-income community business under paragraph (d)(4)(i) of this section. Of W's equity investment in X, $925,000 is a qualified low-income community investment under paragraph (d)(1)(iv)(A)(*2*) of this section because X uses proceeds of W's equity investment to make an equity investment in Y, which uses $925,000 of the proceeds in a manner described in paragraph (d)(1)(iv)(A)(*1*) of this section.

Example 3. U is a partnership and a CDE that has received a new markets tax credit allocation from the Secretary. On September 1, 2004, U uses $975,000 to make an equity investment in V. On October 1, 2004, V uses $950,000 from U's equity investment to make an equity investment in W. On October 5, 2004, W uses $925,000 from V's equity investment to make an equity investment in X. On November 1, 2004, X uses $900,000 from W's equity investment to make an equity investment in Y. V, W, X, and Y are corporations and CDEs. On November 5, 2004, Y uses $875,000 from X's equity investment to make a loan to Z. Z is a qualified active low-income community business under paragraph (d)(4)(i) of this section. U's equity investment in V is not a qualified low-income community investment because X does not use proceeds of W's equity investment in a manner described in paragraph (d)(1)(iv)(A)(*1*) of this section.

* * * * *

(4) * * *

(i) * * *

(A) * * * See paragraph (d)(4)(iv) of this section for circumstances in which an entity will be treated as engaged in the active conduct of a trade or business.

* * * * *

(C) * * * If the entity has no employees, the entity is deemed to satisfy this paragraph (d)(4)(i)(C), and paragraph (d)(4)(i)(A) of this section, if the entity meets the requirement of paragraph (d)(4)(i)(B) of this section if "85 percent" is applied instead of *40 percent*.

* * * * *

(iv) *Active conduct of a trade or business*—(A) *Special rule*. For purposes of paragraph (d)(4)(i)(A) of this section, an entity will be treated as engaged in the active conduct of a trade or business if, at the time the CDE makes a capital or equity investment in, or loan to, the entity, the CDE reasonably expects that the entity will generate revenues (or, in the case of a nonprofit corporation, receive donations) within 3 years after the date the investment or loan is made.

(B) *Example*. The application of paragraph (d)(4)(iv)(A) of this section is illustrated by the following example:

Example. X is a partnership and a CDE that receives a new markets tax credit allocation from the Secretary on July 1, 2004. X makes a ten-year loan to Y. Y is a newly formed entity that will own and operate a shopping center to be constructed in a low-income community. Y has no revenues but X reasonably expects that Y will generate revenues beginning in December 2005. Under paragraph (d)(4)(iv)(A) of this section, Y is treated as engaged in the active conduct of a trade or business for purposes of paragraph (d)(4)(i)(A) of this section.

* * * * *

(6) * * *

(ii) * * *

(B) *Definition of control*. Control means, with respect to an entity, direct or indirect ownership (based on value) or control (based on voting or management rights) of more than 50 percent of the entity.

(C) *Disregard of control*. For purposes of paragraph (d)(6)(ii)(A) of this section, the acquisition of control of an entity by a CDE is disregarded during the 12-month period following such acquisition of control (the 12-month period) if—

(*1*) The CDE's capital or equity investment in, or loan to, the entity met the requirements of paragraph (d)(6)(i) of this section when initially made;

(*2*) The CDE's acquisition of control of the entity is due to financial difficulties of the entity that were unforeseen at the time the investment or loan described in paragraph (d)(6)(ii)(C)(*1*) of this section was made; and

(*3*) If the acquisition of control occurs before the seventh year of the 7-year credit period (as defined in paragraph (c)(5)(i) of this section), either—

(*i*) The entity satisfies the requirements of paragraph (d)(4) of this section by the end of the 12-month period; or

(*ii*) The CDE sells or causes to be redeemed the entire amount of the investment or loan described in paragraph (d)(6)(ii)(C)(*1*) of this section and, by the end of the 12-month period, reinvests the amount received in respect of the sale or redemption in a qualified low-income community investment under paragraph (d)(1) of this section. For this purpose, the amount treated as continuously invested in a qualified low-income community investment is determined under paragraphs (d)(2)(i) and (ii) of this section.

* * * * *

(8) *Special rule for certain loans*—(i) *In general*. For purposes of paragraphs (d)(1)(i), (ii), and (iv) of this section, a loan is treated as made by a CDE to the extent the CDE purchases the loan from the originator (whether or not the originator is a CDE) within 30 days after the date the originator makes the loan if, at the time the loan is made, there is a legally enforceable written agreement between the originator and the CDE which—

(A) Requires the CDE to approve the making of the loan either directly or by imposing specific written loan underwriting criteria; and

(B) Requires the CDE to purchase the loan within 30 days after the date the loan is made.

(ii) *Example*. The application of paragraph (d)(8)(i) of this section is illustrated by the following example:

Example. (i) X is a partnership and a CDE that has received a new markets tax credit allocation from the Secretary. On October 1, 2004, Y enters into a legally enforceable written agreement with W. Y and W are corporations but only Y is a CDE. The agreement between Y and W provides that Y will purchase loans (or portions thereof) from W within 30 days after the date the loan is made by W, and that Y will approve the making of the loans.

(ii) On November 1, 2004, W makes a $825,000 loan to Z pursuant to the agreement between Y and W. Z is a qualified active low-income community business under paragraph (d)(4) of this section. On November 15, 2004, Y purchases the loan from W for $840,000. On December 31, 2004, X purchases the loan from Y for $850,000.

(iii) Under paragraph (d)(8)(i) of this section, the loan to Z is treated as made by Y. Y's loan to Z is a qualified low-income community investment under paragraph (d)(1)(i) of this section. Accordingly, under paragraph (d)(1)(ii)(A) of this section, X's purchase of the loan from Y is a qualified low-income community investment in the amount of $850,000.

* * * * *

(g) * * *

(3) *Other Federal tax benefits*—(i) *In general*. Except as provided in paragraph (g)(3)(ii) of this section, the availability of Federal tax benefits does not limit the availability of the new markets tax credit. Federal tax benefits that do not limit the availability of the new markets tax credit include, for example:

(A) The rehabilitation credit under section 47;

(B) All depreciation deductions under sections 167 and 168, including the additional first-year depreciation under section 168(k), and the expense deduction for certain depreciable property under section 179; and

(C) All tax benefits relating to certain designated areas such as empowerment zones and enterprise communities under sections 1391 through 1397D, the District of Columbia Enterprise Zone under sections 1400 through 1400B, renewal communities under sections 1400E through 1400J, and the New York Liberty Zone under section 1400L.

(ii) *Low-income housing credit*. This paragraph (g)(3) does not apply to the low-income housing credit under section 42.

(4) *Bankruptcy of CDE*. The bankruptcy of a CDE does not preclude a taxpayer from continuing to claim the new markets tax credit on the remaining credit allowance dates under paragraph (b)(2) of this section.

(h) *Effective dates*—(1) *In general*. Except as provided in paragraph (h)(2) of this section, this section applies on or after December 26, 2001, and expires on December 23, 2004.

(2) *Exception for certain provisions*. Paragraphs (c)(3)(ii), (c)(3)(iii), (c)(5)(vi), (d)(1)(ii), (d)(1)(iv), (d)(4)(iv), (d)(6)(ii)(B), (d)(6)(ii)(C), (d)(8), (g)(3),

and (g)(4) of this section, the fourth sentence in paragraph (c)(5)(i) of this section, the last sentence in paragraph (d)(4)(i)(A) of this section, and the last sentence in paragraph (d)(4)(i)(C) of this section apply on or after March 11, 2004, and may be applied by taxpayers before March 11, 2004. The paragraphs of this section that apply before March 11, 2004 are contained in §1.45D–1T as in effect before March 11, 2004 (see 26 CFR part 1 revised as of April 1, 2003).

Mark E. Matthews,
Deputy Commissioner for Services and Enforcement.

Approved March 3, 2004.

Gregory F. Jenner,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on March 10, 2004, 8:45 a.m., and published in the issue of the Federal Register for March 11, 2004, 69 F.R. 11507)

Section 168.—Accelerated Cost Recovery System

26 CFR 1.168(a)–1T: Modified accelerated cost recovery system (temporary).

T.D. 9115

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Depreciation of MACRS Property That is Acquired in a Like-kind Exchange or As a Result of an Involuntary Conversion

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains regulations relating to the depreciation of property subject to section 168 of the Internal Revenue Code (MACRS property). Specifically, these temporary regulations provide guidance on how to depreciate MACRS property acquired in a like-kind exchange under section 1031 or as a result of an involuntary conversion under section 1033 when both the acquired and relinquished property are subject to MACRS in the hands of the acquiring taxpayer. These temporary regulations will affect taxpayers involved in a like-kind exchange under section 1031 or an involuntary conversion under section 1033. The text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking (REG–106590–00) on this subject in this issue of the Bulletin.

DATES: *Effective Dates*: These regulations are effective March 1, 2004.

Applicability Dates: For dates of applicability, see §§1.168(a)–1T(b) and (c), 1.168(b)–1T(b), 1.168(d)–1T(d), 1.168(i)–1T(l), 1.168(i)–6T(k), and 1.168(k)–1T(g).

FOR FURTHER INFORMATION CONTACT: Charles J. Magee, (202) 622–3110 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to 26 CFR part 1 under section 168 of the Internal Revenue Code (Code). Section 168 has been modified by several Acts, including section 201 of the Tax Reform Act of 1986, Public Law 99–514 (100 Stat. 2085, 2121), section 101 of the Job Creation and Worker Assistance Act of 2002, Public Law 107–147 (116 Stat. 21), and section 201 of the Jobs and Growth Tax Relief Reconciliation Act of 2003, Public Law 108–27 (117 Stat. 752). Section 168 provides the depreciation deduction for tangible property generally placed in service after December 31, 1986.

Explanation of Provisions

Background

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 depreciable tangible property placed in service after 1986 generally is determined under section 168 (MACRS property). Under section 1031(a)(1), no gain or loss is recognized on an exchange of property held for productive use in a trade or business or for investment if the property is exchanged solely for property of like kind that is to be held either for productive use in a trade or business or for investment. Section 1031(b) provides that if an exchange would be within the provision of section 1031(a) were it not for the fact that the property received in the exchange consists not only of property permitted to be received in such an exchange, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property. Under section 1031(c), no loss from such a transaction is recognized. Under section 1031(d), the basis of property acquired in an exchange described in section 1031 is the same as that of the property exchanged, decreased by the amount of any money received by the taxpayer and increased by the amount of gain (or decreased by the amount of loss) that was recognized on such exchange.

Section 1033(a)(1) provides that if property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted into property similar or related in service or use to the property so converted, no gain is recognized. Under section 1033(b)(1), the basis of property acquired by the taxpayer in such a transaction is the basis of the converted property. Under section 1033(a)(2)(A), if property is compulsorily or involuntarily converted into money or into property not similar or related in service or use to the converted property, and, within the time frame described in section 1033(a)(2)(B), the taxpayer purchases property that is related in service or use to the converted property or purchases stock in the acquisition of control of a corporation owning such property, then the taxpayer may elect to recognize gain only to the extent that the amount realized upon such conversion exceeds the cost of such other property. Under section 1033(b)(2), if such an election is made, the basis of the replacement property acquired by the taxpayer generally is the cost of that property decreased by any gain not recognized by reason of section 1033(a)(2).

The IRS became aware of inconsistent depreciation treatment by taxpayers of property that has a basis determined under section 1031(d) or section 1033(b) (replacement property). Certain taxpayers were depreciating the replacement property using the same depreciation method, recovery period, and convention as the exchanged or involuntarily converted property (relinquished property) while other taxpayers were depreciating the replacement property as if it were newly placed in service.

In response, the IRS and Treasury issued Notice 2000–4, 2000–1 C.B. 313, published January 18, 2000. Notice 2000–4 instructed taxpayers how to depreciate MACRS property that has a basis determined under section 1031(d) or section 1033(b) (replacement MACRS property), provided that the exchanged or involuntarily converted property was also MACRS property (relinquished MACRS property). The notice stated that replacement MACRS property placed in service after January 3, 2000, is depreciated over the remaining recovery period of, and using the same depreciation method and convention as, the relinquished MACRS property and that any excess of the basis in the replacement MACRS property over the adjusted basis in the relinquished MACRS property is treated as newly purchased MACRS property. Notice 2000–4 also stated that the IRS and Treasury intended to issue regulations to address these transactions. Public comments on the nature and scope of these temporary regulations were requested.

Scope

The temporary regulations instruct taxpayers how to determine the annual depreciation allowance under section 168 for replacement MACRS property. Generally, MACRS property, which is defined in §1.168(b)–1T(a)(2), is tangible property of a character subject to the allowance for depreciation provided in section 167(a) that is placed in service after December 31, 1986, and subject to section 168. The temporary regulations also apply to a transaction to which section 1031(a), (b), or (c) applies (like-kind exchange) or a transaction in which gain or loss is not recognized pursuant to section 1033 (involuntary conversion) involving MACRS property that is replaced with other MACRS property in a transaction between members of the same affiliated group.

Property acquired in a like-kind exchange or involuntary conversion to replace property whose depreciation allowance is computed under a depreciation system other than MACRS, or to replace property for which a taxpayer made a valid election under section 168(f)(1) to exclude it from the application of section 168 (MACRS), is not within the scope of the temporary regulations. Additionally, this regulation does not provide guidance for a taxpayer acquiring property in an exchange for property that the taxpayer depreciated under the Accelerated Cost Recovery System (ACRS) or for a taxpayer acquiring an automobile for another automobile for which the taxpayer used the Standard Mileage Rate method of deducting expenses. Comments are requested on the depreciation treatment of like-kind exchange or involuntary conversion transactions described above and whether the depreciation treatment of these transactions should fall within the scope of this regulation.

The depreciation treatment used by previous owners in determining depreciation allowances for the replacement MACRS property is not relevant. For example, a taxpayer exchanging MACRS property for property that was depreciated under ACRS by the person relinquishing the property may use this regulation (because the acquired property will become MACRS property in the hands of the acquiring taxpayer). In addition, elections made by previous owners in determining depreciation allowances of the replacement MACRS property have no effect on the acquiring taxpayer. For example, a taxpayer exchanging MACRS property that the taxpayer depreciates under the general depreciation system for other MACRS property that the previous owner elected to depreciate under the alternative depreciation system pursuant to section 168(g)(7) does not have to continue using the alternative depreciation system for the replacement MACRS property.

Finally, the IRS has learned that some taxpayers question whether Notice 2000–4 allows depreciation of land, if the land is acquired in a like-kind exchange or involuntary conversion for MACRS property. As explained in further detail below, neither the temporary regulations nor Notice 2000–4 allow taxpayers to depreciate land or other nondepreciable property.

General Rule

Exchanged Basis

The temporary regulations provide rules for determining the applicable recovery period, depreciation method, and convention used to determine the depreciation allowances for the replacement MACRS property with respect to so much of the taxpayer's basis (as determined under section 1031(d) and the regulations under section 1031(d) or section 1033(b) and the regulations under section 1033(b)) in the replacement MACRS property as does not exceed the taxpayer's adjusted depreciable basis in the relinquished MACRS property (exchanged basis). In general, the exchanged basis is depreciated over the remaining recovery period of, and using the depreciation method and convention of, the relinquished MACRS property (general rule).

This general rule applies if the replacement MACRS property has the same or a shorter recovery period or the same or a more accelerated depreciation method than the relinquished MACRS property. Under certain circumstances, this rule could adversely affect taxpayers engaging in like-kind exchanges or involuntary conversions. For example, under the general rule, a taxpayer must depreciate replacement MACRS property with a shorter recovery period over the longer recovery period of the relinquished MACRS property even if the taxpayer could depreciate the replacement MACRS property over a shorter recovery period by treating such property as newly acquired MACRS property. Accordingly, the temporary regulations provide an election not to apply the temporary regulations and to treat the replacement MACRS property as MACRS property placed in service by the acquiring taxpayer at the time of replacement. Taxpayers may use this election to ameliorate the possible adverse effects of applying the general rule to this type of transaction.

The general rule does not apply if the replacement MACRS property has a longer recovery period or less accelerated depreciation method than the relinquished property. If the recovery period of the replacement MACRS property is longer than that of the relinquished MACRS property, the taxpayer's exchanged basis in the relinquished MACRS property is depreciated beginning in the year of replacement over the remainder of the recovery period that would have applied to the replacement MACRS property if the replacement MACRS property had originally been placed in service when the relinquished MACRS property was placed in service by the acquiring taxpayer. Similarly, if the depreciation method of the replacement MACRS property is less accelerated than that of the relinquished MACRS property, then the taxpayer's exchanged basis in the relinquished MACRS property is depreciated beginning in the year of replacement using the less accelerated depreciation method of the replacement MACRS property that would have applied to the replacement MACRS property if the replacement MACRS property had originally been placed in service when the relinquished MACRS property was placed in service by the acquiring taxpayer.

For taxpayers who wish to use the optional depreciation tables to determine the depreciation allowances for the replacement MACRS property instead of the formulas (for example, see section 6 of Rev. Proc. 87–57, 1987–2 C.B. 687, 692), the temporary regulations provide guidance on choosing the applicable optional table as well as how to modify the calculation for computing the depreciation allowances for the replacement MACRS property.

Excess Basis

Any excess of the taxpayer's basis in the replacement MACRS property over the taxpayer's exchanged basis in the relinquished MACRS property is referred to as the excess basis. Generally, the excess basis in the replacement MACRS property is treated as property that is placed in service by the acquiring taxpayer in the taxable year in which the replacement MACRS property is placed in service by the acquiring taxpayer or, if later, the taxable year of the disposition of the relinquished MACRS property (time of replacement). The depreciation allowances for the excess basis are determined by using the applicable recovery period, depreciation method, and convention prescribed under section 168 for the replacement MACRS property at the time of replacement. In addition, the excess basis may be taken into account for purposes of computing the deduction allowed under section 179.

Special Rules

Deferred Exchanges

Because of the complex nature of certain like-kind exchange and involuntary conversion transactions, the temporary regulations provide special rules for certain circumstances. If a taxpayer disposes of the relinquished MACRS property prior to the acquisition of the replacement MACRS property, the temporary regulations do not allow the taxpayer to take depreciation on the relinquished MACRS property during the period between the disposition of the relinquished MACRS property and the acquisition of the replacement MACRS property. This results because, in a deferred exchange under §1.1031(k)–1, or if a taxpayer does not replace converted property until after the taxpayer no longer owns the converted property, the taxpayer has no property to depreciate during that intervening period. Accordingly, the recovery period for the replacement MACRS property is suspended during this period. The temporary regulations do not address the issue of whether an intermediary (such as an exchange accommodation titleholder) is entitled to depreciation.

Acquisition Prior To Disposition

When replacement MACRS property is acquired and placed in service by a taxpayer before the relinquished MACRS property is disposed of by the taxpayer (for example, under threat of condemnation), the regulations allow the taxpayer to depreciate the unadjusted depreciable basis of the replacement MACRS property until the time of disposition of the relinquished MACRS property by the taxpayer. The taxpayer must include in taxable income in the year of disposition of the relinquished MACRS property the excess of the depreciation allowable on the unadjusted depreciable basis of the replacement MACRS property over the depreciation that would be allowable on the excess basis of the replacement MACRS property from the date the replacement MACRS property was placed in service by the taxpayer to the time of disposition of the relinquished MACRS property. The depreciation of the depreciable excess basis of the replacement MACRS property continues to be depreciated by the taxpayer. The IRS and Treasury may consider providing additional future guidance with respect to this issue and request comments relating thereto. The IRS and Treasury also invite taxpayers to comment on whether the allowance of depreciation for the replacement MACRS property should be followed by basis reduction at the time of disposition of the relinquished MACRS property, or whether some other approach should be taken.

Transactions Involving Nondepreciable Property

Because land or other nondepreciable property acquired in a like-kind exchange or involuntary conversion for MACRS property is not depreciable, such property is not within the scope of the temporary regulations. Further, if MACRS property or both MACRS property and land or other nondepreciable property are acquired in a like-kind exchange or involuntary conversion for land or other nondepreciable property, the basis of the replacement MACRS property is treated as property placed in service by the acquiring taxpayer in the year of replacement.

