

Reg. Section 1.168(k)-1(f)(5)(iii)(A)

Additional first year depreciation deduction.

(f) Special rules –

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

- (i) In general. Except as provided in paragraphs (f)(1)(ii) and (iii) of this section, the additional first year depreciation deduction is not allowed for qualified property or 50-percent bonus depreciation property placed in service and disposed of during the same taxable year. Also if qualified property or 50-percent bonus depreciation property is placed in service and disposed of during the same taxable year and then reacquired and again placed in service in a subsequent taxable year, the additional first year depreciation deduction is not allowable for the property in the subsequent taxable year.
- (ii) Technical termination of a partnership. In the case of a technical termination of a partnership under section 708(b)(1)(B), the additional first year depreciation deduction is allowable for any qualified property or 50-percent bonus depreciation property placed in service by the terminated partnership during the taxable year of termination and contributed by the terminated partnership to the new partnership. The allowable additional first year depreciation deduction for the qualified property or the 50-percent bonus depreciation property shall not be claimed by the terminated partnership but instead shall be claimed by the new partnership for the new partnership's taxable year in which the qualified property or the 50-percent bonus depreciation property was contributed by the terminated partnership to the new partnership. However, if qualified property or 50-percent bonus depreciation property is both placed in service and contributed to a new partnership in a transaction described in section 708(b)(1)(B) by the terminated partnership during the taxable year of termination, and if such property is disposed of by the new partnership in the same taxable year the new partnership received such property from the terminated partnership, then no additional first year depreciation deduction is allowable to either partnership.
- (iii) Section 168(i)(7) transactions. If any qualified property or 50-percent bonus depreciation property is transferred in a transaction described in section 168(i)(7) in the same taxable year that the qualified property or the 50-percent bonus depreciation property is placed in service by the transferor, the additional first year depreciation deduction is allowable for the qualified property or the 50-percent bonus depreciation property. The allowable additional first year depreciation deduction for the qualified property or the 50-percent bonus depreciation property for the transferor's taxable year in which the property is placed in service is allocated between the transferor and

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

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

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

Example 2. On January 5, 2002, BB purchased and placed in service new office desks for a total amount of \$ 8,000. On August 20, 2002, BB transferred the office desks to Partnership BC in a transaction described in section 721. BB and Partnership BC are calendar-year taxpayers. Because the transaction between BB and Partnership BC is a transaction described in section 168(i)(7), pursuant to paragraph (f)(1)(iii) of this section the 30-percent additional first year depreciation deduction allowable for the desks is allocated between BB and Partnership BC in accordance with the rules in § 1.168(d)-1(b)(7)(ii) for allocating the depreciation deduction between the transferor and the transferee. Accordingly, the 30-percent additional first year depreciation deduction allowable for the desks for 2002 of \$ 2,400 (the unadjusted depreciable basis of \$ 8,000 multiplied by .30) is allocated between BB and Partnership BC based on the number of months that BB and Partnership BC held the desks in service. Thus, because the desks were held in service by BB for 7 of 12 months, which includes the month in which BB placed the desks in service but does not include the month in which the desks were transferred, BB is allocated \$ 1,400 ($7/12 \times \$ 2,400$ additional first year depreciation deduction). Partnership BC is allocated \$ 1,000, the remaining $5/12$ of the \$ 2,400 additional first year depreciation deduction allowable for the desks.

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

allowable for the qualified property or the 50-percent bonus depreciation property is redetermined as follows:

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

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

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

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

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

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

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

(iii) Definition. Except as otherwise expressly provided by the Internal Revenue Code (for example, section 1017(a)), the regulations under the Internal Revenue Code, or other

guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii)(b) of this chapter), for purposes of this paragraph (f)(2):

- (A) An increase in basis occurs in the taxable year an amount is taken into account under section 461; and
- (B) A decrease in basis occurs in the taxable year an amount would be taken into account under section 451.

