Reg. Section 1.168(k)-1(c)

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 taxpayerafter 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.

(4) Acquisition of property -- (i) In general -- (A) Qualified property. For purposes of the 30-percent additional first year depreciation deduction, depreciable property will meet the requirements of this paragraph (b)(4) if the property is --

(1) Acquired by the taxpayer after September 10, 2001, and before January 1, 2005, but only if no written binding contract for the acquisition of the property was in effect before September 11, 2001; or

(2) Acquired by the taxpayer pursuant to a written binding contract that was entered into after September 10, 2001, and before January 1, 2005.

(B) 50-percent bonus depreciation property. For purposes of the 50-percent additional first year depreciation deduction, depreciable property will meet the requirements of this paragraph (b)(4) if the property is --

(1) Acquired by the taxpayer after May 5, 2003, and before January 1, 2005, but only if no written binding contract for the acquisition of the property was in effect before May 6, 2003; or

(2) Acquired by the taxpayer pursuant to a written binding contract that was entered into after May 5, 2003, and before January 1, 2005.

(ii) Definition of binding contract -- (A) In general. A contract is binding only if it is enforceable under State law against the taxpayer or a predecessor, and does not limit damages to a specified amount (for example, by use of a liquidated damages provision). For this purpose, a contractual provision that limits damages to an amount equal to at least 5 percent of the total contract price will not be treated as limiting damages to a specified amount. In determining whether a contract limits damages, the fact that there may be little or no damages because the contract price does not significantly differ from fair market value will not be taken into account. For example, if a taxpayer entered into an irrevocable written contract to purchase an asset for $ 100 and the contract contained no provision for liquidated damages, the contract is considered binding notwithstanding the fact that the asset had a fair market value of $ 99 and under local law the seller would only recover the difference in the event the purchaser failed to perform. If the contract provided for a full refund of the purchase price in lieu of any damages allowable by law in the event of breach or cancellation, the contract is not considered binding.

(B) Conditions. A contract is binding even if subject to a condition, as long as the condition is not within the control of either party or a predecessor. A contract will continue to be binding if the parties make insubstantial changes in its terms and conditions or because any term is to be determined by a standard beyond the control of either party. A contract that imposes significant obligations on the taxpayer or a predecessor will be treated as binding notwithstanding the fact that certain terms remain to be negotiated by the parties to the contract.

(C) Options. An option to either acquire or sell property is not a binding contract.

(D) Supply agreements. A binding contract does not include a supply or similar agreement if the amount and design specifications of the property to be purchased have not been specified. The contract will not be a binding contract for the property to be purchased until both the amount and the design specifications are specified. For example, if the provisions of a supply or similar agreement state the design specifications of the property to be purchased, a purchase order under the agreement for a specific number of assets is treated as a binding contract.

(E) Components. A binding contract to acquire one or more components of a larger property will not be treated as a binding contract to acquire the larger property. If a binding contract to acquire the component does not satisfy the requirements of this paragraph (b)(4), the component does not qualify for the 30-percent or 50-percent additional first year depreciation deduction, as applicable.

(iii) Self-constructed property -- (A) In general. If a taxpayer manufactures, constructs, or produces property for use by the taxpayer in its trade or business (or for its production of income), the acquisition rules in paragraph (b)(4)(i) of this section are treated as met for qualified property if the taxpayer begins manufacturing, constructing, or producing the property after September 10, 2001, and before January 1, 2005, and for 50-percent bonus depreciation property if the taxpayer begins manufacturing, constructing, or producing the property after May 5, 2003, and before January 1, 2005. Property that is manufactured, constructed, or produced for the taxpayer by another person under a written binding contract (as defined in paragraph (b)(4)(ii) of this section) that is entered into prior to the manufacture, construction, or production of the property for use by the taxpayer in its trade or business (or for its production of income) is considered to be manufactured, constructed, or produced by the taxpayer. If a taxpayer enters into a written binding contract (as defined in paragraph (b)(4)(ii) of this section) after September 10, 2001, and before January 1, 2005, with another person to manufacture, construct, or produce property described in section 168(k)(2)(B) (longer production period property) or section 168(k)(2)(C) (certain aircraft) and the manufacture, construction, or production of this property begins after December 31, 2004, the acquisition rule in paragraph (b)(4)(i)(A)(2) or (b)(4)(i)(B)(2) of this section is met.

(B) When does manufacture, construction, or production begin -- (1) In general. For purposes of paragraph (b)(4)(iii) of this section, manufacture, construction, or production of property begins when physical work of a significant nature begins. Physical work does not include preliminary activities such as planning or designing, securing financing, exploring, or researching. The determination of when physical work of a significant nature begins depends on the facts and circumstances. For example, if a retail motor fuels outlet or other facility is to be constructed on-site, construction begins when physical work of a significant nature commences at the site; that is, when work begins on the excavation for footings, pouring the pads for the outlet, or the driving of foundation pilings into the ground. Preliminary work, such as clearing a site, test drilling to determine soil condition, or excavation to change the contour of the land (as distinguished from excavation for footings) does not constitute the beginning of construction. However, if a retail motor fuels outlet or other facility is to be assembled on-site from modular units manufactured off-site and delivered to the site where the outlet will be used, manufacturing begins when physical work of a significant nature commences at the off-site location.