Automobiles

The IRS received many comments concerning the like-kind exchange of automobiles. In response, the temporary regulations contain detailed rules regarding the annual allowable depreciation for automobiles acquired in a like-kind exchange or involuntary conversion. The temporary regulations provide that if the replacement MACRS property consists of a passenger automobile that is subject to the depreciation limitations of section 280F(a), then the depreciation limitation that applies for the taxable year is based on the date the replacement MACRS automobile is placed in service by the acquiring taxpayer. In allocating the depreciation limitation, the depreciation allowance for the exchanged basis in the replacement MACRS automobile generally is limited to the amount that would have been allowable under section

280F(a) for the relinquished MACRS automobile had the transaction not occurred. The depreciation allowance for the excess basis is generally limited to the section 280F(a) limitation that applies for that taxable year less the amount of the depreciation allowance for the exchanged basis.

Election Not To Apply Temporary Regulations

Commentators suggested that implementing the general rule for all depreciable property was burdensome because taxpayers would have onerous computational and administrative difficulties due to the possibility of having to track different depreciation components of one asset. Responding to these comments, the temporary regulations include a provision by which taxpayers may elect not to apply these temporary regulations. If a taxpayer elects not to apply the temporary regulations, the taxpayer must treat the entire basis (*i.e.*, both the exchanged and excess basis) of the replacement MACRS property as being placed in service by the acquiring taxpayer at the time of replacement. Consistent with this treatment, the taxpayer treats the relinquished MACRS property as disposed of at the time of the disposition of the relinquished MACRS property. The election must be made by typing or legibly printing at the top of Form 4562, *Depreciation and Amortization*, "ELECTION MADE UNDER SECTION 1.168(i)–6T(i)," or in the manner provided for on Form 4562 and its instructions.

Additional First Year Depreciation

Temporary regulations issued under §§1.168(k)–1T and 1.1400L(b)–1T (T.D. 9091, 2003–44 I.R.B. 939 [68 FR 52986] (September 8, 2003)) provide that the exchanged basis (referred to as the "carryover basis" in such regulations) and the excess basis, if any, of the replacement MACRS property (referred to as the "acquired MACRS property" in such regulations) is eligible for the additional first year depreciation deduction provided under section 168(k) or 1400L(b) if the replacement MACRS property is qualified property under section 168(k)(2), 50-percent bonus depreciation property under section 168(k)(4), or qualified New York Liberty Zone property under section 1400L(b)(2). However, if qualified property, 50-percent bonus depreciation property, or qualified New York Liberty Zone property is placed in service by the taxpayer and then disposed of by that taxpayer in a like-kind exchange or involuntary conversion in the same taxable year, the relinquished MACRS property (referred to as the "exchanged or involuntarily converted MACRS property" in such regulations) is not eligible for the additional first year depreciation deduction under section 168(k) or 1400L(b), as applicable. However, the exchanged basis (and excess basis, if any) of the replacement MACRS property may be eligible for the additional first year depreciation deduction under section 168(k) or 1400L(b), as applicable, subject to the requirements of section 168(k) or 1400L(b), as applicable. The rules provided under §§1.168(k)–1T and 1.1400L(b)–1T apply even if the taxpayer elects not to apply these temporary regulations.

These temporary regulations amend the definition of time of replacement in §1.168(k)–1T(f)(5)(ii)(F) to be consistent with the definition of that term under these temporary regulations. In addition, these temporary regulations modify the like-kind exchange or involuntary conversion examples contained in §1.168(k)–1T(f)(5)(v) to reflect the placed in service date (taking into account the convention as determined under these temporary regulations) for the relinquished MACRS property and the replacement MACRS property in the year of disposition and year of replacement.

Since the publication of §§1.168(k)–1T and 1.1400L(b)–1T, we have received comments regarding the application of the additional first year depreciation deduction rules in §§1.168(k)–1T(f)(5) and 1.1400L(b)–1T(f)(5) to qualified property, 50-percent bonus depreciation property, or qualified New York Liberty Zone property acquired in a like-kind exchange or an involuntary conversion. We will consider these comments when §§1.168(k)–1T and 1.1400L(b)–1T are finalized.

General Asset Accounts

Some commentators questioned how the general rule set forth in Notice 2000–4 affects the tax treatment of like-kind exchanges or involuntary conversions involving MACRS assets contained in general asset accounts as described in §1.168(i)–1.

Section 1.168(i)–1(e)(2) treats like-kind exchanges or involuntary conversions as dispositions of the relinquished MACRS property and acquisitions of the replacement MACRS property. As a result, any amount realized on a like-kind exchange or involuntary conversion is recognized as ordinary income and the basis of the relinquished MACRS property in the general asset account continues to be depreciated. However, §1.168(i)–1(e)(3)(iii) allows a taxpayer to elect to terminate general asset account treatment for the relinquished MACRS property, and, as a result, the tax treatment of the like-kind exchange or involuntary conversion is determined under section 1031 or section 1033, as applicable.

These temporary regulations amend the final regulations under section 168(i)(4) (T.D. 8566, 1994–2 C.B. 20 [59 FR 51369] (1994)) to address the like-kind exchange or involuntary conversion of MACRS property contained in a general asset account. Under the temporary regulations, general asset account treatment terminates for the relinquished MACRS property as of the first day of the year of disposition. Because this rule would require taxpayers to track each property in a general asset account, the IRS and Treasury request comments on alternative methods to account for a like-kind exchange or involuntary conversion involving MACRS property contained in a general asset account when the replacement MACRS property has a longer recovery period or less accelerated depreciation method than the relinquished MACRS property or when the basis of the general asset account would change as a result of the like-kind exchange or involuntary conversion.

Exchanges of Multiple Properties

The determination of the basis of property acquired in a like-kind exchange involving multiple properties is described in §1.1031(j)–1 and the determination of the basis of multiple properties acquired as a result of an involuntary conversion is described in §1.1033(b)–1. Commentators question how the rules set forth in Notice 2000–4 affects the depreciation treatment of a like-kind exchange or an involuntary conversion involving multiple properties. At this time, taxpayers may apply the principles of this temporary regulation to determine the depreciation treatment of MACRS property acquired in these transactions. The IRS and Treasury may consider providing future guidance with respect to this issue and request comments relating thereto. Specifically, comments are requested on the depreciation treatment of these transactions when the depreciation methods or recovery periods of the replacement MACRS properties differ from those of the relinquished MACRS properties.

Effect on Other Documents

The following publication is obsolete after February 27, 2004:

Notice 2000–4, 2000–1 C.B. 313.

Taxpayers who have either relinquished or acquired MACRS property in a like-kind exchange or involuntary conversion between January 3, 2000, and February 27, 2004, may rely on Notice 2000–4.

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. For the applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6), refer to the Special Analyses section of the preamble to the cross-reference notice of proposed rulemaking published in this issue of the Bulletin. Pursuant to section 7805(f) of the Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal authors of these regulations are Alan H. Cooper, Office of the Chief Counsel (Small Business/Self Employed), and Charles J. Magee, Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Temporary Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1 — INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

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

§1.168(i)–1T also issued under 26 U.S.C. 168(i)(4).

Par. 2. Sections 1.168(a)–1T and 1.168(b)–1T are added to read as follows:

§1.168(a)–1T Modified accelerated cost recovery system (temporary).

(a) Section 168 determines the depreciation allowance for tangible property that is of a character subject to the allowance for depreciation provided in section 167(a) and that is placed in service after December 31, 1986 (or after July 31, 1986, if the taxpayer made an election under section 203(a)(1)(B) of the Tax Reform Act of 1986; 100 Stat. 2143). Except for property excluded from the application of section 168 as a result of section 168(f) or as a result of a transitional rule, the provisions of section 168 are mandatory for all eligible property. The allowance for depreciation under section 168 constitutes the amount of depreciation allowable under section 167(a). The determination of whether tangible property is property of a character subject to the allowance for depreciation is made under section 167 and the regulations under section 167.

(b) This section is applicable on and after February 27, 2004.

(c) The applicability of this section expires on or before February 26, 2007.

§1.168(b)–1T Definitions (temporary).

(a) *Definitions*. For purposes of section 168 and the regulations under section 168, the following definitions apply:

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

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

(3) *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, and for any adjustments to basis provided by other provisions of the Internal Revenue Code and the regulations under the Code (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).

(4) *Adjusted depreciable basis* is the unadjusted depreciable basis of the property, as defined in §1.168(b)–1T(a)(3), less the adjustments described in section 1016(a)(2) and (3).

(b) *Effective date*. (1) This section is applicable on February 27, 2004.

(2) The applicability of this section expires on or befre February 26, 2007.

Par. 3. Section 1.168(d)–1 is amended by:

1. Revising paragraph (b)(3).
2. Adding paragraph (d)(3).

The addition and revision read as follows:

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

* * * * *

(b) * * *

(3) * * * (i) and (ii) [Reserved]. For further guidance, see §1.168(d)–1T(b)(3)(i) and (ii).

* * * * *

(d) * * *

(3) *Like-kind exchanges and involuntary conversions*. [Reserved]. For further guidance, see §1.168(d)–1T(d)(3)(i).

Par. 4. Section 1.168(d)–1T is amended by:

1. Revising paragraphs (a) through (b)(3)(ii).

2. Adding paragraph (d)(3).

The addition and revisions read as follows:

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

(a) through (b)(2) [Reserved]. For further guidance, see §1.168(d)–1(a) through (b)(2).

(b)(3) *Property placed in service and disposed of in the same taxable year*—(i) Under section 168(d)(3)(B)(ii), the depreciable basis of property placed in service and disposed of in the same taxable year is not taken into account in determining whether the 40-percent test is satisfied. However, the depreciable basis of property placed in service, disposed of, subsequently reacquired, and again placed in service, by the taxpayer in the same taxable year must be taken into account in applying the 40-percent test, but the basis of the property is only taken into account on the later of the dates that the property is placed in service by the taxpayer during the taxable year. Further, see §1.168(i)–6T(c)(4)(v)(B) and §1.168(i)–6T(f) for rules relating to property placed in service and exchanged or involuntarily converted during the same taxable year.

(ii) The applicable convention, as determined under this section, applies to all depreciable property (except nonresidential real property, residential rental property, and any railroad grading or tunnel bore) placed in service by the taxpayer during the taxable year, excluding property placed in service and disposed of in the same taxable year. However, see §1.168(i)–6T(c)(4)(v)(A) and §1.168(i)–6T(f) for rules relating to MACRS property that has a basis determined under section 1031(d) or section 1033(b). No depreciation deduction is allowed for property placed in service and disposed of during the same taxable year. However, see §1.168(k)–1T(f)(1) for rules relating to qualified property or 50-percent bonus depreciation property, and §1.1400L(b)–1T(f)(1) for rules relating to qualified New York Liberty Zone property, that is placed in service by the taxpayer in the same taxable year in which either a partnership is terminated as a result of a technical termination under section 708(b)(1)(B) or the property is transferred in a transaction described in section 168(i)(7).

* * * * *

(d)(2) * * *

(3) *Like-kind exchanges and involuntary conversions*. (i) The last sentence in paragraph (b)(3)(i) and the second sentence in paragraph (b)(3)(ii) of this section apply to exchanges to which section 1031 applies, and involuntary conversions to which section 1033 applies, of MACRS property for which the time of disposition and the time of replacement both occur after February 27, 2004.

(ii) The applicability of this section expires on or before February 26, 2007.

Par. 5. In §1.168(i)–0, the entries for §1.168(i)–1(d)(2), (e)(3)(i), (f), (f)(1), (f)(2), (f)(2)(i), (i), (j) and (l) are revised, the entry for (e)(3)(v) is removed and a new entry for (e)(3)(v) and (vi) is added.

§1.168(i)–0 Table of contents for the general asset account rules.

* * * * *

§1.168(i)–1 General asset accounts.

* * * * *

(d) * * *

(2) [Reserved]. For further guidance, see the entry for §1.168(i)–1T(d)(2).

* * * * *

(e) * * *

(3) * * *

(i) [Reserved]. For further guidance, see the entry for §1.168(i)–1T(e)(3)(i).

* * * * *

(v) and (vi) [Reserved]. For further guidance, see the entries for §1.168(i)–1T(e)(3)(v) and (vi).

* * * * *

(f) through (f)(2)(i) [Reserved]. For further guidance, see the entries for §1.168(i)–1T(f) through (f)(2)(i).

* * * * *

(i) and (j). [Reserved]. For further guidance, see the entries for §1.168(i)–1T(i) and (j).

* * * * *

(l) [Reserved]. For further guidance, see the entry for §1.168(i)–1T(l).

Par. 6. Section 1.168(i)–0T is added to read as follows:

§1.168(i)–0T Table of contents for the general asset account rules (temporary).

This section lists the major paragraphs contained in §1.168(i)–1T.

§1.168(i)–1T General asset accounts (temporary).

(a) through (d)(1) [Reserved]. For further guidance, see the entries for §1.168(i)–1(a) through (d)(1).

(2) Special rule for passenger automobiles.

(e) through (e)(3) [Reserved]. For further guidance, see the entries for §1.168(i)–1(e) through (e)(3).

(i) In general.

(e)(3)(ii) through (e)(3)(iv) [Reserved]. For further guidance, see the entries for §1.168(i)–1(e)(3)(ii) through (iv).

(v) Transactions subject to section 1031 or 1033.

(vi) Anti-abuse rule.

(f) Assets generating foreign source income.

(1) In general.

(2) Source of ordinary income, gain, or loss.

(i) Source determined by allocation and apportionment of depreciation allowed.

(f)(2)(ii) through (h)(2) [Reserved]. For further guidance, see the entries for §1.168(i)–1(f)(2)(ii) through (h)(2).

(i) Identification of disposed or converted asset.

(j) Effect of adjustments on prior dispositions.

(k)(1) through (k)(3) [Reserved]. For further guidance, see the entries for §1.168(i)–1(k)(1) through (k)(3).

(l) Effective date.

(l)(1) through (l)(3) [Reserved]. For further guidance, see the entries for §1.168(i)–1(l)(1) through (l)(3).

Par. 7. Section 1.168(i)–1 is amended by:

1. Redesignating paragraph (e)(3)(v) as paragraph (e)(3)(vi).

2. Adding paragraphs (c)(2)(ii)(E) and (e)(3)(v).

3. Revising paragraphs (d)(2), (e)(3)(i), (e)(3)(iii)(B)(*4*), (e)(3)(vi), (f)(1), (f)(2)(i), (i), (j), and (l).

The additions and revisions read as follows:

§1.168(i)–1 General asset accounts.

* * * * *

(c) * * *

(2) * * * (ii) * * *

(E) [Reserved]. For further guidance, see §1.168(i)–1T(c)(2)(ii)(E).

(d) * * *

(2) [Reserved]. For further guidance, see §1.168(i)–1T(d)(2).

(e) * * *

(3) * * *

(i) [Reserved]. For further guidance, see §1.168(i)–1T(e)(3)(i).

* * * * *

(iii) * * *

(B) * * *

(4) [Reserved]. For further guidance, see §1.168(i)–1T(e)(3)(iii)(B)(*4*).

* * * * *

(e)(3)(v) [Reserved]. For further guidance, see §1.168(i)–1T(e)(3)(v).

(vi) *Anti-abuse rule*—[Reserved]. For further guidance, see §1.168(i)–1T(e)(3)(vi).

(f) *Assets generating foreign source income*—(1) *In general*. [Reserved]. For further guidance, see §1.168(i)–1T(f)(1).

(2) *Source of ordinary income, gain or loss*—(i) [Reserved]. For further guidance, see §1.168(i)–1T(f)(2)(i).

(i) *Identification of disposed or converted asset*. [Reserved]. For further guidance, see §1.168(i)–1T(i).

(j) *Effect of adjustments on prior dispositions*. [Reserved]. For further guidance, see §1.168(i)–1T(j).

* * * * *

(l) *Effective date*—[Reserved]. For further guidance, see §1.168(i)–1T(l).

Par. 8. Section 1.168(i)–1T is added to read as follows:

§1.168(i)–1T General asset accounts (temporary).

(a) through (c)(2)(ii)(D) [Reserved]. For further guidance, see §1.168(i)–1(a) through (c)(2)(ii)(D).

(c)(2)(ii)(E) [Reserved].

(d)(1) [Reserved]. For further guidance, see §1.168(i)–1(d)(1).

(d)(2) *Special rule for passenger automobiles*. For purposes of applying section 280F(a), the depreciation allowance for a general asset account established for passenger automobiles is limited for each taxable year to the amount prescribed in section 280F(a) multiplied by the excess of the number of automobiles originally included in the account over the number of automobiles disposed of during the taxable year or in any prior taxable year in a transaction described in paragraph (e)(3)(iii) (disposition of an asset in a qualifying disposition), (e)(3)(iv) (transactions subject to section 168(i)(7)), (e)(3)(v) (transactions subject to section 1031 or 1033), (e)(3)(vi) (anti-abuse rule), (g) (assets subject to recapture), or (h)(1) (conversion to personal use) of this section.

(e)(1) through (e)(2) [Reserved]. For further guidance, see §1.168(i)–1(e)(1) through (e)(2).

(e)(3) *Special rules*—(i) *In general*. This paragraph (e)(3) provides the rules for terminating general asset account treatment upon certain dispositions. While the rules under paragraphs (e)(3)(ii) and (iii) of this section are optional rules, the rules under paragraphs (e)(3)(iv), (v), and (vi) of this section are mandatory rules. A taxpayer applies paragraph (e)(3)(ii) or (iii) of this section by reporting the gain, loss, or other deduction on the taxpayer's timely filed Federal income tax return (including extensions) for the taxable year in which the disposition occurs. For purposes of applying paragraph (e)(3)(iii) through (vi) of this section, see paragraph (i) of this section for identifying the unadjusted depreciable basis of a disposed asset.

(e)(3)(ii) through (e)(3)(iii)(B)(*3*) [Reserved]. For further guidance, see §1.168(i)–1(e)(3)(ii) through (e)(3)(iii)(B)(*3*).

(e)(3)(iii)(B)(*4*) A transaction, other than a transaction described in paragraph (e)(3)(iv) of this section (pertaining to transactions subject to section 168(i)(7)) and (e)(3)(v) of this section (pertaining to transactions subject to section 1031 or 1033), to which a nonrecognition section of the Code applies (determined without regard to this section).

(e)(3)(iii)(C) through (e)(3)(iv) [Reserved]. For further guidance, see §1.168(i)–1(e)(iii)(C) through (e)(3)(iv).

(e)(3)(v) *Transactions subject to section 1031 or section 1033*—(A) *Like-kind exchange or involuntary conversion of all assets remaining in a general asset account*. If all the assets, or the last asset, in a general asset account are transferred by a taxpayer in a like-kind exchange (as defined under §1.168–6T(b)(11)) or in an involuntary conversion (as defined under §1.168–6T(b)(12)), the taxpayer must apply this paragraph (e)(3)(v)(A) (instead of applying paragraph (e)(2), (e)(3)(ii), or (e)(3)(iii) of this section). Under this paragraph (e)(3)(v)(A), the general asset account terminates as of the first day of the year of disposition (as defined in §1.168(i)–6T(b)(5)) and—

(*1*) The amount of gain or loss for the general asset account is determined under section 1001(a) by taking into account the adjusted depreciable basis of the general asset account at the time of disposition (as defined in §1.168(i)–6T(b)(3)). The depreciation allowance for the general asset account in the year of disposition is determined in the same manner as the depreciation allowance for the relinquished MACRS property (as defined in §1.168(i)–6T(b)(2)) in the year of disposition is determined under §1.168(i)–6T. The recognition and character of gain or loss are determined in accordance with paragraph (e)(3)(ii)(A) of this section (notwithstanding that paragraph (e)(3)(ii) of this section is an optional rule); and

(*2*) The adjusted depreciable basis of the general asset account at the time of disposition is treated as the adjusted depreciable basis of the relinquished MACRS property.