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

Example 1.

- (i) On May 15, 2002, CC, a cash-basis taxpayer, purchased and placed in service qualified property that is 5-year property at a cost of \$ 200,000. In addition to the \$ 200,000, CC agrees to pay the seller 25 percent of the gross profits from the operation of the property in 2002. On May 15, 2003, CC paid to the seller an additional \$ 10,000. CC depreciates the 5-year property placed in service in 2002 using the optional depreciation table that corresponds with the general depreciation system, the 200-percent declining balance method, a 5-year recovery period, and the half-year convention.
- (ii) For 2002, CC is allowed a 30-percent additional first year depreciation deduction of \$ 60,000 (the unadjusted depreciable basis of \$ 200,000 multiplied by .30). In addition, CC 's depreciation deduction for 2002 for the remaining adjusted depreciable basis of \$ 140,000 (the unadjusted depreciable basis of \$ 200,000 reduced by the additional first year depreciation deduction of \$ 60,000) is \$ 28,000 (the remaining adjusted depreciable basis of \$ 140,000 multiplied by the annual depreciation rate of .20 for recovery year 1).
- (iii) For 2003, CC 's depreciation deduction for the remaining adjusted depreciable basis of \$ 140,000 is \$ 44,800 (the remaining adjusted depreciable basis of \$ 140,000 multiplied by the annual depreciation rate of .32 for recovery year 2). In addition, pursuant to paragraph (f)(2)(i) of this section, CC is allowed an additional first year depreciation deduction for 2003 for the \$ 10,000 increase in basis of the qualified property. Consequently, CC is allowed an additional first year depreciation deduction of \$ 3,000 (the increase in basis of \$ 10,000 multiplied by .30). Also, CC is allowed a depreciation deduction for 2003 attributable to the remaining increase in basis of \$ 7,000 (the increase in basis of \$ 10,000 reduced by the additional first year depreciation deduction of \$ 3,000). The depreciation deduction allowable for 2003 attributable to the remaining increase in basis of \$ 7,000 is \$ 3,111 (the remaining increase in basis of \$ 7,000 multiplied by .4444, which is equal to $1/\text{remaining recovery period of 4.5 years at January 1, 2003, multiplied by 2}$). Accordingly, for 2003, CC 's total depreciation deduction allowable for the qualified property is \$ 50,911.

Example 2.