(2) Safe harbor. For purposes of paragraph (b)(4)(iii)(B)(1) of this section, a taxpayer may choose to determine when physical work of a significant nature begins in accordance with this paragraph (b)(4)(iii)(B)(2). Physical work of a significant nature will not be considered to begin before the taxpayer incurs (in the case of an accrual basis taxpayer) or pays (in the case of a cash basis taxpayer) more than 10 percent of the total cost of the property (excluding the cost of any land and preliminary activities such as planning or designing, securing financing, exploring, or researching). When property is manufactured, constructed, or produced for the taxpayer by another person, this safe harbor test must be satisfied by the taxpayer. For example, if a retail motor fuels outlet or other facility is to be constructed for an accrual basis taxpayer by another

person for the total cost of $ 200,000 (excluding the cost of any land and preliminary activities such as planning or designing, securing financing, exploring, or researching), construction is deemed to begin for purposes of this paragraph (b)(4)(iii)(B)(2) when the taxpayer has incurred more than 10 percent (more than $ 20,000) of the total cost of the property. A taxpayer chooses to apply this paragraph (b)(4)(iii)(B)(2) by filing an income tax return for the placed-in-service year of the property that determines when physical work of a significant nature begins consistent with this paragraph (b)(4)(iii)(B)(2).

(C) Components of self-constructed property -- (1) Acquired components. If a binding contract (as defined in paragraph (b)(4)(ii) of this section) to acquire a component does not satisfy the requirements of paragraph (b)(4)(i) of thissection, the component does not qualify for the 30-percent or 50-percent additional first year depreciation deduction, as applicable. A binding contract (as defined in paragraph (b)(4)(ii) of this section) to acquire one or more components of a larger self-constructed property will not preclude the larger self-constructed property from satisfying the acquisition rules in paragraph (b)(4)(iii)(A) of this section. Accordingly, the unadjusted depreciable basis of the larger self-constructed property that is eligible for the 30-percent or 50-percent additional first year depreciation deduction, as applicable (assuming all other requirements are met), must not include the unadjusted depreciable basis of any component that does not satisfy the requirements of paragraph (b)(4)(i) of this section. If the manufacture, construction, or production of the larger self-constructed property begins before September 11, 2001, for qualified property, or before May 6, 2003, for 50-percent bonus depreciation property, the larger self-constructed property and any acquired components related to the larger self-constructed property do not qualify for the 30-percent or 50-percent additional first year depreciation deduction, as applicable. If a binding contract to acquire the component is entered into after September 10, 2001, for qualified property, or after May 5, 2003, for 50-percent bonus depreciation property, and before January 1, 2005, but the manufacture, construction, or production of the larger self-constructed property does not begin before January 1, 2005, the component qualifies for the additional first year depreciation deduction (assuming all other requirements are met) but the larger self-constructed property does not.

(2) Self-constructed components. If the manufacture, construction, or production of a component does not satisfy the requirements of paragraph (b)(4)(iii)(A) of this section, the component does not qualify for the 30-percent or 50-percent additional first year depreciation deduction, as applicable. However, if the manufacture, construction, or production of a component does not satisfy the requirements of paragraph (b)(4)(iii)(A) of this section, but the manufacture, construction, or production of the larger self-constructed property satisfies the requirements of paragraph (b)(4)(iii)(A) of this section, the larger self-constructed property qualifies for the 30-percent or 50-percent additional first year depreciation deduction, as applicable (assuming all other requirements are met) even though the component does not qualify for the 30-percent or 50-percent additional first year depreciation deduction. Accordingly, the unadjusted depreciable basis of the larger self-constructed property that is eligible for the 30-percent or 50-percent additional first year depreciation deduction, as applicable (assuming all other requirements are met), must not include the unadjusted depreciable basis of any component that does not qualify for the 30-percent or 50-percent additional first year depreciation deduction. If the manufacture, construction, or production of the larger self-constructed property began before September 11, 2001, for qualified property, or before May 6, 2003, for 50-percent bonus depreciation property, the larger self-constructed property and any self-constructed components related to the larger self-constructed property do not qualify for the 30-percent or 50-percent additional first year depreciation deduction, as

applicable. If the manufacture, construction, or production of a component begins after September 10, 2001, for qualified property, or after May 5, 2003, for 50-percent bonus depreciation property, and before January 1, 2005, but the manufacture, construction, or production of the larger self-constructed property does not begin before January 1, 2005, the component qualifies for the additional first year depreciation deduction (assuming all other requirements are met) but the larger self-constructed property does not.