(B) *Like-kind exchange or involuntary conversion of less than all assets remaining in a general asset account*. If an asset in a general asset account is transferred by a taxpayer in a like-kind exchange or in an involuntary conversion and if paragraph (e)(3)(v)(A) of this section does not apply to this asset, the taxpayer must apply this paragraph (e)(3)(v)(B) (instead of applying paragraph (e)(2), (e)(3)(ii), or (e)(3)(iii) of this section). Under this paragraph (e)(3)(v)(B), general asset account treatment for the asset terminates as of the first day of the year of disposition (as defined in §1.168(i)–6T(b)(5)), and—

(*1*) The amount of gain or loss for the asset is determined by taking into account the asset's adjusted basis at the time of disposition (as defined in §1.168(i)–6T(b)(3)). The adjusted basis of the asset at the time of disposition equals the unadjusted depreciable basis of the asset less the depreciation allowed or allowable for the asset, computed by using the depreciation method, recovery period, and convention applicable to the general asset account in which the asset was included. The depreciation allowance for the asset in the year of disposition is determined in the same manner as the depreciation allowance for the relinquished MACRS property (as defined in §1.168(i)–6T(b)(2)) in the year of disposition is determined under §1.168(i)–6T. The recognition and character of the gain or loss are determined in accordance with paragraph (e)(3)(iii)(A) of this section (notwithstanding that paragraph (e)(3)(iii) of this section is an optional rule); and

(*2*) As of the first day of the year of disposition, the taxpayer must remove the relinquished asset from the general asset account and make the adjustments to the general asset account described in paragraph (e)(3)(iii)(C)(*2*) through (*4*) of this section.

(e)(3)(vi) *Anti-abuse rule*—(A) *In general*. If an asset in a general asset account is disposed of by a taxpayer in a transaction described in paragraph (e)(3)(vi)(B) of this section, general asset account treatment for the asset terminates as of the first day of the taxable year in which the disposition occurs. Consequently, the taxpayer must determine the amount of gain, loss, or other deduction attributable to the disposition in the manner described in paragraph (e)(3)(iii)(A) of this section (notwithstanding that paragraph (e)(3)(iii)(A) of this section is an optional rule) and must make the adjustments to the general asset account described in paragraph (e)(3)(iii)(C)(*1*) through (*4*) of this section.

(B) *Abusive transactions*. A transaction is described in this paragraph (e)(3)(vi)(B) if the transaction is not described in paragraph (e)(3)(iv) or (e)(3)(v) of this section and the transaction is entered into, or made, with a principal purpose of achieving a tax benefit or result that would not be available absent an election under this section. Examples of these types of transactions include—

(*1*) A transaction entered into with a principal purpose of shifting income or deductions among taxpayers in a manner that would not be possible absent an election under this section in order to take advantage of differing effective tax rates among the taxpayers; or

(*2*) An election made under this section with a principal purpose of disposing of an asset from a general asset account in order to utilize an expiring net operating loss or credit. The fact that a taxpayer with a net operating loss carryover or a credit carryover transfers an asset to a related person or transfers an asset pursuant to an arrangement where the asset continues to be used (or is available for use) by the taxpayer pursuant to a lease (or otherwise) indicates, absent strong evidence to the contrary, that the transaction is described in this paragraph (e)(3)(vi)(B).

(f) *Assets generating foreign source income*—(1) *In general*. This paragraph (f) provides the rules for determining the source of any income, gain, or loss recognized, and the appropriate section 904(d) separate limitation category or categories for any foreign source income, gain, or loss recognized, on a disposition (within the meaning of paragraph (e)(1) of this section) of an asset in a general asset account that consists of assets generating both United States and foreign source income. These rules apply only to a disposition to which paragraph (e)(2) (general disposition rules), (e)(3)(ii) (disposition of all assets remaining in a general asset account), (e)(3)(iii) (disposition of an asset in a qualifying disposition), (e)(3)(v) (transactions subject to section 1031 or 1033), or (e)(3)(vi) (anti-abuse rule) of this section applies.

(*2*) *Source of ordinary income, gain or loss*—(i) *Source determined by allocation and apportionment of depreciation allowed*. The amount of any ordinary income, gain, or loss that is recognized on the disposition of an asset in a general asset account must be apportioned between United States and foreign sources based on the allocation and apportionment of the—

(A) Depreciation allowed for the general asset account as of the end of the taxable year in which the disposition occurs if paragraph (e)(2) of this section applies to the disposition;

(B) Depreciation allowed for the general asset account as of the time of disposition if the taxpayer applies paragraph (e)(3)(ii) of this section to the disposition of all assets, or the last asset, in the general asset account, or if all the assets, or the last asset, in the general asset account are disposed of in a transaction described in paragraph (e)(3)(v)(A) of this section; or

(C) Depreciation allowed for the disposed asset for only the taxable year in which the disposition occurs if the taxpayer applies paragraph (e)(3)(iii) of this section to the disposition of the asset in a qualifying disposition, if the asset is disposed of in a transaction described in paragraph (e)(3)(v)(B) of this section (like-kind exchange or involuntary conversion), or if the asset is disposed in a transaction described in paragraph (e)(3)(vi) of this section (anti-abuse rule).

(f)(2)(ii) through (h) [Reserved]. For further guidance, see §1.168(i)–1(f)(2)(ii) through (h).

(i) *Identification of disposed or converted asset*. A taxpayer may use any reasonable method that is consistently applied to the taxpayer's general asset accounts for purposes of determining the unadjusted depreciable basis of a disposed or converted asset in a transaction described in paragraph (e)(3)(iii) (disposition of an asset in a qualifying disposition), (e)(3)(iv) (transactions subject to section 168(i)(7)), (e)(3)(v) (transactions subject to section 1031 or 1033), (e)(3)(vi) (anti-abuse rule), (g) (assets subject to recapture), or (h)(1) (conversion to personal use) of this section.

(j) *Effect of adjustments on prior dispositions*. The adjustments to a general asset account under paragraph (e)(3)(iii), (e)(3)(iv), (e)(3)(v), (e)(3)(vi), (g), or (h)(1) of this section have no effect on the recognition and character of prior dispositions subject to paragraph (e)(2) of this section.

(k) [Reserved]. For further guidance, see §1.168(i)–1(k).

(l) *Effective date*—(1) *In general*. Except as provided in paragraphs (l)(2) and (l)(3) of this section, this section applies to depreciable assets placed in service in taxable years ending on or after October 11, 1994. For depreciable assets placed in service after December 31, 1986, in taxable years ending before October 11, 1994, the Internal Revenue Service will allow any reasonable method that is consistently applied to the taxpayer's general asset accounts.

(2) [Reserved].

(3) *Like-kind exchanges and involuntary conversions*. (i) This section applies for an asset transferred by a taxpayer in a like-kind exchange (as defined under §1.168–6T(b)(11) or in an involuntary conversion (as defined under §1.168–6T(b)(12)) for which the time of disposition (as defined in §1.168(i)–6T(b)(3)) and the time of replacement (as defined in §1,168(i)–6T(b)(4)) both occur after February 27, 2004. For an asset transferred by a taxpayer in a like-kind exchange or in an involuntary conversion for which the time of disposition, the time of replacement, or both occur on or before February 27, 2004, see §1.168(i)–1 in effect prior to February 27, 2004 (§1.168(i)–1 as contained in 26 CFR part 1 edition revised as of April 1, 2003).

(ii) The applicability of this section expires on or before February 26, 2007.

Par. 9. Section 1.168(i)–5T is added to read as follows:

§1.168(i)–5T Table of contents (temporary).

This section lists the major paragraphs contained in §1.168(i)–6T.

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

Par. 10. Section 1.168(i)–6T is added to read as follows:

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

(a) *Scope*. This section provides the rules for determining the depreciation allowance for MACRS property acquired in a like-kind exchange or an involuntary conversion, including a like-kind exchange or an involuntary conversion of MACRS property that is exchanged or replaced with other MACRS property in a transaction between members of the same affiliated group. The allowance for depreciation under this section constitutes the amount of depreciation allowable under section 167(a) for the year of replacement and any subsequent taxable year for the replacement MACRS property and for the year of disposition of the relinquished MACRS property. The provisions of this section apply only to MACRS property to which §1.168(h)–1 (like-kind exchanges of tax-exempt use property) does not apply. Additionally, paragraphs (c) through (f) of this section apply only to MACRS property for which an election has not been made under paragraph (i) of this section.

(b) *Definitions*. For purposes of this section, the following definitions apply:

(1) *Replacement MACRS property* is MACRS property (as defined in §1.168(b)–1T(a)(2)) in the hands of the acquiring taxpayer that is acquired for other MACRS property in a like-kind exchange or an involuntary conversion.

(2) *Relinquished MACRS property* is MACRS property that is transferred by the taxpayer in a like-kind exchange, or in an involuntary conversion.

(3) *Time of disposition* is when the disposition of the relinquished MACRS property takes place under the convention, as determined under §1.168(d)–1T, that applies to the relinquished MACRS property.

(4) *Time of replacement* is the later of:

(i) When the replacement MACRS property is placed in service under the convention, as determined under this section, that applies to the replacement MACRS property; or

(ii) The time of disposition of the exchanged or involuntarily converted property.

(5) *Year of disposition* is the taxable year that includes the time of disposition.

(6) *Year of replacement* is the taxable year that includes the time of replacement.

(7) *Exchanged basis* is determined after the depreciation deductions for the year of disposition are determined under paragraph (c)(5)(i) of this section and is the lesser of—

(i) The basis in the replacement MACRS property, as determined under section 1031(d) and the regulations under section 1031(d) or section 1033(b) and the regulations under section 1033(b); or

(ii) The adjusted depreciable basis (as defined in §1.168(b)–1T(a)(4)) of the relinquished MACRS property.

(8) *Excess basis* is any excess of the basis in the replacement MACRS property, as determined under section 1031(d) and the regulations under section 1031(d) or section 1033(b) and the regulations under section 1033(b), over the exchanged basis as determined under paragraph (b)(7) of this section.

(9) *Depreciable exchanged basis* is the exchanged basis as determined under paragraph (b)(7) of this section reduced by—

(i) The percentage of such basis attributable to the taxpayer's use of property for the taxable year other than in the taxpayer's trade or business (or for the production of income); and

(ii) Any adjustments to basis provided by other provisions of the Internal Revenue Code and the regulations under the Code (including section 1016(a)(2) and (3), for example, depreciation deductions in the year of replacement allowable under section 168(k) or 1400L(b)).

(10) *Depreciable excess basis* is the excess basis as determined under paragraph (b)(8) of this section reduced by—

(i) The percentage of such basis attributable to 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);

(ii) Any portion of the basis the taxpayer properly elects to treat as an expense under section 179; and

(iii) Any adjustments to basis provided by other provisions of the Internal Revenue Code and the regulations under the Code (including section 1016(a)(2) and (3), for example, depreciation deductions in the year of replacement allowable under section 168(k) or 1400L(b)).

(11) *Like-kind exchange* is an exchange of property for other property (or money) in a transaction to which section 1031(a)(1), (b), or (c) applies.

(12) *Involuntary conversion* is a transaction described in section 1033(a)(1) or (2) that resulted in the nonrecognition of any part of the gain realized as the result of the conversion.

(c) *Determination of depreciation allowance*—(1) *Computation of the depreciation allowance for depreciable exchanged basis beginning in the year of replacement*—(i) *In general*. This paragraph (c) provides rules for determining the applicable recovery period, the applicable depreciation method, and the applicable convention used to determine the depreciation allowances for the depreciable exchanged basis beginning in the year of replacement. See paragraph (c)(5) of this section for rules relating to the computation of the depreciation allowance for the year of disposition and for the year of replacement. See paragraph (d)(1) of this section for rules relating to the computation of the depreciation allowance for depreciable excess basis. See paragraph (d)(4) of this section if the replacement MACRS property is acquired before disposition of the relinquished MACRS property in a transaction to which section 1033 applies. See paragraph (e) of this section for rules relating to the computation of the depreciation allowance using the optional depreciation tables.

(ii) *Applicable recovery period, depreciation method, and convention*. The recovery period, depreciation method, and convention determined under this paragraph (c) are the only permissible methods of accounting for MACRS property within the scope of this section unless the taxpayer makes the election under paragraph (i) of this section not to apply this section.

(2) *Effect of depreciation treatment of the replacement MACRS property by previous owners of the acquired property*. If replacement MACRS property is acquired by a taxpayer in a like-kind exchange or an involuntary conversion, the depreciation treatment of the replacement MACRS property by previous owners has no effect on the determination of depreciation allowances for the replacement MACRS property in the hands of the acquiring taxpayer. For example, a taxpayer exchanging, in a like-kind exchange, MACRS property for property that was depreciated under ACRS by the previous owner must use this section because the replacement property will become MACRS property in the hands of the acquiring taxpayer. In addition, elections made by previous owners in determining depreciation allowances for the replacement MACRS property have no effect on the acquiring taxpayer. For example, a taxpayer exchanging, in a like-kind exchange, MACRS property that the taxpayer depreciates under the general depreciation system for other MACRS property that the previous owner elected to depreciate under the alternative depreciation system (ADS) pursuant to section 168(g)(7) does not have to continue using the ADS for the replacement MACRS property.

(3) *Recovery period and/or depreciation method of the properties are the same, or both are not the same*—(i) *In general*. For purposes of paragraphs (c)(3) and (c)(4) of this section in determining whether the recovery period and the depreciation method prescribed under section 168 for the replacement MACRS property are the same as the recovery period and the depreciation method prescribed under section 168 for the relinquished MACRS property, the recovery period and the de-

preciation method for the replacement MACRS property are considered to be the recovery period and the depreciation method that would have applied, taking into account any elections made by the acquiring taxpayer under section 168(b)(5) or 168(g)(7), had the replacement MACRS property been placed in service by the acquiring taxpayer at the same time as the relinquished MACRS property.

(ii) *Both the recovery period and the depreciation method are the same*. If both the recovery period and the depreciation method prescribed under section 168 for the replacement MACRS property are the same as the recovery period and the depreciation method prescribed under section 168 for the relinquished MACRS property, the depreciation allowances for the replacement MACRS property beginning in the year of replacement are determined by using the same recovery period and depreciation method that were used for the relinquished MACRS property. Thus, the replacement MACRS property is depreciated over the remaining recovery period (taking into account the applicable convention), and by using the depreciation method, of the relinquished MACRS property. Except as provided in paragraph (c)(5) of this section, the depreciation allowances for the depreciable exchanged basis for any 12-month taxable year beginning with the year of replacement are determined by multiplying the depreciable exchanged basis by the applicable depreciation rate for each taxable year (for further guidance, for example, see section 6 of Rev. Proc. 87–57, 1987–2 C.B. 687, 692, and §601.601(d)(2)(ii)(*b*) of this chapter).

(iii) *Either the recovery period or the depreciation method is the same, or both are not the same*. If either the recovery period or the depreciation method prescribed under section 168 for the replacement MACRS property is the same as the recovery period or the depreciation method prescribed under section 168 for the relinquished MACRS property, the depreciation allowances for the depreciable exchanged basis beginning in the year of replacement are determined using the recovery period or the depreciation method that is the same as the relinquished MACRS property. See paragraph (c)(4) of this section to determine the depreciation allowances when the recovery period or the depreciation method of the replacement MACRS property is not the same as that of the relinquished MACRS property.

(4) *Recovery period or depreciation method of the properties is not the same*. If the recovery period prescribed under section 168 for the replacement MACRS property (as determined under paragraph (c)(3)(i) of this section) is not the same as the recovery period prescribed under section 168 for the relinquished MACRS property, the depreciation allowances for the depreciable exchanged basis beginning in the year of replacement are determined under this paragraph (c)(4). Similarly, if the depreciation method prescribed under section 168 for the replacement MACRS property (as determined under paragraph (c)(3)(i) of this section) is not the same as the depreciation method prescribed under section 168 for the relinquished MACRS property, the depreciation method used to determine the depreciation allowances for the depreciable exchanged basis beginning in the year of replacement is determined under this paragraph (c)(4).

(i) *Longer recovery period*. If the recovery period prescribed under section 168 for the replacement MACRS property (as determined under paragraph (c)(3)(i) of this section) is longer than that prescribed for the relinquished MACRS property, the depreciation allowances for the depreciable exchanged basis beginning in the year of replacement are determined as though the replacement MACRS property had originally been placed in service by the acquiring taxpayer in the same taxable year the relinquished MACRS property was placed in service by the acquiring taxpayer, but using the longer recovery period of the replacement MACRS property (as determined under paragraph (c)(3)(i) of this section) and the convention determined under paragraph (c)(4)(v) of this section. Thus, the depreciable exchanged basis is depreciated over the remaining recovery period (taking into account the applicable convention) of the replacement MACRS property.

(ii) *Shorter recovery period*. If the recovery period prescribed under section 168 for the replacement MACRS property (as determined under paragraph (c)(3)(i) of this section) is shorter than that of the relinquished MACRS property, the depreciation allowances for the depreciable exchanged basis beginning in the year of replacement are determined using the same recovery period as that of the relinquished MACRS property. Thus, the depreciable exchanged basis is depreciated over the remaining recovery period (taking into account the applicable convention) of the relinquished MACRS property.

(iii) *Less accelerated depreciation method*—(A) If the depreciation method prescribed under section 168 for the replacement MACRS property (as determined under paragraph (c)(3)(i) of this section) is less accelerated than that of the relinquished MACRS property at the time of disposition, the depreciation allowances for the depreciable exchanged basis beginning in the year of replacement are determined as though the replacement MACRS property had originally been placed in service by the acquiring taxpayer at the same time the relinquished MACRS property was placed in service by the acquiring taxpayer, but using the less accelerated depreciation method. Thus, the depreciable exchanged basis is depreciated using the less accelerated depreciation method.

(B) Except as provided in paragraph (c)(5) of this section, the depreciation allowances for the depreciable exchanged basis for any 12-month taxable year beginning in the year of replacement are determined by multiplying the adjusted depreciable basis by the applicable depreciation rate for each taxable year. If, for example, the depreciation method of the replacement MACRS property in the year of replacement is the 150-percent declining balance method and the depreciation method of the relinquished MACRS property in the year of replacement is the 200-percent declining balance method, and neither method had been switched to the straight line method in the year of replacement or any prior taxable year, the applicable depreciation rate for the year of replacement and subsequent taxable years is determined by using the depreciation rate of the replacement MACRS property as if the replacement MACRS property was placed in service by the acquiring taxpayer at the same time the relinquished MACRS property was placed in service by the acquiring taxpayer, until the 150-percent declining balance method has been switched to the straight line method. If, for example, the depreciation method of the replacement MACRS property is the straight line method, the applicable depreciation rate for the year of replacement is determined by using the remaining recovery period at the beginning of the year of disposition (as determined under this paragraph (c)(4) and taking into account the applicable convention).

(iv) *More accelerated depreciation method*—(A) If the depreciation method prescribed under section 168 for the replacement MACRS property (as determined under paragraph (c)(3)(i) of this section) is more accelerated than that of the relinquished MACRS property at the time of disposition, the depreciation allowances for the replacement MACRS property beginning in the year of replacement are determined using the same depreciation method as the relinquished MACRS property.

(B) Except as provided in paragraph (c)(5) of this section, the depreciation allowances for the depreciable exchanged basis for any 12-month taxable year beginning in the year of replacement are determined by multiplying the adjusted depreciable basis by the applicable depreciation rate for each taxable year. If, for example, the depreciation method of the relinquished MACRS property in the year of replacement is the 150-percent declining balance method and the depreciation method of the replacement MACRS property in the year of replacement is the 200-percent declining balance method, and neither method had been switched to the straight line method in the year of replacement or any prior taxable year, the applicable depreciation rate for the year of replacement and subsequent taxable years is the same depreciation rate that applied to the relinquished MACRS property in the year of replacement, until the 150-percent declining balance method has been switched to the straight line method. If, for example, the depreciation method is the straight line method, the applicable depreciation rate for the year of replacement is determined by using the remaining recovery period at the beginning of the year of disposition (as determined under this paragraph (c)(4) and taking into account the applicable convention).