- (i) On May 15, 2002, DD, a calendar-year taxpayer, purchased and placed in service qualified property that is 5-year property at a cost of \$ 400,000. To purchase the property, DD borrowed \$ 250,000 from Bank2. On May 15, 2003, Bank2 forgives \$ 50,000 of the indebtedness. DD makes the election provided in section 108(b)(5) to apply any portion of the reduction under section 1017 to the basis of the depreciable property of the taxpayer. DD depreciates the 5-year property placed in service in 2002 using the optional depreciation table that corresponds with the general depreciation system, the 200-percent declining balance method, a 5-year recovery period, and the half-year convention.
- (ii) For 2002, DD is allowed a 30-percent additional first year depreciation deduction of \$ 120,000 (the unadjusted depreciable basis of \$ 400,000 multiplied by .30). In addition, DD's depreciation deduction allowable for 2002 for the remaining adjusted depreciable basis of \$ 280,000 (the unadjusted depreciable basis of \$ 400,000 reduced by the additional first year depreciation deduction of \$ 120,000) is \$ 56,000 (the remaining adjusted depreciable basis of \$ 280,000 multiplied by the annual depreciation rate of .20 for recovery year 1).
- (iii) For 2003, DD's deduction for the remaining adjusted depreciable basis of \$ 280,000 is \$ 89,600 (the remaining adjusted depreciable basis of \$ 280,000 multiplied by the annual depreciation rate .32 for recovery year 2). Although Bank2 forgave the indebtedness in 2003, the basis of the property is reduced on January 1, 2004, pursuant to sections 108(b)(5) and 1017(a) under which basis is reduced at the beginning of the taxable year following the taxable year in which the discharge of indebtedness occurs.
- (iv) For 2004, DD's deduction for the remaining adjusted depreciable basis of \$ 280,000 is \$ 53,760 (the remaining adjusted depreciable basis of \$ 280,000 multiplied by the annual depreciation rate .192 for recovery year 3). However, pursuant to paragraph (f)(2)(ii) of this section, DD must reduce the amount otherwise allowable as a depreciation deduction for 2004 by the excess depreciation previously claimed for the \$ 50,000 decrease in basis of the qualified property. Consequently, DD must reduce the amount of depreciation otherwise allowable for 2004 by the excess additional first year depreciation of \$ 15,000 (the decrease in basis of \$ 50,000 multiplied by .30). Also, DD must reduce the amount of depreciation otherwise allowable for 2004 by the excess depreciation attributable to the remaining decrease in basis of \$ 35,000 (the decrease in basis of \$ 50,000 reduced by the excess additional first year depreciation of \$ 15,000). The reduction in the amount of depreciation otherwise allowable for 2004 for the remaining decrease in basis of \$ 35,000 is \$ 19,999 (the remaining decrease in basis of \$ 35,000 multiplied by .5714, which is equal to 1/remaining recovery period of 3.5 years at January 1, 2004, multiplied by 2). Accordingly, assuming the qualified property is the only depreciable property owned by DD, for 2004, DD's total depreciation deduction allowable for the qualified property is \$ 18,761 (\$ 53,760 minus \$ 15,000 minus \$ 19,999).
- (3) Section 1245 and 1250 depreciation recapture. For purposes of section 1245 and the regulations thereunder, the additional first year depreciation deduction is an amount allowed or allowable for depreciation. Further, for purposes of section 1250(b) and the

regulations thereunder, the additional first year depreciation deduction is not a straight line method.

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

(5) Like-kind exchanges and involuntary conversions –

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

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

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

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

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

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

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

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

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

(iii) Computation –



(A) In general. Assuming all other requirements of section 168(k) and this section are met, the remaining carryover basis for the year of replacement and the remaining excess basis, if any, for the year of replacement for the acquired MACRS property or the acquired computer software, as applicable, are eligible for the additional first year depreciation deduction. The 30-percent additional first year depreciation deduction applies to the remaining carryover basis and the remaining excess basis, if any, of the acquired MACRS property or the acquired computer software if the time of replacement is after September 10, 2001, and before May 6, 2003, or if the taxpayer made the election provided in paragraph (e)(1)(ii)(A) of this section. The 50-percent additional first year depreciation deduction applies to the remaining carryover basis and the remaining excess basis, if any, of the acquired MACRS property or the acquired computer software if the time of replacement is after May 5, 2003, and before January 1, 2005, or, in the case of acquired MACRS property or acquired computer software that is 50-percent bonus depreciation property described in section 168(k)(2)(B) or (C), the time of replacement is after May 5, 2003, and before January 1, 2006 (or the time of replacement is after May 5, 2003, and before January 1, 2007, in the case of 50-percent bonus depreciation property described in section 168(k)(2)(B) or (C) to which section 105 of the Gulf Opportunity Zone Act of 2005 (Pub. L. 109-135, 119 Stat. 2577) applies (for further guidance, see Announcement 2006-29 (2006-19 I.R.B. 879) and § 601.601(d)(2)(ii)(b) of this chapter)). The additional first year depreciation deduction is computed separately for the remaining carryover basis and the remaining excess basis.

