

Reg. Section 1.168(k)-1(b)(3)(v), Example 4

Additional first year depreciation deduction.

(a) Scope and definitions –

- (1) Scope. This section provides the rules for determining the 30-percent additional first year depreciation deduction allowable under section 168(k)(1) for qualified property and the 50-percent additional first year depreciation deduction allowable under section 168(k)(4) for 50-percent bonus depreciation property.
- (2) Definitions. For purposes of section 168(k) and this section, the following definitions apply:
 - (i) Depreciable property is property that is of a character subject to the allowance for depreciation as determined under section 167 and the regulations thereunder.
 - (ii) MACRS property is tangible, depreciable property that is placed in service after December 31, 1986 (or after July 31, 1986, if the taxpayer made an election under section 203(a)(1)(B) of the Tax Reform Act of 1986; 100 Stat. 2143) and subject to section 168, except for property excluded from the application of section 168 as a result of section 168(f) or as a result of a transitional rule.
 - (iii) Unadjusted depreciable basis is the basis of property for purposes of section 1011 without regard to any adjustments described in section 1016(a)(2) and (3). This basis reflects the reduction in basis for the percentage of the taxpayer's use of property for the taxable year other than in the taxpayer's trade or business (or for the production of income), for any portion of the basis the taxpayer properly elects to treat as an expense under section 179 or section 179C, and for any adjustments to basis provided by other provisions of the Internal Revenue Code and the regulations thereunder (other than section 1016(a)(2) and (3)) (for example, a reduction in basis by the amount of the disabled access credit pursuant to section 44(d)(7)). For property subject to a lease, see section 167(c)(2).
 - (iv) Adjusted depreciable basis is the unadjusted depreciable basis of the property, as defined in § 1.168(k)-1(a)(2)(iii), less the adjustments described in section 1016(a)(2) and (3).

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

- (1) In general. Qualified property or 50-percent bonus depreciation property is depreciable property that meets all the following requirements in the first taxable year in which the

property is subject to depreciation by the taxpayer whether or not depreciation deductions for the property are allowable:

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

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

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

- (A) MACRS property (as defined in § 1.168(k)-1(a)(2)(ii)) that has a recovery period of 20 years or less. For purposes of this paragraph (b)(2)(i)(A) and section 168(k)(2)(B)(i)(II) and 168(k)(4)(C), the recovery period is determined in accordance with section 168(c) regardless of any election made by the taxpayer under section 168(g)(7);

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

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

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

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

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

- (1) Described in section 168(f);

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

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

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

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

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

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

(3) Original use --

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

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

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

(B) Inventory to business or income-producing use. If a taxpayer initially acquires new property and holds the property primarily for sale to customers in the ordinary course of the taxpayer's business and subsequently withdraws the property from inventory and uses the property primarily in the taxpayer's trade or

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

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

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

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

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

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

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

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

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

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

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



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

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

However, the tractors are not eligible for the additional first year depreciation deduction because JJ acquired the tractors before September 11, 2001.

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