(v) *Convention*—(A) *In general*. The applicable convention for the exchanged basis is determined under this paragraph (c)(4)(v). The applicable convention for the exchanged basis is deemed to be the mid-month convention for replacement MACRS property that is nonresidential real property, residential rental property, or any railroad grading or tunnel bore. Thus, if the relinquished MACRS property was depreciated using the mid-month convention, then the replacement MACRS property is deemed to have been placed in service by the acquiring taxpayer in the same month as the relinquished MACRS property and must continue to be depreciated using the mid-month convention. If nonresidential real property, residential rental property, or any railroad grading or tunnel bore is received as a result of an exchange or an involuntary conversion of MACRS property that was depreciated using the mid-quarter convention, the replacement MACRS property is deemed to have been placed in service by the acquiring taxpayer in the month that includes the mid-point of the quarter that the relinquished MACRS property was placed in service and must be depreciated using the mid-month convention. If nonresidential real property, residential rental property, or any railroad grading or tunnel bore is received as a result of an exchange or an involuntary conversion of MACRS property that was depreciated using the half-year convention, the replacement MACRS property is deemed to have been placed in service by the acquiring taxpayer in the month that includes the mid-point of the placed-in-service year and must be depreciated using the mid-month convention (for example, for a calendar-year taxpayer with a full 12-month taxable year, the mid-point is the first day of the second half of the taxable year (the seventh month)). For all other replacement MACRS property, the applicable convention is the half-year convention, unless the applicable convention for the relinquished MACRS property is the mid-quarter convention, in which case the mid-quarter convention is applied to the replacement MACRS property.

(B) *Mid-quarter convention*. See paragraph (f) of this section for purposes of applying the 40-percent test of section 168(d)(3) to any replacement MACRS property.

(5) *Year of disposition and year of replacement*. No depreciation deduction is allowable for MACRS property disposed of by a taxpayer in a like-kind exchange or involuntary conversion in the same taxable year that such property was placed in service by the taxpayer. If replacement MACRS property is disposed of by a taxpayer during the same taxable year that the relinquished MACRS property is placed in service by the taxpayer, no depreciation deduction is allowable for either MACRS property. Otherwise, the depreciation allowances for the year of disposition and for the year of replacement are determined as follows:

(i) *Relinquished MACRS property*. Except as provided in paragraphs (e) and (i) of this section, the depreciation allowance in the year of disposition for the relinquished MACRS property is computed by multiplying the allowable depreciation deduction for the property for that year by a fraction, the numerator of which is the number of months (including fractions of months) the property is deemed to be placed in service during the year of disposition (taking into account the applicable convention of the relinquished MACRS property), and the denominator of which is 12. However, if the year of disposition is less than 12 months, the depreciation allowance determined under this paragraph (c)(5)(i) must be adjusted for a short taxable year (for further guidance, for example, see Rev. Proc. 89–15, 1989–1 C.B. 816, and §601.601(d)(2)(ii)(*b*) of this chapter). In the case of termination under §1.168(i)–1T(e)(3)(v) of general asset account treatment of an asset, or of all the assets remaining, in a general asset account, the allowable depreciation deduction in the year of disposition for the asset or assets for which general asset account treatment is terminated is determined using the depreciation method, recovery period, and convention of the general asset account. This allowable depreciation deduction is adjusted to account for the period the asset or assets is deemed to be in service in accordance with this paragraph (c)(5)(i).

(ii) *Replacement MACRS property*—(A) *Year of replacement is 12 months*. Except as provided in paragraphs (c)(5)(iii), (e), and (i) of this section, the depreciation allowance in the year of replacement for the depreciable exchanged basis is determined by—

(*1*) calculating the applicable depreciation rate for that taxable year by taking into account the recovery period and depreciation method prescribed for the replacement MACRS property under paragraph (c)(3) or (4) of this section;

(*2*) calculating the depreciable exchanged basis of the replacement MACRS property, and adding to that amount the amount determined under paragraph (c)(5)(i) of this section for the year of disposition; and

(*3*) multiplying the product of the amounts determined under §1.168(i)–6T(c)(5)(ii)(A)(*1*) and (A)(*2*) by a fraction, the numerator of which is the number of months (including fractions of months) the property is deemed to be in service during the year of replacement (in the year of replacement the replacement MACRS property is deemed to be placed in service by the acquiring taxpayer at the time of replacement under the convention determined under paragraph (c)(4)(v) of this section), and the denominator of which is 12.

(B) *Year of replacement is less than 12 months*. If the year of replacement is less than 12 months, the depreciation allowance determined under paragraph (c)(5)(ii)(A) of this section must be adjusted for a short taxable year (for further guidance, for example, see Rev. Proc. 89–15, 1989–1 C.B. 816, and §601.601(d)(2)(ii)(*b*) of this chapter).

(iii) *Deferred transactions*—(A) *In general*. If the replacement MACRS property is not acquired until after the disposition of the relinquished MACRS property, taking into account the applicable convention of the relinquished MACRS property and the replacement MACRS property, depreciation is not allowable during the period between the disposition of the relinquished MACRS property and the acquisition of the replacement MACRS property. The recovery period for the replacement MACRS property is suspended during this period. For purposes of paragraph (c)(5)(ii) of this section, only the depreciable exchanged basis of the replacement MACRS property is taken into account for calculating the amount in paragraph (c)(5)(ii)(A)(*2*) of this section if the year of replacement is a taxable year subsequent to the year of disposition.

(B) *Allowable depreciation for a qualified intermediary*. [Reserved].

(iv) *Remaining recovery period*. The remaining recovery period of the replacement MACRS property is determined as of the beginning of the year of disposition of the relinquished MACRS property. For purposes of determining the remaining recovery period of the replacement MACRS property, the replacement MACRS property is deemed to have been originally placed in service under the convention determined under paragraph (c)(4)(v) of this section but at the time the relinquished MACRS property was deemed to be placed in service under the convention that applied to it when it was placed in service.

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

Example 1. A1, a calendar-year taxpayer, exchanges Building M, an office building, for Building N, a warehouse in a like-kind exchange. Building M is relinquished in July 2004 and Building N is acquired and placed in service in October 2004. A1 did not make any elections under section 168 for either Building M or Building N. The unadjusted depreciable basis of Building M was $4,680,000 when placed in service in July 1997. Since the recovery period and depreciation method prescribed under section 168 for Building N (39 years, straight line method) are the same as the recovery period and depreciation method prescribed under section 168 for Building M (39 years, straight line method), Building N is depreciated over the remaining recovery period of, and using the same depreciation method and convention as that of, Building M. Thus, Building N will be depreciated using the straight line method over a remaining recovery period of 32 years beginning in October 2004 (the remaining recovery period of 32 years and 6.5 months at the beginning of 2004, less the 6.5 months of depreciation taken prior to the disposition of the exchanged MACRS property (Building M) in 2004). For 2004, the year in which the transaction takes place, the depreciation allowance for Building M is ($120,000)(6.5/12) which equals $65,000. The depreciation allowance for Building N for 2004 is ($120,000)(2.5/12) which equals $25,000. For 2005 and subsequent years, Building N is depreciated over the remaining recovery period of, and using the same depreciation method and convention as that of, Building M. Thus, the depreciation allowance for Building N is the same as Building M, namely $10,000 per month.

Example 2. B, a calendar-year taxpayer, placed in service Bridge P in January 1998. Bridge P is depreciated using the half-year convention. In January 2004, B exchanges Bridge P for Building Q, an apartment building, in a like-kind exchange. B did not make any elections under section 168 for either Bridge P or Building Q. Since the recovery period prescribed under section 168 for Building Q (27.5 years) is longer than that of Bridge P (15 years), Building Q is depreciated as if it had originally been placed in service in July 1998 and disposed of in July 2004 using a 27.5-year recovery period. Additionally, since the depreciation method prescribed under section 168 for Building Q (straight line method) is less accelerated than that of Bridge P (150-percent declining balance method), then the depreciation allowance for Building Q is computed using the straight line method. Thus, when Building Q is acquired and placed in service in 2004, its basis is depreciated over the remaining 21.5-year recovery period using the straight line method of depreciation and the mid-month convention beginning in July 2004.

Example 3. C, a calendar-year taxpayer, placed in service Building R, a restaurant, in January 1996. In January 2004, C exchanges Building R for Tower S, a radio transmitting tower, in a like-kind exchange. C did not make any elections under section 168 for either Building R or Tower S. Since the recovery period prescribed under section 168 for Tower S (15 years) is shorter than that of Building R (39 years), Tower S is depreciated over the remaining recovery period of Building R. Additionally, since the depreciation method prescribed under section 168 for Tower S (150% declining balance method) is more accelerated than that of Building R (straight line method), then the depreciation allowance for Tower S is also computed using the same depreciation method as Building R. Thus, Tower S is depreciated over the remaining 31-year recovery period of Building R using the straight line method of depreciation and the mid-month convention. Alternatively, C may elect under paragraph (i) of this section to treat Tower S as though it is placed in service in January 2004. In such case, C uses the applicable recovery period, depreciation method, and convention prescribed under section 168 for Tower S.

Example 4. (i) In February 2001, D, a calendar-year taxpayer and manufacturer of rubber products, acquired for $60,000 and placed in service Asset T (a special tool) and depreciated Asset T using the straight line method election under section 168(b)(5) and the mid-quarter convention over its 3-year recovery period. In June 2004, D exchanges Asset T for Asset U (not a special tool) in a like-kind exchange. D elected not to deduct the additional first year depreciation for 7-year property placed in service in 2004. Since the recovery period prescribed under section 168 for Asset U (7 years) is longer than that of Asset T (3 years), Asset U is depreciated as if it had originally been placed in service in February 2001 using a 7-year recovery period. Additionally, since the depreciation method prescribed under section 168 for Asset U (200-percent declining balance method) is more accelerated than that of Asset T (straight line method) at the time of disposition, the depreciation allowance is computed using the straight line method. Asset U is depreciated over its remaining recovery period of 3.75 years using the straight line method of depreciation and the mid-quarter convention.

(ii) The 2004 depreciation allowance for Asset T is $938 ($2,500 allowable depreciation deduction ($60,000 original basis minus $17,500 depreciation deduction for 2001 minus $20,000 depreciation deduction for 2002 minus $20,000 depreciation deduction for 2003) × 4.5 months ÷ 12).

(iii) The depreciation rate in 2004 for Asset U is 0.2424 (1 ÷ 4.125 years (the length of the applicable recovery period remaining as of the beginning of 2004)). Therefore, the depreciation allowance in 2004 is $379 (0.2424 × $2,500 (the sum of the $1,562 depreciable exchanged basis of Asset U ($2,500 basis at the beginning of 2004 for Asset T, less the $938 depreciation allowable for Asset T for 2004) and the $938 depreciation allowable for Asset T for 2004) × 7.5 months ÷ 12).

Example 5. On January 1, 2004, E, a calendar-year taxpayer, acquired and placed in service Canopy V, a gas station canopy. The purchase price of Canopy

V was $60,000. On August 1, 2004, Canopy V was destroyed in a hurricane and was therefore no longer usable in E's business. On October 1, 2004, as part of the involuntary conversion, E acquired and placed in service Canopy W with the insurance proceeds E received due to the loss of Canopy V. E elected not to deduct the additional first year depreciation for 5-year property placed in service in 2004. E depreciates both canopies 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. No depreciation deduction is allowable for Canopy V. The depreciation deduction allowable for Canopy W for 2004 is $12,000 ($60,000 × the annual depreciation rate of .40 × 1/2 year).

Example 6. Same facts as in *Example 5*, except that E did not make the election out of the additional first year depreciation for 5-year property placed in service in 2004. E depreciates both canopies 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. No depreciation deduction is allowable for Canopy V. For 2004, E is allowed a 50-percent additional first year depreciation deduction of $30,000 for Canopy W (the unadjusted depreciable basis of $60,000 multiplied by .50), and a regular MACRS depreciation deduction of $6,000 for Canopy W (the depreciable exchanged basis of $30,000 multiplied by the annual depreciation rate of .40 × 1/2 year). For 2005, E is allowed a regular MACRS depreciation deduction of $9,600 for Canopy W (the depreciable exchanged basis of $24,000 ($30,000 minus regular 2003 depreciation of $6,000) multiplied by the annual depreciation rate of .40).

(d) *Special rules for determining depreciation allowances*—(1) *Excess basis*—(i) *In general*. Any excess basis in the replacement MACRS property is treated as property that is placed in service by the acquiring taxpayer in the year of replacement. Thus, the depreciation allowances for the depreciable excess basis are determined by using the applicable recovery period, depreciation method, and convention prescribed under section 168 for the property at the time of replacement. However, if replacement MACRS property is disposed of during the same taxable year the relinquished MACRS property is placed in service by the acquiring taxpayer, no depreciation deduction is allowable for either MACRS property. See paragraph (g) of this section regarding the application of section 179. See paragraph (h) of this section regarding the application of section 168(k) or 1400L(b).

(ii) *Example*. The application of this paragraph (d)(1) is illustrated by the following example:

Example. In 1989, G placed in service a hospital. On January 16, 2004, G exchanges this hospital plus $2,000,000 cash for an office building in a like-kind exchange. On January 16, 2004, the hospital has an adjusted depreciable basis of $1,500,000. After the exchange, the basis of the office building is $3,500,000. The depreciable exchanged basis of the office building is depreciated in accordance with paragraph (c) of this section. The depreciable excess basis of $2,000,000 is treated as being placed in service by G in 2004 and, as a result, is depreciated using the applicable depreciation method, recovery period, and convention prescribed for the office building under section 168 at the time of replacement.

(2) *Depreciable and nondepreciable property*—(i) If land or other nondepreciable property is acquired in a like-kind exchange for, or as a result of an involuntary conversion of, depreciable property, the land or other nondepreciable property is not depreciated. If both MACRS and nondepreciable property are acquired in a like-kind exchange for, or as part of an involuntary conversion of, MACRS property, the basis allocated to the nondepreciable property (as determined under section 1031(d) and the regulations under section 1031(d) or section 1033(b) and the regulations under section 1033(b)) is not depreciated and the basis allocated to the replacement MACRS property (as determined under section 1031(d) and the regulations under section 1031(d) or section 1033(b) and the regulations under section 1033(b)) is depreciated in accordance with this section.

(ii) If MACRS property is acquired, or if both MACRS and nondepreciable property are acquired, in a like-kind exchange for, or as part of an involuntary conversion of, land or other nondepreciable property, the basis in the replacement MACRS property that is attributable to the relinquished nondepreciable property is treated as though the replacement MACRS property is placed in service by the acquiring taxpayer in the year of replacement. Thus, the depreciation allowances for the replacement MACRS property are determined by using the applicable recovery period, depreciation method, and convention prescribed under section 168 for the replacement MACRS property at the time of replacement. See paragraph (g) of this section regarding the application of section 179. See paragraph (h) of this section regarding the application of section 168(k) or 1400L(b).

(3) *Depreciation limitations for automobiles*—(i) *In general*. Depreciation allowances under section 179 and section 167 (including allowances under sections 168 and 1400L(b)) for a passenger automobile, as defined in section 280F(d)(5), are subject to the limitations of section 280F(a). The depreciation allowances for a passenger automobile that is replacement MACRS property (replacement MACRS passenger automobile) generally are limited in any taxable year to the replacement automobile section 280F limit for the taxable year. The taxpayer's basis in the replacement MACRS passenger automobile is treated as being comprised of two separate components. The first component is the exchanged basis and the second component is the excess basis, if any. The depreciation allowances for a passenger automobile that is relinquished MACRS property (relinquished MACRS passenger automobile) for the taxable year generally are limited to the relinquished automobile section 280F limit for that taxable year. For purposes of this paragraph (d)(3), the following definitions apply:

(A) *Replacement automobile section 280F limit* is the limit on depreciation deductions under section 280F(a) for the taxable year based on the time of replacement of the replacement MACRS passenger automobile (including the effect of any elections under section 168(k) or section 1400L(b), as applicable).

(B) *Relinquished automobile section 280F limit* is the limit on depreciation deductions under section 280F(a) for the taxable year based on when the relinquished MACRS passenger automobile was placed in service by the taxpayer.

(ii) *Order in which limitations on depreciation under section 280F(a) are applied*. Generally, depreciation deductions allowable under section 280F(a) reduce the basis in the relinquished MACRS passenger automobile and the exchanged basis of the replacement MACRS passenger automobile, before the excess basis of the replacement MACRS passenger automobile is reduced. The depreciation deductions for the relinquished MACRS passenger automobile in the year of disposition and the replacement MACRS passenger automobile in the year of replacement and each subsequent taxable year are allowable in the following order:

(A) The depreciation deduction allowable for the relinquished MACRS passenger automobile as determined under paragraph (c)(5)(i) of this section for the year of disposition to the extent of the smaller of the replacement automobile section 280F limit and the relinquished automobile section 280F limit, if the year of disposition is the year of replacement. If the year of replacement is a taxable year subsequent to the year of disposition, the depreciation deduction allowable for the relinquished MACRS passenger automobile for the year of disposition is limited to the relinquished automobile section 280F limit.

(B) The additional first year depreciation allowable on the remaining exchanged basis (remaining carryover basis as determined under §1.168(k)–1T(f)(5) or §1.1400L(b)–1T(f)(5), as applicable) of the replacement MACRS passenger automobile, as determined under §1.168(k)–1T(f)(5) or §1.1400L(b)–1T(f)(5), as applicable, to the extent of the excess of the replacement automobile section 280F limit over the amount allowable under paragraph (d)(3)(ii)(A) of this section.

(C) The depreciation deduction allowable for the taxable year on the depreciable exchanged basis of the replacement MACRS passenger automobile determined under paragraph (c) of this section to the extent of any excess over the sum of the amounts allowable under paragraphs (d)(3)(ii)(A) and (B) of this section of the smaller of the replacement automobile section 280F limit and the relinquished automobile section 280F limit.

(D) Any section 179 deduction allowable in the year of replacement on the excess basis of the replacement MACRS passenger automobile to the extent of the excess of the replacement automobile section 280F limit over the sum of the amounts allowable under paragraphs (d)(3)(ii)(A), (B), and (C) of this section.

(E) The additional first year depreciation allowable on the remaining excess basis of the replacement MACRS passenger automobile, as determined under §1.168(k)–1T(f)(5) or §1.1400L(b)–1T(f)(5), as applicable, to the extent of the excess of the replacement automobile section 280F limit over the sum of the amounts allowable under paragraphs (d)(3)(ii)(A), (B), (C), and (D) of this section.

(F) The depreciation deduction allowable under paragraph (d) of this section for the depreciable excess basis of the replacement MACRS passenger automobile to the extent of the excess of the replacement automobile section 280F limit over the sum of the amounts allowable under paragraphs (d)(3)(ii)(A), (B), (C), (D), and (E) of this section.

(iii) *Examples*. The application of this paragraph (d)(3) is illustrated by the following examples:

Example 1. H, a calendar-year taxpayer, acquired and placed in service Automobile X in January 2000 for $30,000 to be used solely for H's business. In December 2003, H exchanges, in a like-kind exchange, Automobile X plus $15,000 cash for new Automobile Y that will also be used solely in H's business. Automobile Y is 50-percent bonus depreciation property for purposes of section 168(k)(4). Both automobiles are depreciated using the double declining balance method, the half-year convention, and a five-year recovery period. The relinquished automobile section 280F limit for 2003 for Automobile X is $1,775. The replacement automobile section 280F limit for Automobile Y is $10,710. The exchanged basis for Automobile Y is $17,315 ($30,000 less total depreciation allowable of $12,685 ($3,060 for 2000, $4,900 for 2001, $2,950 for 2002, and $1,775 for 2003)). Without taking section 280F into account, the additional first year depreciation deduction for the remaining exchanged basis is $8,658 ($17,315 x 0.5). Because this amount is less than $8,935 ($10,710 (the replacement automobile section 280F limit for 2003 for Automobile Y) - $1,775 (the depreciation allowable for Automobile X for 2003)) the additional first year depreciation deduction for the exchanged basis is $8,658. No depreciation deduction is allowable in 2003 for the depreciable exchanged basis because the depreciation deductions taken for Automobile X and the remaining exchanged basis exceed the exchanged automobile section 280F limit. An additional first year depreciation deduction of $277 is allowable for the excess basis of $15,000 in Automobile Y. Thus at the end of 2003 the adjusted depreciable basis in Automobile Y is $23,379 comprised of adjusted depreciable exchanged basis of $8,657 ($17,315 (exchanged basis) - $8,658 (additional first year depreciation for exchanged basis)) and of an adjusted depreciable excess basis of $14,723 ($15,000 (excess basis) - $277 (additional first year depreciation for 2003)).