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

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

- (D) Alternative minimum tax. The 30-percent or 50-percent additional first year depreciation deduction is allowed for alternative minimum tax purposes for the year of replacement of acquired MACRS property or acquired computer software that is qualified property or 50-percent bonus depreciation property. The 30-percent or 50-percent additional first year depreciation deduction for alternative minimum tax purposes is based on the remaining carryover basis and the remaining excess basis, if any, of the acquired MACRS property or the acquired computer software for alternative minimum tax purposes.
- (iv) Sale-leaseback transaction. For purposes of this paragraph (f)(5), if MACRS property or computer software is sold to a taxpayer and leased back to a person by the taxpayer within three months after the time of disposition of the MACRS property or computer software, as applicable, the time of replacement for this MACRS property or computer software, as applicable, shall not be earlier than the date on which the MACRS property or computer software, as applicable, is used by the lessee under the leaseback.
- (v) Acquired MACRS property or acquired computer software that is acquired and placed in service before disposition of involuntarily converted MACRS property or involuntarily converted computer software. If, in an involuntary conversion, a taxpayer acquires and places in service the acquired MACRS property or the acquired computer software before the time of disposition of the involuntarily converted MACRS property or the involuntarily converted computer software and the time of disposition of the involuntarily converted MACRS property or the involuntarily converted computer software is after December 31, 2004, or, in the case of property described in section 168(k)(2)(B) or (C), after December 31, 2005 (or after December 31, 2006, in the case of property described in section 168(k)(2)(B) or (C) to which section 105 of the Gulf Opportunity Zone Act of 2005 (Pub. L. 109-135, 119 Stat. 2577) applies (for further guidance, see Announcement 2006-29 (2006-19 I.R.B. 879) and § 601.601(d)(2)(ii)(b) of this chapter)), then --
- (A) Time of replacement. The time of replacement for purposes of this paragraph (f)(5) is when the acquired MACRS property or acquired computer software is placed in service by the taxpayer, provided the threat or imminence of requisition or condemnation of the involuntarily converted MACRS property or involuntarily converted computer software existed before January 1, 2005, or, in the case of property described in section 168(k)(2)(B) or (C), existed before January 1, 2006 (or existed before January 1, 2007, in the case of property described in section 168(k)(2)(B) or (C) to which section 105 of the Gulf Opportunity Zone Act of 2005 (Pub. L. 109-135, 119 Stat. 2577) applies (for further guidance, see Announcement 2006-29 (2006-19 I.R.B. 879) and § 601.601(d)(2)(ii)(b) of this chapter)); and
- (B) Depreciation of acquired MACRS property or acquired computer software. The taxpayer depreciates the acquired MACRS property or acquired computer software in accordance with paragraph (d) of this section. However, at the time of disposition of the involuntarily converted MACRS property, the taxpayer determines the exchanged basis (as defined in § 1.168(i)-6(b)(7)) and the excess

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

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

Example 1.

- (i) In December 2002, EE, a calendar-year corporation, acquired for \$ 200,000 and placed in service Canopy V1, a gas station canopy. Canopy V1 is qualified property under section 168(k)(1) and is 5-year property under section 168(e). EE depreciated Canopy V1 under the general depreciation system of section 168(a) by using the 200-percent declining balance method of depreciation, a 5-year recovery period, and the half-year convention. EE elected to use the optional depreciation tables to compute the depreciation allowance for Canopy V1. On January 1, 2003, Canopy V1 was destroyed in a fire and was no longer usable in EE's business. On June 1, 2003, in an involuntary conversion, EE acquired and placed in service new Canopy W1 with all of the \$ 160,000 of insurance proceeds EE received due to the loss of Canopy V1. Canopy W1 is 50-percent bonus depreciation property under section 168(k)(4) and is 5-year property under section 168(e). Pursuant to paragraph (g)(3)(ii) of this section and § 1.168(i)-6(k)(2)(i), EE decided to apply § 1.168(i)-6 to the involuntary conversion of Canopy V1 with the replacement of Canopy W1, the acquired MACRS property.
- (ii) For 2002, EE is allowed a 30-percent additional first year depreciation deduction of \$ 60,000 for Canopy V1 (the unadjusted depreciable basis of \$ 200,000 multiplied by .30), and a regular MACRS depreciation deduction of \$ 28,000 for Canopy V1 (the remaining adjusted depreciable basis of \$ 140,000 multiplied by the annual depreciation rate of .20 for recovery year 1).