Example 2. Same facts as in *Example 1*, except that H placed in service Automobile X in January 2002, and H elected not to claim the additional first year depreciation deduction for 5-year property placed in service in 2002 and 2003. The relinquished automobile section 280F limit for Automobile X for 2003 is $4,900. Because the replacement automobile section 280F limit for 2003 for Automobile Y ($3,060) is less than the relinquished automobile section 280F limit for Automobile X for 2003 and is less than $5,388 (($30,000 (cost) - $3,060 (depreciation allowable for 2002)) x 0.4 x 6/12), the depreciation that would be allowable for Automobile X (determined without regard to section 280F) in the year of disposition, the depreciation for Automobile X in the year of disposition is limited to $3,060. For 2003 no depreciation is allowable for the excess basis and the exchanged basis in Automobile Y.

Example 3. AB, a calendar-year taxpayer, purchased and placed in service Automobile X1 in February 2000 for $10,000. X1 is a passenger automobile subject to section 280F(a) and is used solely for AB's business. AB depreciated X1 using a five-year recovery period, the double declining balance method and the half-year convention. As of January 1, 2003, the adjusted basis of X1 was $2,880 ($10,000 original cost minus $2,000 depreciation deduction for 2000, minus $3,200 depreciation deduction for 2001, and $1,920 depreciation deduction for 2002). In November 2003, AB exchanges, in a like-kind exchange, Automobile X1 plus $14,000 cash for new Automobile Y1 that will be used solely in AB's business. Automobile Y1 is 50-percent bonus depreciation property for purposes of section 168(k)(4) and qualifies for the expensing election under section 179. Pursuant to paragraph §1.168(k)–1T(g)(3)(ii) and paragraph (k)(2)(i) of this section, AB decided to apply §1.168(i)–6T to the exchange of Automobile X1 for Automobile Y1, the replacement MACRS property. AB also makes the election under section 179 for the excess basis of Automobile Y1. AB depreciates Y1 using a five-year recovery period, the double declining balance method and the half-year convention. For 2003, the relinquished automobile section 280F limit for Automobile X1 is $1,775 and the replacement automobile section 280F limit for 2003 for Automobile Y1 is $10,710.

(i) The 2003 depreciation deduction for Automobile X1 is $576. The depreciation deduction calculated for X1 is $576 (the adjusted depreciable basis of Automobile X1 at the beginning of 2003 of $2,880 × 40% × 1/2 year), which is less than the relinquished automobile section 280F limit and the replacement automobile section 280F limit.

(ii) The additional first year depreciation deduction for the exchanged basis is $1,152. The additional first year depreciation deduction of $1,152 (remaining exchanged basis of $2,304 ($2,880 adjusted basis of Automobile X1 at the beginning of 2003 minus $576) × 0.5)) is less than the replacement automobile section 280F limit minus $576.

(iii) AB's MACRS depreciation deduction allowable in 2003 for the remaining exchanged basis of $1,152 is $47 (the relinquished automobile section 280F limit of $1,775 less the depreciation deduction of $576 taken for Automobile X1 less the additional first year depreciation deduction of $1,152 taken for the exchanged basis) which is less than the depreciation deduction calculated for the depreciable exchanged basis.

(iv) For 2003, AB takes a $1,400 section 179 deduction for the excess basis of Automobile Y1. AB must reduce the excess basis of $14,000 by the section 179 deduction of $1,400 to determine the remaining excess basis of $12,600.

(v) For 2003, AB is allowed a 50-percent additional first year depreciation deduction of $6,300 (the remaining excess basis of $12,600 multiplied by .50).

(vi) For 2003, AB's depreciation deduction for the depreciable excess basis is limited to $1,235. The depreciation deduction computed without regard to the replacement automobile section 280F limit is $1,260 ($6,300 depreciable excess basis x 0.4 x 6/12). However the depreciation deduction for the depreciable excess basis is limited to $1,235 ($10,710 (replacement automobile section 280F limit) - $576 (depreciation deduction for Automobile X1) - $1,152 (additional first year depreciation deduction for the exchanged basis) - $47 (depreciation deduction for exchanged basis) -$1,400 (section 179 deduction) - $6,300 (additional first year depreciation deduction for remaining excess basis)).

(4) *Replacement MACRS property acquired and placed-in-service before disposition of relinquished MACRS property*. If, in an involuntary conversion, a taxpayer acquires and places in service the replacement MACRS property before the date of disposition of the relinquished MACRS property, the taxpayer depreciates the unadjusted depreciable basis of the replacement MACRS property under section 168 beginning in the taxable year when the replacement MACRS property is placed in service by the taxpayer and by using the applicable depreciation method, recovery period, and convention prescribed under section 168 for the replacement MACRS property at the placed-in-service date. However, at the time of disposition of the relinquished MACRS property, the taxpayer determines the exchanged basis and the excess basis of the replacement MACRS property and begins to depreciate the depreciable exchanged basis of the replacement MACRS property in accordance with paragraph (c) of this section. The depreciable excess basis of the replacement MACRS property continues to be depreciated by the taxpayer in accordance with the first sentence of this paragraph (d)(4). Further, in the year of disposition of the relinquished MACRS property, the taxpayer must include in taxable income the excess of the depreciation deductions allowable on the unadjusted depreciable basis of the replacement MACRS property over the depreciation deductions that would have been allowable to the taxpayer on the depreciable excess basis of the replacement MACRS property from the date the replacement MACRS property was placed in service by the taxpayer (taking into account the applicable convention) to the time of disposition of the relinquished MACRS property.

(e) *Use of optional depreciation tables*—(1) *Taxpayer not bound by prior use of table*. If a taxpayer used an optional depreciation table for the relinquished MACRS property, the taxpayer is not required to use an optional table for the depreciable exchanged basis of the replacement MACRS property. Conversely, if a taxpayer did not use an optional depreciation table for the relinquished MACRS property, the taxpayer may use the appropriate table for the depreciable exchanged basis of the replacement MACRS property. If a taxpayer decides not to use the table for the depreciable exchanged basis of the replacement MACRS property, the depreciation allowance for this property for the year of replacement and subsequent taxable years is determined under paragraph (c) of this section. If a taxpayer decides to use the optional depreciation tables, no depreciation deduction is allowable for MACRS property placed in service by the acquiring taxpayer and subsequently exchanged or involuntarily converted by such taxpayer in the same taxable year, and, if, during the same taxable year, MACRS property is placed in service by the acquiring taxpayer, exchanged or involuntarily converted by such taxpayer, and the replacement MACRS property is disposed of by such taxpayer, no depreciation deduction is allowable for either MACRS property.

(2) *Determination of the depreciation deduction*—(i) *Relinquished MACRS property*. In the year of disposition, the depreciation allowance for the relinquished MACRS property is computed by multiplying the unadjusted depreciable basis (less 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) of the relinquished MACRS property by the annual depreciation rate (expressed as a decimal equivalent) specified in the appropriate table for the recovery year corresponding to the year of disposition. This product is then multiplied by a fraction, the numerator of which is the number of months (including fractions of months) the property is deemed to be placed in service during the year of the exchange or involuntary conversion (taking into account the applicable convention) and the denominator of which is 12. However, if the year of disposition is less than 12 months, the depreciation allowance determined under this paragraph (e)(2)(i) must be adjusted for a short taxable year (for further guidance, for example, see Rev. Proc. 89–15, 1989–1 C.B. 816, and §601.601(d)(2)(ii)(*b*) of this chapter).

(ii) *Replacement MACRS property*—(A) *Determination of the appropriate optional depreciation table*. If a taxpayer chooses to use the appropriate optional depreciation table for the depreciable exchanged basis, the depreciation allowances for the depreciable exchanged basis beginning in the year of replacement are determined by choosing the optional depreciation table that corresponds to the recovery period, depreciation method, and convention of the replacement MACRS property determined under paragraph (c) of this section.

(B) *Calculating the depreciation deduction for the replacement MACRS property*—(*1*) The depreciation deduction for the taxable year is computed by first determining the appropriate recovery year in the table identified under paragraph (e)(2)(ii)(A) of this section. The appropriate recovery year for the year of replacement is the same as the recovery year for the year of disposition, regardless of the taxable year in which the replacement property is acquired. For example, if the recovery year for the year of disposition would have been Year 4 in the table that applied before the disposition of the relinquished MACRS property, then the recovery year for the year of replacement is Year 4 in the table identified under paragraph (e)(2)(ii)(A) of this section.

(*2*) Next, the annual depreciation rate (expressed as a decimal equivalent) for each recovery year is multiplied by a transaction coefficient. The transaction coefficient is the formula (1 / (1 - x)) where x equals the sum of the annual depreciation rates from the table identified under paragraph (e)(2)(ii)(A) of this section (expressed as a decimal equivalent) corresponding to the replacement MACRS property (as determined under paragraph (e)(2)(ii)(A) of this section) for the taxable years beginning with the placed-in-service year of the relinquished MACRS property through the taxable year immediately prior to the year of disposition. The product of the annual depreciation rate and the transaction coefficient is multiplied by the depreciable exchanged basis (taking into account paragraph (e)(2)(i) of this section). In the year of replacement, this product is then multiplied by a fraction, the numerator of which is the number of months (including fractions of months) the property is deemed to be placed in service by the acquiring taxpayer during the year of replacement (taking into account the applicable convention) and the denominator of which is 12. However, if the year of replacement is the year the relinquished

MACRS property is placed in service by the acquiring taxpayer, the preceding sentence does not apply. In addition, if the year of replacement is less than 12 months, the depreciation allowance determined under paragraph (e)(2)(ii) of this section must be adjusted for a short taxable year (for further guidance, for example, see Rev. Proc. 89–15, 1989–1 C.B. 816, and §601.601(d)(2)(ii)(*b*) of this chapter).

(iii) *Unrecovered basis*. If the replacement MACRS property would have unrecovered depreciable basis after the final recovery year (for example, due to a deferred exchange), the unrecovered basis is an allowable depreciation deduction in the taxable year that corresponds to the final recovery year unless the unrecovered basis is subject to a depreciation limitation such as section 280F.

(3) *Excess basis*. As provided in paragraph (d)(1) of this section, any excess basis in the replacement MACRS property is treated as property that is placed in service by the acquiring taxpayer at the time of replacement. Thus, if the taxpayer chooses to use the appropriate optional depreciation table for the depreciable excess basis in the replacement MACRS property, the depreciation allowances for the depreciable excess basis are determined by multiplying the depreciable excess basis by the annual depreciation rate (expressed as a decimal equivalent) specified in the appropriate table for each taxable year. The appropriate table for the depreciable excess basis is based on the depreciation method, recovery period, and convention applicable to the depreciable excess basis under section 168 at the time of replacement. However, If the year of replacement is less than 12 months, the depreciation allowance determined under this paragraph (e)(3) must be adjusted for a short taxable year (for further guidance, for example, see Rev. Proc. 89–15, 1989–1 C.B. 816, and §601.601(d)(2)(ii)(*b*) of this chapter).

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

Example 1. J, a calendar-year taxpayer, acquired 5-year property for $10,000 and placed it in service in January 2001. J uses the optional tables to depreciate the property. J uses the half-year convention and did not make any elections for the property. In December 2003, J exchanges the 5-year property for used 7-year property in a like-kind exchange. The depreciable exchanged basis of the 7-year property equals the adjusted depreciable basis of the 5-year property at the time of disposition of the relinquished MACRS property, namely $3,840 ($10,000 less $2,000 depreciation in 2001, $3,200 depreciation in 2002, and $960 depreciation in 2003). J must first determine the appropriate optional depreciation table pursuant to paragraph (c) of this section. Since the replacement MACRS property has a longer recovery period and the same depreciation method as the relinquished MACRS property, J uses the optional depreciation table corresponding to a 7-year recovery period, the 200% declining balance method, and the half-year convention (because the 5-year property was depreciated using a half-year convention). Had the replacement MACRS property been placed in service in the same taxable year as the placed-in-service year of the relinquished MACRS property, the depreciation allowance for the replacement MACRS property for the year of replacement would be determined using recovery year 3 of the optional table. The depreciation allowance equals the depreciable exchanged basis ($3,840) multiplied by the annual depreciation rate for the current taxable year (.1749 for recovery year 3) as modified by the transaction coefficient [1 / (1 - (.1429 + .2449))] which equals 1.6335. Thus, J multiplies $3,840, its depreciable exchanged basis in the replacement MACRS property, by the product of .1749 and 1.6335, and then by one-half, to determine the depreciation allowance for 2003, $549. For 2004, J multiples its depreciable exchanged basis in the replacement MACRS property determined at the time of replacement of $3,840 by the product of the modified annual depreciation rate for the current taxable year (.1249 for recovery year 4) and the transaction coefficient (1.6335) to determine its depreciation allowance of $783.

Example 2. K, a calendar-year taxpayer, acquired used Asset V for $100,000 and placed it in service in January 1999. K depreciated Asset V under the general depreciation system of section 168(a) by using a 5-year recovery period, the 200-percent declining balance method of depreciation, and the half-year convention. In December 2003, as part of the involuntary conversion, Asset V is involuntarily converted due to an earthquake. In October 2005, K purchases used Asset W with the insurance proceeds from the destruction of Asset V and places Asset W in service to replace Asset V. If Asset W had been placed in service when Asset V was placed in service, it would have been depreciated using a 7-year recovery period, the 200-percent declining balance method, and the half-year convention. K uses the optional depreciation tables to depreciate Asset V and Asset W. For 2003 (recovery year 5 on the optional table), the depreciation deduction for Asset V is $5,760 ((0.1152)($100,000)(1/2)). Thus, the adjusted depreciable basis of Asset V at the time of replacement is $11,520 ($100,000 less $20,000 depreciation in 1999, $32,000 depreciation in 2000, $19,200 depreciation in 2001, $11,520 depreciation in 2002, and $5,760 depreciation in 2003). Under the table that applied to Asset V, the year of disposition was recovery year 5 and the depreciation deduction was determined under the straight line method. The table that applies for Asset W is the table that applies the straight line depreciation method, the half-year convention, and a 7-year recovery period. The appropriate recovery year under this table is recovery year 5. The depreciation deduction for Asset W for 2005 is $1,646 (($11,520)(0.1429)(1/(1–0.5))(1/2)). Thus, the depreciation deduction for Asset W in 2006 (recovery year 6) is $3,290 ($11,520)(0.1428)(1/(1–0.5)). The depreciation deduction for 2007 (recovery year 7) is $3,292 (($11,520)(.1429)(1/(1-.5))). The depreciation deduction for 2008 (recovery year 8) is $3,292 ($11,520 less allowable depreciation for Asset W for 2005 through 2007 ($1,646 + $3,290 + $3,292)).

Example 3. L, a calendar-year taxpayer, placed in service used Computer X in January 2002 for $5,000. L depreciated Computer X 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. Computer X is destroyed in a fire in March 2004. For 2004, the depreciation deduction allowable for Computer X equals $480 ([($5,000)(.1920)] x (1/2)). Thus, the adjusted depreciable basis of Computer X was $1,920 when it was destroyed ($5,000 unadjusted depreciable basis less $1,000 depreciation for 2002, $1,600 depreciation for 2003, and $480 depreciation for 2004). In April 2004, as part of the involuntary conversion, L acquired and placed in service used Computer Y with the insurance proceeds received due to loss of Computer X. Computer Y will be depreciated using the same depreciation method, recovery period, and convention as Computer X. L elected to use the optional depreciation tables to compute the depreciation allowance for Computer X and Computer Y. The depreciation deduction allowable for 2004 for Computer Y equals $384 ([$1,920 x (.1920)(1/(1-.52))] x (1/2)).

(f) *Mid-quarter convention*. For purposes of applying the 40-percent test under section 168(d) and the regulations under section 168(d), the following rules apply:

(1) *Exchanged basis*. If, in a taxable year, MACRS property is placed in service by the acquiring taxpayer (but not as a result of a like-kind exchange or involuntary conversion) and—

(i) In the same taxable year, is disposed of by the acquiring taxpayer in a like-kind exchange or an involuntary conversion and replaced by the acquiring taxpayer with replacement MACRS property, the exchanged basis (determined without any adjustments for depreciation deductions during the taxable year) of the replacement MACRS property is taken into account in the year of replacement in the quarter the relinquished MACRS property was placed in service by the acquiring taxpayer; or

(ii) In the same taxable year, is disposed of by the acquiring taxpayer in a like-kind exchange or an involuntary conversion, and in a subsequent taxable year is replaced by the acquiring taxpayer with replacement MACRS property, the exchanged basis (determined without any adjustments for depreciation deductions during the taxable year) of the replacement

MACRS property is taken into account in the year of replacement in the quarter the replacement MACRS property was placed in service by the acquiring taxpayer; or

(iii) In a subsequent taxable year, disposed of by the acquiring taxpayer in a like-kind exchange or involuntary conversion, the exchanged basis of the replacement MACRS property is not taken into account in the year of replacement.

(2) *Excess basis*. Any excess basis is taken into account in the quarter the replacement MACRS property is placed in service by the acquiring taxpayer.

(3) *Depreciable property acquired for nondepreciable property*. Both the exchanged basis and excess basis of the replacement MACRS property described in paragraph (d)(2)(ii) of this section (depreciable property acquired for nondepreciable property), are taken into account for determining whether the mid-quarter convention applies in the year of replacement.

(g) *Section 179 election*. In applying the section 179 election, only the excess basis, if any, in the replacement MACRS property is taken into account. If the replacement MACRS property is described in paragraph (d)(2)(ii) of this section (depreciable property acquired for nondepreciable property), only the excess basis in the replacement MACRS property is taken into account.

(h) *Additional first year depreciation deduction*. See §1.168(k)–1T(f)(5) (for qualified property or 50-percent bonus depreciation property) and §1.1400L(b)–1T(f)(5) (for qualified New York Liberty Zone property).

(i) *Election not to apply this section*. A taxpayer may elect not to apply this section for any MACRS property involved in a like-kind exchange or involuntary conversion. An election under this paragraph (i) applies only to the taxpayer making the election and the election applies to both the relinquished MACRS property and the replacement MACRS property. If an election is made under this paragraph (i), the depreciation allowances for the replacement MACRS property beginning in the year of replacement and for the relinquished MACRS property in the year of disposition are not determined under this section. Instead, for depreciation purposes, the exchanged basis and excess basis, if any, in the replacement MACRS property are treated as being placed in service by the taxpayer at the time of replacement and the adjusted depreciable basis of the relinquished MACRS property is treated as being disposed of by the taxpayer at the time of disposition. Paragraphs (c)(5)(i) (determination of depreciation for relinquished MACRS property in the year of disposition), (c)(5)(iii) (rules for deferred transactions), (g) (section 179 election), and (h) (additional first year depreciation deduction) of this section apply to property to which this paragraph (i) applies. See paragraph (j) of this section for the time and manner of making the election under this paragraph (i).

(j) *Time and manner of making elections*—(1) *In general*. The election provided in paragraph (i) of this section is made separately by each person acquiring replacement MACRS property. The election is made for each member of a consolidated group by the common parent of the group, by the partnership (and not by the partners separately) in the case of a partnership, or by the S corporation (and not by the shareholders separately) in the case of an S corporation. A separate election under paragraph (i) of this section is required for each like-kind exchange or involuntary conversion. The election provided in paragraph (i) of this section must be made within the time and manner provided in paragraph (j)(2) and (3) of this section and may not be made by the taxpayer in any other manner (for example, the election cannot be made through a request under section 446(e) to change the taxpayer's method of accounting), except as provided in paragraph (k)(2) of this section.

(2) *Time for making election*. The election provided in paragraph (i) of this section is made by the due date (including extensions) of the taxpayer's federal tax return for the year of replacement.

(3) *Manner of making election*. The election provided in paragraph (i) of this section is made by typing or legibly printing at the top of Form 4562, *Depreciation and Amortization*, "ELECTION MADE UNDER SECTION 1.168(i)–6T(i)," or in the manner provided for on Form 4562 and its instructions. If Form 4562 is revised or renumbered, any reference in this section to that form is treated as a reference to the revised or renumbered form.

(4) *Revocation*. The election provided in paragraph (i) of this section, once made, may be revoked only with the consent of the Commissioner of Internal Revenue. Such consent will be granted only in extraordinary circumstances. Requests for consent are requests for a letter ruling and must be filed with the Commissioner of Internal Revenue, Washington, DC, 20224. Requests for consent may not be made in any other manner (for example, through a request under section 446(e) to change the taxpayer's method of accounting).

(k) *Effective date*—(1) *In general*. (i) This section applies to a like-kind exchange or an involuntary conversion of MACRS property for which the time of disposition and the time of replacement both occur after February 27, 2004.

(ii) The applicability of this section expires on or before February 26, 2007.

(2) *Application to pre-effective date like-kind exchanges and involuntary conversions*. For a like-kind exchange or an involuntary conversion of MACRS property for which the time of disposition, the time of replacement, or both occur on or before February 27, 2004, a taxpayer may:

(i) Apply the provisions of this section. If a taxpayer's applicable federal income tax return has been filed on or before February 27, 2004, and the taxpayer has treated the replacement MACRS property as acquired, and the relinquished MACRS property as disposed of, in a like-kind exchange or an involuntary conversion, the taxpayer changes its method of accounting for depreciation of the replacement MACRS property and relinquished MACRS property in accordance with this paragraph (k)(2)(i) by following the applicable administrative procedures issued under §1.446–1T(e)(3)(ii) for obtaining the Commissioner's automatic consent to a change in method of accounting (for further guidance, see Rev. Proc. 2002–9, 2002–1 C.B. 327, and §601.601(d)(2)(ii)(*b*) of this chapter); or

(ii) Rely on prior guidance issued by the Internal Revenue Service for determining the depreciation deductions of replacement MACRS property and relinquished MACRS property (for further guidance, for example, see Notice 2000–4, 2001–1 C.B. 313, and §601.601(d)(2)(ii)(*b*) of this chapter). In relying on such guidance, a taxpayer may use any reasonable, consistent method of determining depreciation in the year of disposition and the year of replacement. If a taxpayer's applicable federal income tax return has been filed on or before February 27, 2004, and the taxpayer has treated the replacement MACRS property as acquired, and the relinquished MACRS property as disposed of, in a like-kind exchange or an involuntary conversion, the taxpayer changes its method of accounting for depreciation of the replacement MACRS property and relinquished MACRS property in accordance with this paragraph (k)(2)(ii) by following the applicable administrative procedures issued under §1.446–1T(e)(3)(ii) for obtaining the Commissioner's automatic consent to a change in method of accounting (for further guidance, see Rev. Proc. 2002–9, 2002–1 C.B. 327, and §601.601(d)(2)(ii)(*b*) of this chapter).

Par. 11. Section 1.168(k)–1T is amended by:

1. Revising paragraphs (f)(5)(ii)(F)(*2*) and (f)(5)(v).

2. Redesignating paragraph (g)(1) as paragraph (g)(1)(i).

3. Revising the last sentence in newly designated paragraph (g)(1)(i) and redesignating as new paragraph (g)(1)(ii).

4. Redesignating paragraph (g)(3) as paragraph (g)(3)(i).

5. Adding paragraph (g)(3)(ii).

The addition and revisions read as follows:

§1.168(k)–1T Additional first year depreciation (temporary).

* * * * *

(f) * * *

(5) * * *

(ii) * * *

(F) * * *

(*2*) The time of disposition of the exchanged or involuntarily converted property.

* * * * *

(v) *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 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.

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

(iii) For 2003, EE is allowed a regular MACRS depreciation deduction of $22,400 for Canopy V1 (the remaining adjusted depreciable basis of $140,000 multiplied by the annual depreciation rate of .32 for recovery year 2 × 1/2 year).

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

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

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

(iii) For 2003, EE is allowed a regular MACRS depreciation deduction of $32,000 for Canopy V1 (the unadjusted depreciable basis of $200,000 multiplied by the annual depreciation rate of .32 for recovery year 2 × 1/2 year).

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

Example 3. (i) In December 2001, FF, a calendar-year corporation, acquired for $10,000 and placed in service Computer X2. Computer X2 is qualified property under section 168(k)(1) and is 5-year property under section 168(e). FF depreciated Computer X2 under the general depreciation system of section 168(a) by using the 200-percent declining balance method of depreciation, a 5-year recovery period, and the half-year convention. FF elected to use the optional depreciation tables to compute the depreciation allowance for Computer X2. On January 1, 2002, FF acquired 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.

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

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

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

Example 4. (i) In September 2002, GG, a June 30 year-end corporation, acquired for $20,000 and placed in service Equipment X3. Equipment X3 is qualified property under section 168(k)(1) and is 5-year property under section 168(e). GG depreciated Equipment X3 under the general depreciation system of section 168(a) by using the 200-percent declining balance method of depreciation, a 5-year recovery period, and the half-year convention. GG elected to use the optional depreciation tables to compute the depreciation allowance for Equipment X3. In December 2002, GG acquired 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.

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

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

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

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

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

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

* * * * *

(g) * * * (1) * * * (i) * * *

(ii) Except as provided in paragraph (g)(3)(ii) of this section, the applicability of this section expires on or before September 4, 2006.

(2) * * *

(3) *Like-kind exchanges and involuntary conversions*—(i). * * *

(ii) Paragraph (f)(5)(ii)(F)(2) of this section and paragraph (f)(5)(v) of this section apply to a like-kind exchange or an involuntary conversion of MACRS property and computer software for which the time of disposition and the time of replacement both occur after February 27, 2004. For a like-kind exchange or an involuntary conversion of MACRS property for which the time of disposition, the time of replacement, or both occur on or before February 27, 2004, see §1.168(i)–6T(k)(2)(ii). For a like-kind exchange or involuntary conversion of computer software for which the time of disposition, the time of replacement, or both occur on or before February 27, 2004, a taxpayer may rely on prior guidance issued by the Internal Revenue Service for determining the depreciation deductions of the acquired computer software and the exchanged or involuntarily converted computer software (for further guidance, see §1.168(k)–1T(f)(5) published in the **Federal Register** on September 8, 2003 (68 FR 53000)). In relying on such guidance, a taxpayer may use any reasonable, consistent method of determining depreciation in the year of disposition and the year of replacement. The applicability of paragraph (f)(5) of this section expires on or before February 26, 2007.

* * * * *

Mark E. Matthews,
Deputy Commissioner for Services and Enforcement.

Approved February 17, 2004.

Pamela F. Olson,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on February 27, 2004, 8:45 a.m., and published in the issue of the Federal Register for March 1, 2004, 69 F.R. 9529)

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of April 2004. See Rev. Rul. 2004-39, page 700.

Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change

The adjusted applicable federal long-term rate is set forth for the month of April 2004. See Rev. Rul. 2004-39, page 700.

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of April 2004. See Rev. Rul. 2004-39, page 700.

Section 467.—Certain Payments for the Use of Property or Services

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of April 2004. See Rev. Rul. 2004-39, page 700.

Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of April 2004. See Rev. Rul. 2004-39, page 700.

Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of April 2004. See Rev. Rul. 2004-39, page 700.

Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of April 2004. See Rev. Rul. 2004-39, page 700.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of April 2004. See Rev. Rul. 2004-39, page 700.

Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of April 2004. See Rev. Rul. 2004-39, page 700.

Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of April 2004. See Rev. Rul. 2004-39, page 700.

Section 1274.—Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

(Also sections 42, 280G, 382, 412, 467, 468, 482, 483, 642, 807, 846, 1288, 7520, 7872.)

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for April 2004.

Rev. Rul. 2004–39

This revenue ruling provides various prescribed rates for federal income tax purposes for April 2004 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Finally, Table 5 contains the federal rate for determining the present value of annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 2004–39 TABLE 1

Applicable Federal Rates (AFR) for April 2004

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-Term				
AFR	1.47%	1.46%	1.46%	1.46%
110% AFR	1.62%	1.61%	1.61%	1.60%
120% AFR	1.76%	1.75%	1.75%	1.74%
130% AFR	1.91%	1.90%	1.90%	1.89%
Mid-Term				
AFR	3.15%	3.13%	3.12%	3.11%
110% AFR	3.47%	3.44%	3.43%	3.42%
120% AFR	3.80%	3.76%	3.74%	3.73%
130% AFR	4.11%	4.07%	4.05%	4.04%
150% AFR	4.76%	4.70%	4.67%	4.65%
175% AFR	5.56%	5.48%	5.44%	5.42%
Long-Term				
AFR	4.66%	4.61%	4.58%	4.57%
110% AFR	5.13%	5.07%	5.04%	5.02%
120% AFR	5.61%	5.53%	5.49%	5.47%
130% AFR	6.08%	5.99%	5.95%	5.92%

REV. RUL. 2004–39 TABLE 2

Rates Under Section 382 for April 2004

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	1.17%	1.17%	1.17%	1.17%
Mid-term adjusted AFR	2.34%	2.33%	2.32%	2.32%
Long-term adjusted AFR	4.05%	4.01%	3.99%	3.98%

REV. RUL. 2004–39 TABLE 3

Rates Under Section 382 for April 2004

Adjusted federal long-term rate for the current month	4.05%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	4.31%

REV. RUL. 2004–39 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for April 2004

Appropriate percentage for the 70% present value low-income housing credit	7.91%
Appropriate percentage for the 30% present value low-income housing credit	3.39%

REV. RUL. 2004–39 TABLE 5

Rate Under Section 7520 for April 2004

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	3.8%

Section 1288.—Treatment of Original Issue Discounts on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of April 2004. See Rev. Rul. 2004-39, page 700.

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of April 2004. See Rev. Rul. 2004-39, page 700.

Section 7872.—Treatment of Loans With Below-Market Interest Rates

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of April 2004. See Rev. Rul. 2004-39, page 700.

26 CFR 1.1441–5: Withholding on payments to partnerships, trusts and estates.

Amendment to Final Agreement for Withholding Foreign Partnerships and Withholding Foreign Trusts and Additional Guidance for Qualified Intermediaries under Rev. Proc. 2003–64

Rev. Proc. 2004–21

SECTION 1. PURPOSE AND SCOPE

This revenue procedure modifies the final withholding foreign partnership ("WP") and withholding foreign trust ("WT") agreements, contained in Rev. Proc. 2003–64, 2003–32 I.R.B. 306, by expanding the availability of certain simplified documentation, reporting, and withholding procedures. This revenue procedure also makes a conforming change to the portion of the Qualified Intermediary ("QI") withholding agreement (the "QI agreement") contained in Rev. Proc. 2003–64.

SECTION 2. BACKGROUND

Rev. Proc. 2003–64 contains the WP and WT agreements described in Treasury Regulation § 1.1441–5(c)(2)(ii) and (e)(5)(v) and sets forth the application procedures for entering into such agreements. Rev. Proc. 2003–64 also amends the QI agreement, contained in Rev. Proc. 2000–12, 2000–1 C.B. 387, to add new Section 4A.

Section 10.01 of the WP and WT agreements and new Section 4A.01 of the QI agreement provide generally that a QI, WP, or WT may apply simplified documentation, reporting, and withholding procedures to a foreign trust or foreign partnership if certain conditions are met (the "Joint Account Provision"). Currently a QI, WP, or WT may apply the Joint Account Provision only if, among other things, the foreign partnership or trust receives from the QI, WP, or WT less than $200,000 of reportable amounts for a calendar year (the "$200,000 cap").

The IRS and Treasury have received comments seeking an expansion of the Joint Account Provision. The comments indicated that expanding the availability of the Joint Account Provision by eliminating the $200,000 cap would facilitate compliance by QIs, WPs, and WTs with their documentation, reporting, and withholding obligations with respect to foreign partnerships and foreign simple and grantor trusts. After considering these comments, the IRS and Treasury have concluded that expanding the availability of the Joint Account Provision by eliminating the $200,000 cap would be consistent with the objectives of the underlying reporting and withholding regimes.

SECTION 3. EXPANSION OF JOINT ACCOUNT PROVISION

Appendices 1, 2, and 3 of Rev. Proc. 2003–64, containing the WP and WT agreements and new Section 4A of the QI agreement, respectively, are amended as follows. In Appendices 1 and 2, the first paragraph of Section 10.01 of the WP and WT agreements are amended by inserting "and" before "(iii)" and by deleting "and (iv) the total reportable amounts distributed to, and included in the distributive share of, the partnership or trust for the calendar year do not exceed $200,000." In Appendix 3, the first paragraph of Section 4A.01 of the QI agreement is amended by inserting "and" before "(iii)" and by deleting "and (iv) the total reportable amounts that QI has paid to accounts of the partnership or trust that are covered by the QI agreement do not exceed $200,000 for the calendar year."

SECTION 4. EFFECTIVE DATE

The modifications to Rev. Proc 2003–64 made by this revenue procedure are effective as of July 10, 2003, the effective date of Rev. Proc. 2003–64. Pursuant to Section 12.02 of the QI agreement, and Section 11.02 of the WP and WT agreements, these amendments apply to all existing QI, WP, and WT agreements. These amendments will be incorporated into the text of all QI, WP, and WT agreements entered into on or after the date this revenue procedure is released.

As described in section 1.01 of Rev. Proc. 2003–64, a WP or WT agreement entered into during a calendar year may be made effective as of the first day of that calendar year. With the changes made by this revenue procedure, some foreign partnerships and trusts may wish to act as WPs or WTs beginning in 2003. Therefore, upon request, the IRS will execute WP and WT agreements with terms beginning on January 1, 2003, even if the application to enter into a WP or WT agreement was or is received after December 31, 2003, provided that the IRS receives the completed application on or before June 30, 2004.

SECTION 5. REQUEST FOR COMMENTS

Section 4A.02 of the QI agreement and Section 10.02 of the WP and WT agreements allow the QI, WP, or WT to use simplified documentation, reporting, and withholding procedures if, among other things, the QI, WP, or WT is a general partner of the partnership or a trustee of the trust (the "related-party requirement"). The IRS and Treasury are reviewing the related-party requirement and solicit comments as to whether it presents difficulties for taxpayers considering participation in the QI, WP, or WT programs, and, if so, the reasons for such difficulties. Comments also are requested regarding the possibility of eliminating the requirement or modifying it to address any such difficulties, while ensuring consistency with the objectives of the underlying reporting and withholding regimes.

More generally, the IRS and Treasury remain committed to the QI, WP, and WT programs and are continuing to review them to ensure their optimal effectiveness. Therefore, comments are requested regarding additional ways the programs' current rules and forms of agreement could be improved in a manner that is consistent with the objectives of the underlying reporting and withholding regimes.

SECTION 6. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2003–64, 2003–32 I.R.B. 306, is modified.

SECTION 7. CONTACT INFORMATION

For further information regarding this revenue procedure, contact Ethan Atticks, Carl Cooper, or Valerie Mark Lippe at (202) 622–3840 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking; Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations; Notice of Public Hearing; and Partial Withdrawal of Proposed Regulations

Depreciation of MACRS Property That is Acquired in a Like-Kind Exchange or As a Result of an Involuntary Conversion

REG–106590–00, REG–138499–02

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking; notice of proposed rule making by cross-reference to temporary regulations; notice of public hearing; and partial withdrawal of proposed regulations.

SUMMARY: In this issue of the Bulletin, the IRS is issuing temporary regulations (T.D. 9115) relating to the depreciation of property subject to section 168 of the Internal Revenue Code (MACRS property). Specifically, the temporary regulations provide guidance on how to depreciate MACRS property acquired in a like-kind exchange under section 1031 or as a result of an involuntary conversion under section 1033 when both the acquired and relinquished property are subject to MACRS in the hands of the acquiring taxpayer. The text of those temporary regulations also serves as the text of these proposed regulations. This document also provides notice of a public hearing on these proposed regulations and a partial withdrawal of proposed regulations (REG–138499–02, 2003–37 I.R.B. 541) published July 21, 2003.

DATES: Written or electronic comments must be received by May 30, 2004. Outlines of topics to be discussed at the public hearing scheduled for June 3, 2004, at 10 a.m. must be received by May 13, 2004.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG–106590–00), room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Alternatively, submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–106590–00), Courier's Desk, Internal Revenue Service, 1111 Constitution Ave., NW, Washington, DC, or sent electronically, via the IRS Internet site at *http://www.irs.gov/regs*. The public hearing will be held in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Charles J. Magee, (202) 622–3110; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Robin Jones, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Temporary regulations in this issue of the Bulletin amend 26 CFR part 1 relating to section 168 of the Internal Revenue Code (Code). The temporary regulations provide guidance under section 168 on how to depreciate MACRS property acquired in a like-kind exchange under section 1031 or as a result of an involuntary conversion under section 1033 when both the acquired and relinquished property are subject to MACRS in the hands of the acquiring taxpayer. The text of those regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the temporary regulations and these proposed regulations.

Special Analyses

It has been determined that this notice of proposed rulemaking 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 Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department specifically request comments on the clarity of the proposed rules and how they may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for June 3, 2004, beginning at 10 a.m. in the Auditorium of the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the **FOR FURTHER INFORMATION CONTACT** section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by May 13, 2004. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal authors of these regulations are Alan H. Cooper, Office of the Chief Counsel (Small Business/Self Employed), and Charles J. Magee, Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Partial Withdrawal of Proposed Regulations

Under the authority of 26 U.S.C. 7805, §§1.168(a)–1 and 1.168(b)–1 of the notice of proposed rulemaking (REG–138499–02, 2003–37 I.R.B. 541 [68 FR 43047]) published in the **Federal Register** on July 21, 2003, are withdrawn.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 reads as follows:

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

§1.168(i)–1 also issued under 26 U.S.C. 168(i)(4).

Par. 2. Sections 1.168(a)–1 and 1.168(b)–1 are added to read as follows:

§1.168(a)–1 Modified accelerated cost recovery system.

[The text of this proposed section is the same as the text of §1.168(a)–1T(a) and (b) published elsewhere in this issue of the Bulletin].

§1.168(b)–1 Definitions.

[The text of this proposed section is the same as the text of §1.168(b)–1T(a) and (b)(1) published elsewhere in this issue of the Bulletin].

Par. 3. Section 1.168(d)–1 is amended to read as follows:

1. Revising paragraph (b)(3)(i) and (ii).
2. Adding paragraph (d)(3).

The revision and addition read as follows:

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

* * * * *

(b) * * *

(3) * * *

(i) and (ii) [The text of the proposed amendment to §1.168(d)–1(b)(3)(i) and (ii) is the same as the text of §1.168(d)–1T(b)(3)(i) and (ii) published elsewhere in this issue of the Bulletin].

* * * * *

(d) * * *

(3) [The text of the proposed amendment to §1.168(d)–1(d)(3) is the same as the text of §1.168(d)–1T(d)(3) published elsewhere in this issue of the Bulletin.]

Par. 4. Section 1.168(i)–0 is amended by revising the entries for §1.168(i)–1(d)(2), (e)(3)(i), (e)(3)(v) and (vi), (f)(1), (f)(2), (f)(2)(i), (i), (j), and (l) to read as follows:

§1.168(i)–0 Table of contents for the general asset account rules.

* * * * *

§1.168(i)–1 General asset accounts.

* * * * *

(d) * * *

(2) [The text of the proposed entry for §1.168(i)–1(d)(2) is the same as the entry for §1.168(i)–1T(d)(2) published elsewhere in this issue of the Bulletin].

* * * * *

(e) * * *

(3) * * *

(i) [The text of the proposed entry for §1.168(i)–1(e)(3)(i) is the same as the entry for §1.168(i)–1T(e)(3)(i) published elsewhere in this issue of the Bulletin].

* * * * *

(vi) [The text of the proposed entries for §1.168(i)–1(e)(3)(vi) is the same as the entries for §1.168(i)–1T(e)(3)(vi) published elsewhere in this issue of the Bulletin].

* * * * *

(f) * * *

(f)(1) through (f)(2)(i) [The text of the proposed entries for §1.168(i)–1(f)(1) through (f)(2)(i) is the same as the text of the entries for §1.168(i)–1T(f)(1) through (f)(2)(i) published elsewhere in this issue of the Bulletin].

* * * * *

(i) and (j) [The text of the proposed entries for §1.168(i)–1(i) and (j) is the same as the entries for §1.168(i)–1T(i) and (j) published elsewhere in this issue of the Bulletin].

* * * * *

(l) [The text of the proposed entry for §1.168(i)–1(l) is the same as the entry for §1.168(i)–1T(l) published elsewhere in this issue of the Bulletin].

Par. 5. Section 1.168(i)–1 is amended by revising paragraphs (c)(2)(ii)(E), (d)(2), (e)(3)(i), (e)(3)(iii)(B)(*4*), (e)(3)(vi), (f)(1), (f)(2)(i), (i), (j), and (l) to read as follows:

§1.168(i)–1 General asset accounts.