- (iii) For 2003, EE is allowed a regular MACRS depreciation deduction of \$ 22,400 for Canopy V1 (the remaining adjusted depreciable basis of \$ 140,000 multiplied by the annual depreciation rate of .32 for recovery year 2 x 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 x 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 new Computer Y2 by exchanging Computer X2 and \$ 1,000 cash in a like-kind exchange. Computer Y2 is qualified property under section 168(k)(1) and is 5-year property under section 168(e). Pursuant to paragraph (g)(3)(ii) of this section and § 1.168(i)-6(k)(2)(i), FF decided to apply § 1.168(i)-6 to the exchange of Computer X2 for Computer Y2, the acquired MACRS property.
- (ii) For 2001, FF is allowed a 30-percent additional first year depreciation deduction of \$ 3,000 for Computer X2 (unadjusted basis of \$ 10,000 multiplied by .30), and

a regular MACRS depreciation deduction of \$ 1,400 for Computer X2 (the remaining adjusted depreciable basis of \$ 7,000 multiplied by the annual depreciation rate of .20 for recovery year 1).

- (iii) For 2002, FF is allowed a regular MACRS depreciation deduction of \$ 1,120 for Computer X2 (the remaining adjusted depreciable basis of \$ 7,000 multiplied by the annual depreciation rate of .32 for recovery year 2 x 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 new Equipment Y3 by exchanging Equipment X3 and \$ 5,000 cash in a like-kind exchange. Equipment Y3 is qualified property under section 168(k)(1) and is 5-year property under section 168(e). Pursuant to paragraph (g)(3)(ii) of this section and § 1.168(i)-6(k)(2)(i), GG decided to apply § 1.168(i)-6 to the exchange of Equipment X3 for Equipment Y3, the acquired MACRS property.
- (ii) Pursuant to paragraph (f)(5)(iii)(B) of this section, no additional first year depreciation deduction is allowable for Equipment X3 and, pursuant to § 1.168(d)-1T(b)(3)(ii), no regular depreciation deduction is allowable for Equipment X3, for the taxable year ended June 30, 2003.
- (iii) Pursuant to paragraph (f)(5)(iii)(A) of this section, the 30-percent additional first year depreciation deduction for Equipment Y3 is allowable for the remaining carryover basis at the time of replacement of \$ 20,000 (Equipment X3's unadjusted depreciable basis of \$ 20,000) and for the remaining excess basis at the time of replacement of \$ 5,000 (cash paid for Equipment Y3). Thus, the 30-percent additional first year depreciation deduction for the remaining carryover basis at the time of replacement equals \$ 6,000 (\$ 20,000 multiplied by .30) and

for the remaining excess basis at the time of replacement equals \$ 1,500 (\$ 5,000 multiplied by .30), which totals \$ 7,500.

Example 5.

- (i) Same facts as in Example 4. GG depreciated Equipment Y3 under the general depreciation system of section 168(a) by using the 200-percent declining balance method of depreciation, a 5-year recovery period, and the half-year convention. GG elected to use the optional depreciation tables to compute the depreciation allowance for Equipment Y3. On July 1, 2003, GG acquired new Equipment Z1 by exchanging Equipment Y3 in a like-kind exchange. Equipment Z1 is 50-percent bonus depreciation property under section 168(k)(4) and is 5-year property under section 168(e). Pursuant to paragraph (g)(3)(ii) of this section and § 1.168(i)-6(k)(2)(i), GG decided to apply § 1.168(i)-6 to the exchange of Equipment Y3 for Equipment Z1, the acquired MACRS property.
- (ii) For the taxable year ending June 30, 2003, the regular MACRS depreciation deduction allowable for the remaining carryover basis at the time of replacement (after taking into account the additional first year depreciation deduction) of Equipment Y3 is \$ 2,800 (the remaining carryover basis at the time of replacement of \$ 20,000 minus the additional first year depreciation deduction of \$ 6,000, multiplied by the annual depreciation rate of .20 for recovery year 1) and for the remaining excess basis at the time of replacement (after taking into account the additional first year depreciation deduction) of Equipment Y3 is \$ 700 (the remaining excess basis at the time of replacement of \$ 5,000 minus the additional first year depreciation deduction of \$ 1,500, multiplied by the annual depreciation rate of .20 for recovery year 1), which totals \$ 3,500.
- (iii) For the taxable year ending June 30, 2004, the regular MACRS depreciation deduction allowable for the remaining carryover basis (after taking into account the additional first year depreciation deduction) of Equipment Y3 is \$ 2,240 (the remaining carryover basis at the time of replacement of \$ 20,000 minus the additional first year depreciation deduction of \$ 6,000, multiplied by the annual depreciation rate of .32 for recovery year 2 x 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 x 1/2 year), which totals \$ 2,800.
- (iv) For the taxable year ending June 30, 2004, pursuant to paragraph (f)(5)(iii)(A) of this section, the 50-percent additional first year depreciation deduction for Equipment Z1 is allowable for the remaining carryover basis at the time of replacement of \$ 11,200 (Equipment Y3's unadjusted depreciable basis of \$ 25,000 minus the total additional first year depreciation deduction of \$ 7,500 minus the total 2003 regular MACRS depreciation deduction of \$ 3,500 minus the total 2004 regular depreciation deduction (taking into account the half-year convention) of \$ 2,800). Thus, the 50-percent additional first year depreciation

deduction for the remaining carryover basis at the time of replacement equals \$ 5,600 (\$ 11,200 multiplied by .50).

Example 6.

- (i) In April 2004, SS, a calendar year-end corporation, acquired and placed in service Equipment K89. Equipment K89 is 50-percent bonus depreciation property under section 168(k)(4). In November 2004, SS acquired and placed in service used Equipment N78 by exchanging Equipment K89 in a like-kind exchange.
- (ii) Pursuant to paragraph (f)(5)(iii)(B) of this section, no additional first year deduction is allowable for Equipment K89 and, pursuant to § 1.168(d)-1T(b)(3)(ii), no regular depreciation deduction is allowable for Equipment K89, for the taxable year ended December 31, 2004.
- (iii) Equipment N78 is not qualified property under section 168(k)(1) or 50-percent bonus depreciation property under section 168(k)(4) because the original use requirement of paragraph (b)(3) of this section is not met. Accordingly, no additional first year depreciation deduction is allowable for Equipment N78.

(6) Change in use –

- (i) Change in use of depreciable property. The determination of whether the use of depreciable property changes is made in accordance with section 168(i)(5) and regulations thereunder.
- (ii) Conversion to personal use. If qualified property or 50-percent bonus depreciation property is converted from business or income-producing use to personal use in the same taxable year in which the property is placed in service by a taxpayer, the additional first year depreciation deduction is not allowable for the property.

(iii) Conversion to business or income-producing use –

- (A) During the same taxable year. If, during the same taxable year, property is acquired by a taxpayer for personal use and is converted by the taxpayer from personal use to business or income-producing use, the additional first year depreciation deduction is allowable for the property in the taxable year the property is converted to business or income-producing use (assuming all of the requirements in paragraph (b) of this section are met). See paragraph (b)(3)(ii) of this section relating to the original use rules for a conversion of property to business or income-producing use.
- (B) Subsequent to the acquisition year. If property is acquired by a taxpayer for personal use and, during a subsequent taxable year, is converted by the taxpayer from personal use to business or income-producing use, the additional first year depreciation deduction is allowable for the property in the taxable year the property is converted to business or income-producing use (assuming all of the requirements in paragraph (b) of this section are met). For purposes of paragraphs (b)(4) and (5) of this section, the property must be acquired by the taxpayer for

personal use after September 10, 2001 (for qualified property), or after May 5, 2003 (for 50-percent bonus depreciation property), and converted by the taxpayer from personal use to business or income-producing use by January 1, 2005. See paragraph (b)(3)(ii) of this section relating to the original use rules for a conversion of property to business or income-producing use.