* * * * *

(c) * * *

(2) * * *

(ii) * * *

(E) [The text of the proposed amendment to §1.168(i)–1(c)(2)(ii)(E) is the same as the text of §1.168(i)–1T(c)(2)(ii)(E) published elsewhere in this issue of the Bulletin].

* * * * *

(d) * * *

(2) [The text of the proposed amendment to §1.168(i)–1(d)(2) is the same as the text of §1.168(i)–1T(d)(2) published elsewhere in this issue of the Bulletin].

* * * * *

(e) * * *

(3) * * *

(i) [The text of the proposed amendment to §1.168(i)–1(e)(3)(i) is the same as the text of §1.168(i)–1T(e)(3)(i) published elsewhere in this issue of the Bulletin].

* * * * *

(iii) * * *

(B) * * *

(*4*) [The text of the proposed amendment to §1.168(i)–1(e)(3)(iii)(B)(*4*) is the same as the text of §1.168(i)–1T(e)(3)(iii)(B)(*4*) published elsewhere in this issue of the Bulletin].

* * * * *

(e)(3)(vi) [The text of the proposed amendment to §1.168(i)–1(e)(3)(vi) is the same as the text of §1.168(i)–1T(e)(3)(vi) published elsewhere in this issue of the Bulletin].

* * * * *

(f)(1) and (2) [The text of the proposed amendment to §1.168(i)–1(f)(1) and (2) is the same as the text of §1.168(i)–1T(f)(1) and (2) published elsewhere in this issue of the Bulletin].

* * * * *

(i) and (j) [The text of the proposed amendment to §1.168(i)–1(i) and (j) is the same as the text of §1.168(i)–1T(i) and (j) published elsewhere in this issue of the Bulletin].

* * * * *

(l) [The text of the proposed amendment to §1.168(i)–1(l) is the same as the text of §1.168(i)–1T(l)(1) through (l)(3)(i) published elsewhere in this issue of the Bulletin].

Par. 6. Section 1.168(i)–5 is added to read as follows:

§1.168(i)–5 Table of contents.

[The text of this proposed section is the same as the text of §1.168(i)–5T published elsewhere in this issue of the Bulletin].

Par. 7. Section 1.168(i)–6 is added to read as follows:

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

[The text of this proposed section is the same as the text of §1.168(i)–6T published elsewhere in this issue of the Bulletin].

Par. 8. Section 1.168(k)–1 is added to read as follows:

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

(a) through (f)(5)(ii)(F)(*1*) [Reserved]. For further guidance, see §1.168(k)–1T(a) through (f)(5)(ii)(F)(*1*).

(*2*) [The text of the proposed amendment to §1.168(k)–1(f)(5)(ii)(F)(*2*) is the same as the text of §1.168(k)–1T(f)(5)(ii)(F)(*2*) published elsewhere in this issue of the Bulletin].

(f)(5)(ii)(G) through (f)(5)(iv) [Reserved]. For further guidance, see §1.168(k)–1T(f)(5)(ii)(G) through (f)(5)(iv).

(v) [The text of the proposed amendment to §1.168(k)–1(f)(5)(v) is the same as the text of §1.168(k)–1T(f)(5)(v) published elsewhere in this issue of the Bulletin].

(f)(6) through (f)(9) [Reserved]. For further guidance, see §1.168(k)–1T(f)(6) through (f)(9).

(g) *Effective date*. (1) [The text of the proposed amendment to §1.168(k)–1(g)(1) is the same as §1.168(k)–1T(g)(1)(i) published elsewhere in this issue of the Bulletin].

(2) [Reserved]. For further guidance, see §1.168(k)–1T(g)(2).

(3)(i) and (ii) [The text of the proposed amendment to §1.168(k)–1(g)(3)(i) and (ii) is the same as the text of §1.168(k)–1T(g)(3)(i) and (ii) published elsewhere in this issue of the Bulletin].

(g)(4) [Reserved]. For further guidance, see §1.168(k)–1T(g)(4).

Mark E. Matthews,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on February 27, 2004, 8:45 a.m., and published in the issue of the Federal Register for March 1, 2004, 69 F.R. 9560)

Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations and Notice of Public Hearing

New Markets Tax Credit Amendments

REG–115471–03

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations and notice of public hearing.

SUMMARY: In this issue of the Bulletin, the IRS is issuing revised temporary regulations (T.D. 9116) relating to the new markets tax credit. The text of those regulations also serves as the text of these proposed regulations. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by May 10, 2004. Outlines of topics to be discussed at the public hearing scheduled for Wednesday, June 2, 2004, must be received by May 10, 2004.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–115471–03), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Alternatively, submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG–115471–03), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically via the IRS Internet site at *www.irs.gov/regs.* The public hearing will be held in IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Paul F. Handleman or Lauren R. Taylor, (202) 622–3040; concerning submission of comments, the hearing, and/or to be placed on the building access list to attend the hearing, LaNita Van Dyke, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Temporary regulations in this issue of the Bulletin amend the Income Tax Regulations (26 CFR Part 1) relating to section 45D. The temporary regulations provide guidance for taxpayers claiming the new markets tax credit under section 45D. The text of those regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the amendments.

Special Analyses

It has been determined that this notice of proposed rulemaking 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 the regulations do not impose a new collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. Comments are requested on all aspects of the proposed regulations. In addition, the IRS and Treasury Department specifically request comments on the clarity of the proposed regulations and how they can be revised to be more easily understood. All comments will be available for public inspection and copying.

A public hearing has been scheduled for Wednesday, June 2, 2004, at 10 a.m. in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. All visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area at the Constitution Avenue entrance more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons who wish to present oral comments at the hearing must submit written comments and an outline of the topics to be discussed and the time to be devoted to each topic (preferably a signed original and eight (8) copies) by May 10, 2004. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

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

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

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

Par. 2. Section 1.45D–1 is amended to read as follows:

§1.45D–1 New markets tax credit.

[The text of the amendments to this proposed section is the same as the text of the amendments to §1.45D–1T published elsewhere in this issue of the Bulletin.]

Mark E. Matthews,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on March 10, 2004, 8:45 a.m., and published in the issue of the Federal Register for March 11, 2004, 69 F.R. 11561)

Notice of Proposed Rulemaking

Exclusion of Employees of 501(c)(3) Organizations in 401(k) and 401(m) Plans

REG–149752–03

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed amendments to the regulations under section 410(b) of the Internal Revenue Code. The proposed amendments permit, in certain circumstances, employees of a tax-exempt organization described in section 501(c)(3) to be excluded for the purpose of testing whether a section 401(k) plan (or a section 401(m) plan that is provided under the same general arrangement as the section 401(k) plan of the employer) meets the requirements for minimum coverage specified in section 410(b). These regulations will affect tax-exempt employers described in section 501(c)(3), retirement plans sponsored by these employers, and participants in these plans.

DATES: Written or electronic comments and requests for a public hearing must be received by June 14, 2004.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–149752–03), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–149752–03), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet directly to the IRS Internet site at *www.irs.gov/regs*.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, R. Lisa Mojiri-Azad, 202–622–6060, or Stacey Grundman, 202–622–6090; concerning submissions and delivery of comments, Treena Garrett, 202–622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 410(b) of the Internal Revenue Code of 1986 (Code). The amendments implement a directive by Congress, contained in section 664 of the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107–16, 115 Stat. 38) (EGTRRA), to amend §1.410(b)–6(g) of the regulations.

Prior to the enactment of the Small Business Job Protection Act of 1996 (Public Law 104–188, 110 Stat. 1755) (SBJPA), both governmental and tax-exempt entities generally were subject to the section 410(b) coverage requirements and precluded from maintaining section 401(k) plans pursuant to section 401(k)(4)(B). To prevent the section 401(k)(4)(B) prohibition from causing a plan to fail section 410(b), the existing regulations provide that employees of either governmental or tax-exempt entities who are precluded from being eligible employees under a section 401(k) plan by reason of section 401(k)(4)(B) may be treated as excludable in applying the minimum coverage rules to a section 401(k) plan or a section 401(m) plan that is provided under the same general arrangement as the section 401(k) plan, if more than 95 percent of the employees of the employer who are not precluded from being eligible employees by section 401(k)(4)(B) benefit under the plan for the plan year. Although tax-exempt organizations described in section 501(c)(3) were precluded by section 401(k)(4)(B) from maintaining a section 401(k) plan, they were permitted to allow their employees to make salary reduction contributions to a plan or contract that satisfies section 403(b) (a section 403(b) plan).

Section 1426(a) of SBJPA amended section 401(k)(4)(B) to allow nongovernmental tax-exempt organizations (including organizations exempt under section 501(c)(3)) to maintain section 401(k) plans. Thus, a section 501(c)(3) tax-exempt organization can now maintain a section 401(k) plan, a section 403(b) plan, or both. In light of this provision of SBJPA, section 664 of EGTRRA directed the Secretary of the Treasury to modify the regulations under section 410(b) to provide that employees of a tax-exempt organization described in section 501(c)(3) who are eligible to make salary reduction contributions under a section 403(b) plan may be treated as excludable employees for the purpose of testing whether a section 401(k) plan or a section 401(m) plan that is provided under the same general arrangement as the section 401(k) plan meets the minimum coverage requirements contained in section 410(b) if (1) no employee of the organization is eligible to participate in the section 401(k) or section 401(m) plan and (2) at least 95 percent of the employees of the employer who are not employees of the organization are eligible to participate in the section 401(k) or section 401(m) plan.

The change recognizes that many tax-exempt organizations maintained section 403(b) plans prior to the enactment of SBJPA and is needed to allow the continued maintenance of section 403(b) plans by these organizations without requiring the same employees to be covered under a section 401(k) plan and the section 403(b) plan. The change will help an employer that maintains both a section 401(k) plan and a section 403(b) plan to satisfy the section 410(b) coverage requirements without the employer having to provide dual coverage for employees.

Explanation of Provisions

These regulations provide that employees of a tax-exempt organization described in section 501(c)(3) who are eligible to make salary reduction contributions under a section 403(b) plan may be treated as excludable employees for the purpose of testing whether a section 401(k) plan or a section 401(m) plan that is provided under the same general arrangement as the section 401(k) plan meets the minimum coverage requirements contained in section 410(b) if (1) no employee of the tax-exempt organization is eligible to participate in the section 401(k) or section 401(m) plan and (2) at least 95 percent of the employees of the employer who are not employees of the tax-exempt organization are eligible to participate in the section 401(k) or section 401(m) plan.

The proposed regulations do not include any changes to the treatment of governmental plans under the current regulations. Unless grandfathered, state and local governmental entities continue to be precluded from maintaining section 401(k) plans pursuant to section 401(k)(4)(B). However, as a result of section 1505(a)(1) of the Taxpayer Relief Act of 1997 (Public Law 105–34, 111 Stat. 788), which added section 401(a)(5)(G) to the Code, governmental plans (within the meaning of section 414(d)) maintained by a state or local government or political subdivision thereof (or agency or instrumentality thereof) are not subject to the minimum coverage requirements contained in section 410(b). Consequently, the IRS and Treasury request comments on whether it would be appropriate to modify the special rule for governmental plans contained in §1.410(b)–6(g) to reflect the addition of section 401(a)(5)(G) (including whether there continues to be a need for this special rule with respect to governmental plans).

Effective Date

As directed by Congress in section 664 of EGTRRA, the amendments to §1.410(b)–6(g) are proposed to be effective for plan years beginning after December 31, 1996. Taxpayers may rely on these proposed regulations for guidance pending the issuance of final regulations. If, and to the extent, future guidance is more restrictive than the guidance in these proposed regulations, the future guidance will be applied without retroactive effect.

Special Analyses

It has been determined that this notice of proposed rulemaking 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 the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and 8 copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal authors of these proposed regulations are R. Lisa Mojiri-Azad and Stacey Grundman of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury participated in the development of these regulations.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1 — INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entry for §§1.410(b)–2 through 1.410(b)–10 and adding entries in numerical order to read, in part, as follows:

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

§1.410(b)–2 also issued under 26 U.S.C. 410(b)(6).

§1.410(b)–3 also issued under 26 U.S.C. 410(b)(6).

§1.410(b)–4 also issued under 26 U.S.C. 410(b)(6).

§1.410(b)–5 also issued under 26 U.S.C. 410(b)(6).

§1.410(b)–6 also issued under 26 U.S.C. 410(b)(6) and section 664 of the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107–16, 115 Stat. 38).

§1.410(b)–7 also issued under 26 U.S.C. 410(b)(6).

§1.410(b)–8 also issued under 26 U.S.C. 410(b)(6).

§1.410(b)–9 also issued under 26 U.S.C. 410(b)(6).

§1.410(b)–10 also issued under 26 U.S.C. 410(b)(6).* * *

Par. 2. Section 1.410(b)–0, table of contents, the entry for 1.410(b)–6 is amended by:

1. Revising the paragraph heading for 1.410(b)–6(g).

2. Adding paragraph headings for 1.410(b)–6(g)(1) and (g)(2).

The revision and additions read as follows:

§1.410(b)–0 Table of contents.

* * * * *

§1.410(b)–6 Excludable employees.

* * * * *

(g) Employees of certain governmental or tax-exempt entities.

(1) Employees of governmental entities.

(2) Employees of tax-exempt entities.

* * * * *

Par. 3. In §1.410(b)–6, paragraph (g) is revised to read as follows:

§1.410(b)–6 Excludable employees.

* * * * *

(g) *Employees of certain governmental or tax-exempt entities*. For purposes of testing either a section 401(k) plan or a section 401(m) plan that is provided under the same general arrangement as a section 401(k) plan, an employer may treat as excludable those employees described in paragraphs (g)(1) and (2) of this section.

(1) *Employees of governmental entities*. Employees of governmental entities who are precluded from being eligible employees under a section 401(k) plan by reason of section 401(k)(4)(B)(ii) may be treated as excludable employees if more than 95 percent of the employees of the employer who are not precluded from being eligible employees by section 401(k)(4)(B)(ii) benefit under the plan for the plan year.

(2) *Employees of tax-exempt entities*. Employees of a tax-exempt organization described in section 501(c)(3) who are eligible to make salary reduction contributions under a section 403(b) plan may be treated as excludable employees if —

(i) No employee of the organization is eligible to participate in the section 401(k) or section 401(m) plan; and

(ii) At least 95 percent of the employees of the employer who are not employees of the organization are eligible to participate in the section 401(k) or section 401(m) plan.

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Mark E. Matthews,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on March 15, 2004, 8:45 a.m., and published in the issue of the Federal Register for March 16, 2004, 69 F.R. 12291)

Foundations Status of Certain Organizations

Announcement 2004–22

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

58 Group, Chicago, IL
Abraham Lincoln National Cemetery Support Committee, Frankfort, IL
Accessible Creative Theatre, Inc., Carbondale, IL
Adeline House an Orphanage, Cleveland, OH
Adelphic Historical Restoration Society, Battle Creek, MI
African American Community Development Corporation, Canton, OH
A H S Restoration, Inc., Anderson, IN
Aid Angeles, Inc., Aliso Viejo, CA
All My Children Child Care Services, Inc., Cerritos, CA
Alliance for Advancement of HIV-AIDS Therapy, Inc., Palm Springs, CA
Alpha Baydi Dia Fund, Detroit, MI
Alpha Omega Foundation, Inc., Rock Island, IL
Amauzari in the USA Organization, Chicago, IL
American Friends of Ateres Bnos Yervshalayim, Inc., Chicago, IL
American Museum of Magic, Inc., Marshall, MI
Ancient World Society, Inc., Wauconda, IL

Anger Institute, Inc., Chicago, IL
Antioch Mission Fellowship, Buena Park, CA
Apiary of Solution & Knowledge, Inc., Indianapolis, IN
Arab-American Chamber of Commerce, Chicago, IL
Arab-American Congress, Chicago, IL
Ark of Safety, Caseyville, IL
Ashe, Inc., Yuciapa, CA
Asociacion de Fraternidades Guatemaltecas Corp., Lynwood, CA
Assistance Foundation, Palm Springs, CA
Augusta Homes, Upland, CA
Aurora Now Foundation, Tucson, AZ
Ayala Athletic Foundation, Chino Hills, CA
Baby Basket, Lawrenceburg, IN
Backdoor Ministries, Oak Hills, CA
Ballet Folklorico Nuestras Tradiciones, Colton, CA
Bath Charter Township Housing Commission, Bath, MI
Bazan Prayer Ministries Ministerrios de Oracion Bazan, El Canjon, CA
Bellaire - Puritas Meals on Wheels, Cleveland, OH
Bethel Community Housing Corporation, Detroit, MI
Bethel Gospel Missions, Greenville, IL
Bethesda Community Development Center, Elgin, IL
Black Contractors United Foundation, Inc., Chicago, IL
Braceville Parent-Teacher Community Organization, Braceville, IL
Brighter Futures, Chicago, IL
Brightwood Children and Family Cooperative, New Phila, OH
Brosmer Serenity Club, Inc., Jasper, IN
Bucktown Neighbors, Chicago, IL
Business Network of Indiana, Inc., South Bend, IN
Business United Officers and Youth B U O Y I, Detroit, MI
California Heritage Dancers, Temecula, CA
California Wildland Fire Fighter Memorial Committee, Romoland, CA
Camp Whitley, Inc., Columbia City, IN
Care With Love Services, Kalamazoo, MI
Caring About Nursing Disability Organization, Lyndhurst, OH
Case Management Worldwide, San Diego, CA
Catholic Homily, Marengo, OH
Celebrate Me Home, Inc., Palm Springs, CA
Center for Emergency Management, Troy, MI
Center for Informed Health Care Decisions, Chicago, IL
Central America Gospel Mission Center, Anaheim, CA
Cerebral Aneurysm-Tumor Survivors CATS, Lansing, MI
Cerulean Dance Theatre, Chicago, IL
Charities of Indianapolis, Indianapolis, IN
Chicago Area AA Womens Luncheon, Inc., Downers Grove, IL
Chicago Help for Israels Cemeteries & Graves Organization, Chicago, IL
Chicago Neighbors United, Inc., Itasca, IL
Chicago Wind City Artists, Inc., Chicago, IL
Child Rescue International, Mesquite, TX
Childrens Center of Excellence, Inc., Toledo, OH
Childrens Life Line Foundation, North Bergen, NJ
Childrens Voices, Ada, MI
Chinese-American Voters Alliance, Chicago, IL
Chino Hills Community First, Chino Hills, CA
Christ Reaching Asia Mission Worldwide, Inc., Bedford, IN
Christian Service Enterprises, Schoolcraft, MI
Citizens for Community Values of San Diego, Solano Beach, CA
Clarence Darrow Foundation, Chicago, IL
Classic Cruisers, Perris, CA
Cleveland Home Town Program, Cleveland, OH
Cleveland Nama Hatta Program, Cleveland, OH
Clissold School Endowment, Ltd., Chicago, IL
Coalition for Better Schools and Communities, San Diego, CA
Coalition for United Community Labor Force, Chicago, IL
Cobalt Ensemble Theatre, Inc., Chicago, IL
Committee for Improvement of Emerson Community Development Corp., Gary, IN
Committee to Restore America Foundation, Oceanside, CA
Common Education Foundation, Chicago, IL
Community Collaboration for Economic Development, Champaign, IL
Community Collaborative Outreach Gift, Ypsilanti, MI
Community Concern for Families and Youth Freedom, Joliet, IL
Community Leadership Council, South Bend, IN
Community Link Foundation, Inc., Ann Arbor, MI
Community Planning Association, Detroit, MI
Community Preservation Association, Inc., Naperville, IL
Conversemos, Inc., Chicago, IL
Corona Panthers Junior All American Football, Corona, CA
Corporation for Community Housing, Chicago, IL
Crayons for Kids Foundation, Cleveland, OH
Creative Flowering Through the Performing Arts, Chicago, IL
Creative Problem Solving Institute, Inc., Chicago, IL
Critical Incident Stress Management Indiana Network, Inc., Greenfield, IN
Crossroads Christian Ministries International, Inc., San Diego, CA
Curtis Research Institute, Inc., Toledo, OH
Dads of Michigan, Southfield, MI
Delta Centre for Arts & Cultural Affairs, Inc., Grand Rapids, MI
Demand Clean Air, Yorba Linda, CA
Depressive-Manic Depressive Group of Henry County, Geneseo, IL
Desert Gold Computer Resource Center, Yucca Valley, CA
Desert Hot Springs Community Task Force, Desert Hot Springs, CA
Detroit Classical Radio Corporation, Detroit, MI
Detroit Lady Roadrunners, Detroit, MI
Detroit Track and Field Old Times Association, Detroit, MI
Dis N Dat Entertainment, Inc., Indianapolis, IN
Dover New Philadelphia Community Youth Soccer Association, Inc., New Philadelphia, OH
EAI Employment Resources, Inc., Taylor, MI
Earth for All, San Diego, CA
Earth Resource Foundation, Costa Mesa, CA
East Side Baseball League, Inc., Gary, IN
Eco Unity, San Diego, CA
Economic Development Council, Chicago, IL
Einterz Amdg Foundation, Inc., Indianapolis, IN