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

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

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

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

Example 1.

- (i) On January 1, 2002, HH, a calendar year corporation, purchased and placed in service several new computers at a total cost of \$ 100,000. HH used these computers within the United States for 3 months in 2002 and then moved and used the computers outside the United States for the remainder of 2002. On January 1, 2003, HH permanently returns the computers to the United States for use in its business.
- (ii) For 2002, the computers are considered as used predominantly outside the United States in 2002 pursuant to § 1.48-1(g)(1)(i). As a result, the computers are required to be depreciated under the alternative depreciation system of section 168(g). Pursuant to paragraph (b)(2)(ii)(A) 2) of this section, the computers are not qualified property in 2002, the placed-in-service year. Thus, pursuant to (f)(6)(iv)(B) of this section, no additional first year depreciation deduction is allowed for these computers, regardless of the fact that the computers are permanently returned to the United States in 2003.

Example 2.

- (i) On February 8, 2002, II, a calendar year corporation, purchased and placed in service new equipment at a cost of \$ 1,000,000 for use in its California plant. The equipment is 5-year property under section 168(e) and is qualified property under

section 168(k). II depreciates its 5-year property placed in service in 2002 using the optional depreciation table that corresponds with the general depreciation system, the 200-percent declining balance method, a 5-year recovery period, and the half-year convention. On June 4, 2003, due to changes in II 's business circumstances, II permanently moves the equipment to its plant in Mexico.

- (ii) For 2002, II is allowed a 30-percent additional first year depreciation deduction of \$ 300,000 (the adjusted depreciable basis of \$ 1,000,000 multiplied by .30). In addition, II 's depreciation deduction allowable in 2002 for the remaining adjusted depreciable basis of \$ 700,000 (the unadjusted depreciable basis of \$ 1,000,000 reduced by the additional first year depreciation deduction of \$ 300,000) is \$ 140,000 (the remaining adjusted depreciable basis of \$ 700,000 multiplied by the annual depreciation rate of .20 for recovery year 1).
 - (iii) For 2003, the equipment is considered as used predominantly outside the United States pursuant to § 1.48-1(g)(1)(i). As a result of this change in use, the adjusted depreciable basis of \$ 560,000 for the equipment is required to be depreciated under the alternative depreciation system of section 168(g) beginning in 2003. However, the additional first year depreciation deduction of \$ 300,000 allowed for the equipment in 2002 is not redetermined.
- (7) Earnings and profits. The additional first year depreciation deduction is not allowable for purposes of computing earnings and profits.
- (8) Limitation of amount of depreciation for certain passenger automobiles. For a passenger automobile as defined in section 280F(d)(5), the limitation under section 280F(a)(1)(A)(i) is increased by –
- (i) \$ 4,600 for qualified property acquired by a taxpayer after September 10, 2001, and before May 6, 2003; and
 - (ii) \$ 7,650 for qualified property or 50-percent bonus depreciation property acquired by a taxpayer after May 5, 2003.
- (9) Section 754 election. In general, for purposes of section 168(k) any increase in basis of qualified property or 50-percent bonus depreciation property due to a section 754 election is not eligible for the additional first year depreciation deduction. However, if qualified property or 50-percent bonus depreciation property is placed in service by a partnership in the taxable year the partnership terminates under section 708(b)(1)(B), any increase in basis of the qualified property or the 50-percent bonus depreciation property due to a section 754 election is eligible for the additional first year depreciation deduction.
- (10) Coordination with section 47 --
- (i) In general. If qualified rehabilitation expenditures (as defined in section 47(c)(2) and § 1.48-12(c)) incurred by a taxpayer with respect to a qualified rehabilitated building (as defined in section 47(c)(1) and § 1.48-12(b)) are qualified property or 50-percent bonus depreciation property, the taxpayer may claim the rehabilitation credit provided by section 47(a) (provided the requirements of section 47 are met) --

- (A) With respect to the portion of the basis of the qualified rehabilitated building that is attributable to the qualified rehabilitation expenditures if the taxpayer makes the applicable election under paragraph (e)(1)(i) or (e)(1)(ii)(B) of this section not to deduct any additional first year depreciation for the class of property that includes the qualified rehabilitation expenditures; or
- (B) With respect to the portion of the remaining rehabilitated basis of the qualified rehabilitated building that is attributable to the qualified rehabilitation expenditures if the taxpayer claims the additional first year depreciation deduction on the unadjusted depreciable basis (as defined in paragraph (a)(2)(iii) of this section but before the reduction in basis for the amount of the rehabilitation credit) of the qualified rehabilitation expenditures and the taxpayer depreciates the remaining adjusted depreciable basis (as defined in paragraph (d)(2)(i) of this section) of such expenditures using straight line cost recovery in accordance with section 47(c)(2)(B)(i) and § 1.48-12(c)(7)(i). For purposes of this paragraph (f)(10)(i)(B), the remaining rehabilitated basis is equal to the unadjusted depreciable basis (as defined in paragraph (a)(2)(iii) of this section but before the reduction in basis for the amount of the rehabilitation credit) of the qualified rehabilitation expenditures that are qualified property or 50-percent bonus depreciation property reduced by the additional first year depreciation allowed or allowable, whichever is greater.

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

Example.

- (i) Between February 8, 2004, and June 4, 2004, UU, a calendar-year taxpayer, incurred qualified rehabilitation expenditures of \$ 200,000 with respect to a qualified rehabilitated building that is nonresidential real property under section 168(e). These qualified rehabilitation expenditures are 50-percent bonus depreciation property and qualify for the 10-percent rehabilitation credit under section 47(a)(1). UU's basis in the qualified rehabilitated building is zero before incurring the qualified rehabilitation expenditures and UU placed the qualified rehabilitated building in service in July 2004. UU depreciates its nonresidential real property placed in service in 2004 under the general depreciation system of section 168(a) by using the straight line method of depreciation, a 39-year recovery period, and the mid-month convention. UU elected to use the optional depreciation tables to compute the depreciation allowance for its depreciable property placed in service in 2004. Further, for 2004, UU did not make any election under paragraph (e) of this section.
- (ii) Because UU did not make any election under paragraph (e) of this section, UU is allowed a 50-percent additional first year depreciation deduction of \$ 100,000 for the qualified rehabilitation expenditures for 2004 (the unadjusted depreciable basis of \$ 200,000 (before reduction in basis for the rehabilitation credit) multiplied by .50). For 2004, UU also is allowed to claim a rehabilitation credit of \$ 10,000 for the remaining rehabilitated basis of \$ 100,000 (the unadjusted

depreciable basis (before reduction in basis for the rehabilitation credit) of \$ 200,000 less the additional first year depreciation deduction of \$ 100,000). Further, UU's depreciation deduction for 2004 for the remaining adjusted depreciable basis of \$ 90,000 (the unadjusted depreciable basis (before reduction in basis for the rehabilitation credit) of \$ 200,000 less the additional first year depreciation deduction of \$ 100,000 less the rehabilitation credit of \$ 10,000) is \$ 1,059.30 (the remaining adjusted depreciable basis of \$ 90,000 multiplied by the depreciation rate of .01177 for recovery year 1, placed in service in month 7).

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