Elderly Mission of Los Angeles, Inc., Los Angeles, CA
Eliza Tibbets Statue Foundation, Inc., Riverside, CA
Emanon Club of Ypsilanti, Inc., Ypsilanti, MI
Emerge Consortium, Toledo, OH
Endangered Small Animal Conservation Fund, Monmouth, IL
Enterprising Spirits Organization of San Diego, San Diego, CA
Epic Drumline, Inc., Taylor, MI
Ethics for America, Carrollton, IL
Euclid Elementary School Community Foundation, San Diego, CA
Evergreen Institute on Elder Environments, Bloomington, IN
Families for Effective Autism Treatment, Oceanside, CA
Family Systems, Inc., Bedford Hts, OH
Fathers Support Association, Painesville, OH
Fazes Production, Inc., Lake Elsinore, CA
Federation of International Baseball, Moreno Valley, CA
Federation of Vietnamese Catholics in the U S A, Clawson, MI
F E E D S Corp., Davenport, IA
Feminine Sanctuary, Dulzura, CA
Financial Aid to Grandparents Raising Grandchildren Foundation, Calumet Park, IL
First Christian Ladies Affirming Salvation to Sisters, Indianapolis, IN
Fit Frogs, Inc., Greenwood, IN
F I T C H, Inc., Chicago, IL
Flo-Jo Memorial Community Empowerment Foundation, Mission Viejo, CA
Focus First, Inc., Carlsbad, CA
Focus Group, Perris, CA
Foodmobile, Inc., Indianapolis, IN
For the Children, Inc., Southfield, MI
Forest Hills Youth Football League, Ada, MI
Fort Wayne Tutoring Foundation, Fort Wayne, IN
Foundation for Advancement in Media Education, Southfield, MI
Foundation for Handicapped Mobility, Indianapolis, IN
Free Riders Community and Youth Outreach Service, Detroit, MI
Freedom Credit Counseling Service, Inc., Franklin, TN
Friends of Bills Family, Chicago, IL
Friends of Gary Public Library, Gary, IN
Friends of Lightning Bend and the Pines, Belding, MI
Friends of Owen County, Inc., Spencer, IN
Friends of Roanoke Scouting, Inc., Huntington, IN
Friends of South Africa, Detroit, MI
Friends of the Forgotten, Prospect Heights, IL
Friends of the Oscoda County Library, Mio, MI
Friends of the Swim Team, Inc., Linton, IN
Friends of the Victory, Inc., Evansville, IN
Front Row Center, Inc., Seal Beach, CA
Galama Mountains Conservation Fund, Inc., New York, NY
Garish House, Caledonia, OH
Garth Youth Services, Inc., Chicago, IL
Gathering Point, Chicago, IL
Genesis Counseling, Inc., Enid, OK
Gilead, Chicago, IL
Glenwood Baseball, Inc., Glenwood, IL
Global Action Network, San Diego, CA
Globewings, Akron, OH
Golden Corridor Association for the Education of Young Children, Schaumburg, IL
Golden Dreams for Children Foundation, Plainfield, IL
Goshen Arts Alliance, Goshen, IN
Gospel Quartet Society, Inc., Yorba Linda, CA
Graduate Psychology Students Community Outreach Foundation, Rolling Meadows, IL
Grand River Improvement Association, Detroit, MI
Grant County Wrestling Club, Jonesboro, IN
Great Chung Hwa Higher Education Foundation, Rancho Palos Verdes, CA
Great Lakes Credit Counseling, Grand Rapids, MI
Greater Alton Community Development, Inc., Alton, IL
Greater Brighton Area Chamber Foundation, Brighton, MI
Greater St. Stephen Non-Profit Housing Development Corporation, Detroit, MI
Growth Ministries, El Cajon, CA
Grupo Folklorico Xcaret, Santa Ana, CA
Haiku North America-Chicago 1999, Evanston, IL
Hamilton Foundation of Chicago, Chicago, IL
Hand-Up Foundation, St. Charles, IL
Harrison-Brook Life Enhancement Center, Inc., Indianapolis, IN
Have Luv, Incorporated, Moreno Valley, CA
Health & Habitat for the Elderly, Upland, CA
Heartland Communities, Inc., Ft. Wayne, IN
Heavenly Helpers, Inc., San Bernardino, CA
Heavens Gifts Youth and Family Services, Moreno Valley, CA
Help the Kids Foundation, Inc., Palm Beach, FL
Henry County Safe House, Inc., Kewanee, IL
Hepatitis United, Oregon, IL
Heritage Child, Inc., Gary, IN
High Kicks for High Hopes, Taylorsville, IL
High Score, Pomona, CA
Highschool of Commerce East Commerce Alumni Assoc., Lansing, MI
Hillside Neighborhood Improvement Association, Benton Harbor, MI
Hispanic Illinois State Law Enforcement Association Foundation, Chicago, IL
Homeless Rehabilitation and Recovery, Inc., Urbana, IL
Homerville Little League, Homerville, OH
Hometown Cinema, Inc., Woodland Hills, CA
Hometown Sports & Recreation, Inc., Las Vegas, CA
Hondures Relief Fund, Schaumburg, IL
Hope 21, Indianapolis, IN
Hope Cancer Fund, N. Hollywood, CA
House of Luke Ministry, Hemet, CA
House Rabbit Society of Chicago, Prospect Heights, IL
Housing Coalition for Urban Advancement, Cleveland, OH
Huntertown Hurricanes Youth Soccer Club, Inc., Fort Wayne, IN
Illinois Baptist Bible Fellowship, Decatur, IL
Illinois Educators Advocacy Retirement Network, Inc., Springfield, IL
Illinois Sports Hall of Fame and Museum, Peoria, IL
Illinois State Taekwondo Association, Arlington Heights, IL
Impact Staffing, Inc., Grand Rapids, MI
Imperial Valley Childrens Services, Calexico, CA
In the Spirit of Ujima, Inc., Mansfield, OH
Independent Living Center for Brain Injury Survivors, San Diego, CA
Indian Creek Military Museum, Petersburg, IL

Indiana Association of Drug Court Professionals, Lawrenceburg, IN
Indiana Hall of Fame, Inc., Indianapolis, IN
Indiana National Organization for Women Foundation, Inc., Indianapolis, IN
Indiana State Title I Parents Steering Committee, Indianapolis, IN
Indiana Volks Clubs, Plainville, IN
Inland Counties Hispanic Roundtable, San Bernardino, CA
Inland Empire Police Canine Association, Ontario, CA
Inner City Voices and Visions Project, Detroit, MI
Inner Prizes Perform, Chicago, IL
Institute for Anti-Aging Medicine, San Marcos, CA
Institute for Classical Art, Steubenville, OH
Institute for the Study of Academic Racism, Big Rapids, MI
Interactive Gym, Inc., Carmel, IN
International Care Services, Detroit, MI
International Christian Broadcasting, Inc., Newport Beach, CA
International Christian Fellowship for Mission Chicago Chapter, Chicago, IL
International Medical Assistance, Ada, MI
International Missing Children Network, Inc., Indianapolis, IN
Internet Society of Orthopedic Surgery and Trauma, Chicago, IL
Ironwood Theatre Project, Chicago, IL
Italian American Womens Organization, Melrose Park, IL
James Gallagher Sr. Memorial Fund, Oak Lawn, IL
Jasper County Interfaith Alliance, Inc., Rensselaer, IN
Jesse Campbell Memorial CDC, Chicago, IL
Jesus Video Project North County, Escondido, CA
Jim Mullen Charitable Foundation, Niles, IL
John Green, Sr. Golf House for Kids, Inc., Indianapolis, IN
Jubilee International, Inc., Carmel, IN
Keeping Up the Faith for the Future, Inc., Clinton Twp, MI
Kids Not Criminals, Inc., Chicago, IL
Kim Moore Ministries, Plymouth, MI
Kingdom Climbers, Inc., Indianapolis, IN
Kisses for Kids, Indianapolis, IN
KJU, Incorporated, Upland, CA
Kokomo Childrens Choir, Kokomo, IN
Ktiv Noam, Inc., W. Bloomfield, MI
La Casa Del Alfarero, Chicago, IL
Lady Lions Hockey Club, Lagrange, IL
Lafave Scholarship Fund, Inc., Jackson, MI
Lake Pointe Homeowners Association of NW Ohio, Toledo, OH
Lakeview Center for Education, Niles, IL
Land of Lincoln Wheelchair Athletic Association, Petersburg, IL
Lanesville Improvement Fund, Incorporated, Lanesville, IN
Leadership Education Seminar Facilitator Team, Oceanside, CA
Let the Children Play, Paris Crossing, IN
Lewis Cross Babe Ruth Parents Organization, Inc., Onward, IN
Life Impact Ministries International, Rancho Santa Margarita, CA
Life Long Fitness, Inc., Detroit, MI
Light for the Lost Mission, Sacramento, CA
Linda E. Beck Mission for Women and Youths, Long Beach, CA
Linnie B. Robertson Crises Intervention Center, Chicago, IL
Little Thunder Kids Golf Foundation, Inc., S. Madison, OH
L O C of Detroit, Inc., Detroit, MI
Lordstown T O G E T H E R, Inc., Lordstown, OH
Love Outreach Development Center, Inc., Indianapolis, IN
Love Unlimited Ministries, Prospect Heights, IL
Madison Co. Sheriffs Dept. Police Benevolent and Protective Association, Edwardsville, IL
Magic of Children Foundation, Birmingham, MI
Mahogany in Motion, Highland, CA
Mahogany Scholarship Foundation, Chicago, IL
Main Street Sandwich, Sandwich, IL
Mamie Bone Foundation, Chicago, IL
Manchester Baseball Association, Inc., Alliance, OH
Manufacturing Technology Center at Indianapolis, Inc., Indianapolis, IN
Maranatha Ministries Worldwide, Inc., Detroit, MI
Margeys River of Hope, McHenry, IL
Marquis Foundation, Inc., Lafayette, IN
Marriage Forum Foundation, San Diego, CA
Maurice James Ministries, Inc., Chicago, IL
Mediation Center for Justice, Apple Valley, CA
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Memorial Pointe Health Care Center, Inc., Evansville, IN
Meta Driscoll Homes, Palm Desert, CA
M G A Booster Club, Riverside, CA
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Minority Communications Resource Organization, Youngstown, OH
Minority Economic Development Council of Jefferson County, Inc., Steubenville, OH
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Mission of Jehovah Yireh, Lucerne Valley, CA
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Mohan Narasimhan Memorial Tr 010197, Cerritos, CA
Monroe County Taxpayers Association, Inc., Bloomington, IN
Moriah Community Development Corporation, Chicago, IL
Mountainaires Community and Family Life Services, Inc., Detroit, MI
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Muslim Prisoners Assistance Association, Dearborn Heights, MI
Mustard Seed Society International, Cypress, CA
Na Hoa O Ka Hale Kanu, Colton, CA
National Church Music Conference, Inc., Indianapolis, IN
National Image Development Center, Inc., Detroit, MI
National Jewish Education Foundation, Inc., Chicago, IL
National Scholastic Speedskating, Inc., Champaign, IL
National Youth Innovations, Inc., Chula Vista, CA
National Youth Motivation and Education Center, Inc., Detroit, MI
Natures Lifeguard, Inc., Trinidad, CA
Needy Not Greedy, Madison Heights, MI
Nehemiah Urban Church Ministries, Chicago, IL
New Beginnings Foster and Adoptive Family Support Group, Hastings, MI
New Hope Healing Institute, Inc., Indianapolis, IN
New Life Foundation, Upland, CA

NGB Community Outreach and Nonprofit Housing Corporation, Ecorse, MI
North American Association for Service Education and Relief, Alta Loma, CA
Northrop Choral Association, Fort Wayne, IN
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Path to Rome, Chicago, IL
Patriots American Legion Baseball Boosters, Buffalo Grove, IL
Pause for Patriotism, Bradley, IL
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Perry County Museum, Inc., Cannelton, IN
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Phoenician Society, Inc., Indianapolis, IN
PJAM, Inc., National City, CA
Play and Learn, Incorporated, Diamond Bar, CA
Polish Humanities Foundation, Chicago, IL
Preparatory Youth-Sports, Inc., Indianapolis, IN
Prescription Dog Love, Inc., Seville, OH
Preserving Communities Through Economic Unity, Harvey, IL
Price Adult Family Homes, Toledo, OH
Project HMS Detroit, Canada
Project Impact-Plus, Champaign, IL
Promoting Peace in Our Communities, W. Bloomfield, MI
PTSA Michigan Congress of Parents Teachers and Students, Walker, MI
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Ridgewood Students Music Education Booster Association, Inc., W. Lafayette, OH
Rising Sons-Alpha Psi Omega, Toledo, OH
Rising Star Ministries, Inc., Jacksonville, IL
Riverboat Child Care Center, Inc., Madison, IN
Robbins Action to Deliver Shelter, Inc., Robbins, IL
Rose of Sharon Development Corporation, Detroit, MI
Rose Reder Memorial Scholarship Fund, Toledo, OH
Round Lake Area B E S T, Incorporated, Round Lake, IL
RTW Services, Inc., Garden Grove, CA
Rugrats, Inc., Grayling, MI
Running Rebel Track Club, Cuyahoga Falls, OH
Rural Community Assistance Center, New Berlin, IL
Rutland Township Historical Society, Hampshire, IL
Saginaw Clergy Community Development Corporation, Saginaw, MI
Saginaw Survivors of Suicide, Inc., Saginaw, MI
San Diego Grand Prix Kids, San Diego, CA
San Diego Post 6 Activities Foundation, San Diego, CA
Save the Cottage Association, Evanston, IL
School of Ministry Training, Berea, OH
Second Chance Animal Rescue & Education Network, Madison, WI
Second Chance Thoroughbred Adoption Agency, Blanchard, MI
Shawn K. Crawford Memorial Education Foundation, Chicago, IL
Sierra Leone Association of Michigan, Inc., Oak Park, MI
Skills Ville Youth Corporation, Detroit, MI
Sleeping Bear Literacy Foundation, Chelsea, MI
Slovak-American International Cultural Foundation, Inc., Wauconda, IL
Slovenians of California, Fontana, CA
Small Fri Academy, Inc., Merrillville, IN
Smart N Safe Foundation, Hemet, CA
Society for Manic Depression, Las Vegas, NV
Society for the Advancement of African Americans, Detroit, MI
Sonye, Chicago, IL
South Euclid Lyndhurst Youth Football, Lyndhurst, OH
South Suburban and Vicinity Ministers Fellowship, Harvey, IL
Southeastern Indiana Emmaus Community, Inc., Dillsboro, IN
Southern California Public Transportation Corporation, Irvine, CA
Southern California Velodrome Association, Encinitas, CA
Southern Illinois Evangelistics Association, Carbondale, IL
Southwest Illinois Swimming Association, Godfrey, IL
Sri Venkateswara Psychiatric Foundation, Incorporated, Bloomfield, MI
St. Elmo Fifth Quarter, St. Elmo, IL
St. Joseph Community Programs, Inc., Detroit, MI
Standardbred Pleasure Horse Organization SPHO Midwest, Aurora, IL
Stars of Lebanon American Society of Cleveland, Cleveland, OH
Stewart Francke Leukemia Foundation, Bloomfield, MI
Stop the Abuse Against Forever, Inc., Spiceland, IN

Straight Legs Foundation,
Palm Desert, CA
Stretching the Limits II, Beachwood, OH
Students Helping Seniors, Inc.,
Swartz Creek, MI
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Summit Housing Consortium, Inc.,
Bloomington, IN
Sunrise Ballet Theatre, Anaheim, CA
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Detroit, MI
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Talking Bible Project, Escondido, CA
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Versailles Community Center, Inc.,
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VEVE Visual Environments for Visual
Education, San Diego, CA
Vic Miller Foundation, Novi, MI
Victorious Living, Rialto, CA
Victory Foundation, Inc., Cleveland, OH
Vigo County Agencies of Emergency
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Villa Park, Inc., Carbondale, IL
Virtual Christianity, Inc., Lincoln, IL
Vision Community Outreach
Organization, Detroit, MI
Vision for the Advancement of Twinsburg
Township, Twinsburg, OH
Vision Thru Fine Art, Inc., Chicago, IL
Visions of Grace Urban Enrichment
Community Center, Inc., Markham, IL
Visual Archives Foundation,
Temecula, CA
Volunteers for Animals, Memphis, TN
Warsaw Community Schools Theater
Boosters, Warsaw, IN
Washington Park Foundation, Chicago, IL
We Too Club, Inc., Sandusky, OH
Wesley Foundation, Shadyside, OH
West Hills High School Foundation, Inc.,
Santee, CA
West Michigan Waves Disabled Sports
Team, Grand Rapids, MI
West Town Alternative Health Project,
Chicago, IL
Westside Pastoral Coalition for AIDS,
Chicago, IL
WFC Foundation, Springfield, IL
White County Family YMCA, Inc.,
Monticello, IN
Whiteside County Crime Stoppers
Program, Inc., Sterling, IL
William Simpson Essay Scholarship
Foundation, Park Forest, IL
Willingham Foundation, East Lansing, MI
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World Bar Association,
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Little Rock, AR
Young Dads, Inc., Grand Rapids, MI
Youth Enterprises, Chicago, IL
Youth Excellence in Sports, Inc.,
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Youth Learning Innovation & Networking
for Knowledge & Success, Detroit, MI
Zeta Rho Foundation, Inc.,
Harbor City, CA

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

New Revision of Publication 971, *Innocent Spouse Relief (And Separation of Liability and Equitable Relief)*

Announcement 2004–24

Publication 971, revised March 2004, is now available from the Internal Revenue Service. It replaces the July 2003 revision. It discusses the innocent spouse relief provisions available to taxpayers whose spouses improperly report or omit items on their joint tax returns.

You can get a copy of this publication by calling 1–800–TAX–FORM (1–800–829–3676) or by writing to the IRS Forms Distribution Center nearest you. Check your income tax package for the address. The publication is also available on the IRS Internet website at *www.irs.gov*.

Deletions From Cumulative List of Organizations Contributions to Which are Deductible Under Section 170 of the Code

Announcement 2004–27

The name of an organization that no longer qualifies as an organization described in section 170(c)(2) of the Internal Revenue Code of 1986 is listed below.

Generally, the Service will not disallow deductions for contributions made to a listed organization on or before the date of announcement in the Internal Revenue Bulletin that an organization no longer qualifies. However, the Service is not precluded from disallowing a deduction for any contributions made after an organization ceases to qualify under section 170(c)(2) if the organization has not timely filed a suit for declaratory judgment under section 7428 and if the contributor (1) had knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for or was aware of the activities or omissions of the organization that brought about this revocation.

If on the other hand a suit for declaratory judgment has been timely filed, contributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) would begin on November 5, 2001, and would end on the date the court first determines that the organization is not described in section 170(c)(2) as more particularly set forth in section 7428(c)(1). For individual contributors, the maximum deduction protected is $1,000, with a husband and wife treated as one contributor. This benefit is not extended to any individual, in whole or in part, for the acts or omissions of the organization that were the basis for revocation.

Innovative Horizons, Inc.
Bartlesville, OK

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in laws or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in a new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D. —Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z —Corporation.

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[1] A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2003–27 through 2003–52 is in Internal Revenue Bulletin 2003–52, dated December 29, 2003.

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