(iv) Disqualified transactions -- (A) In general. Property does not satisfy the requirements of this paragraph (b)(4) if the user of the property as of the date on which the property was originally placed in service (including by operation of paragraphs (b)(5)(ii), (iii), and (iv) of this section), or a related party to the user or to the taxpayer, acquired, or had a written binding contract (as defined in paragraph (b)(4)(ii) of this section) in effect for the acquisition of the property at any time before September 11, 2001 (for qualified property), or before May 6, 2003 (for 50-percent bonus depreciation property). In addition, property manufactured, constructed, or produced for the use by the user of the property or by a related party to the user or to the taxpayer does not satisfy the requirements of this paragraph (b)(4) if the manufacture, construction, or production of the property for the user or the related party began at any time before September 11, 2001 (for qualified property), or before May 6, 2003 (for 50-percent bonus depreciation property).

(B) Related party defined. For purposes of this paragraph (b)(4)(iv), persons are related if they have a relationship specified in section 267(b) or 707(b) and the regulations thereunder.

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

Example 1. On September 1, 2001, J, a corporation, entered into a written agreement with K, a manufacturer, to purchase 20 new lamps for $ 100 each within the next two years. Although the agreement specifies the number of lamps to be purchased, the agreement does not specify the design of the lamps to be purchased. Accordingly, the agreement is not a binding contract pursuant to paragraph (b)(4)(ii)(D) of this section.

Example 2. Same facts as Example 1. On December 1, 2001, J placed a purchase order with K to purchase 20 new model XPC5 lamps for $ 100 each for a total amount of $ 2,000. Because the agreement specifies the number of lamps to be purchased and the purchase order specifies the design of the lamps to be purchased, the purchase order placed by J with K on December 1, 2001, is a binding contract pursuant to paragraph (b)(4)(ii)(D) of this section. Accordingly, the cost of the 20 lamps qualifies for the 30-percent additional first year depreciation deduction.

Example 3. Same facts as Example 1 except that the written agreement between J and K is to purchase 100 model XPC5 lamps for $ 100 each within the next two years. Because this agreement specifies the amount and design of the lamps to be purchased, the agreement is a binding contract pursuant to paragraph (b)(4)(ii)(D) of this section. Accordingly, because the agreement was entered into before September 11, 2001, any lamp acquired by J under this contract does not qualify for the additional first year depreciation deduction.

Example 4. On September 1, 2001, L began constructing an electric generation power plant for its own use. On November 1, 2002, L ceases construction of the power plant prior to its completion. Between September 1, 2001, and November 1, 2002, L incurred $ 3,000,000 for the construction of the power plant. On May 6, 2003, L resumed construction of the power plant and completed its construction on August 31, 2003. Between May 6, 2003, and August 31, 2003, L incurred another $ 1,600,000 to complete the construction of the power plant and, on September 1, 2003, L placed the power plant in service. None of L 's total expenditures of $ 4,600,000 qualify for the additional first year depreciation deduction because, pursuant to paragraph (b)(4)(iii)(A) of this section, L began constructing the power plant before September 11, 2001.

Example 5. Same facts as Example 4 except that L began constructing the electric generation power plant for its own use on October 1, 2001. L 's total expenditures of $ 4,600,000 qualify for the additional first year depreciation deduction because, pursuant to paragraph (b)(4)(iii)(A) of this section, L began constructing the power plant after September 10, 2001, and placed the power plant in service before January 1, 2005. Accordingly, the additional first year depreciation deduction for the power plant will be $ 1,380,000, computed as $ 4,600,000 multiplied by 30 percent.

Example 6. On August 1, 2001, M entered into a written binding contract to acquire a new turbine. The new turbine is a component part of a new electric generation power plant that is being constructed on M 's behalf. The construction of the new electric generation power plant commenced in November 2001, and the new electric generation power plant was completed in November 2002. Because M entered into a written binding contract to acquire a component part (the new turbine) prior to September 11, 2001, pursuant to paragraph (b)(4)(iii)(C) of this section, the component part does not qualify for the additional first year depreciation deduction. However, pursuant to paragraphs (b)(4)(iii)(A) and (C) of this section, the new plant constructed for M will qualify for the 30-percent additional first year depreciation deduction because construction of the new plant began after September 10, 2001, and before May 6, 2003. Accordingly, the unadjusted depreciable basis of the new plant that is eligible for the 30-percent additional first year depreciation deduction must not include the unadjusted depreciable basis of the new turbine.

Example 7. Same facts as Example 6 except that M entered into the written binding contract to acquire the new turbine on September 30, 2002, and construction of the new plant commenced on August 1, 2001. Because M began construction of the new plant prior to September 11, 2001, pursuant to paragraphs (b)(4)(iii)(A) and (C) of this section, neither the new plant constructed for M nor the turbine will qualify for the additional first year depreciation deduction because self-construction of the new plant began prior to September 11, 2001.

Example 8. On September 1, 2001, N began constructing property for its own use. On October 1, 2001, N sold its rights to the property to O, a related party under section 267(b). Pursuant to paragraph (b)(4)(iv) of this section, the property is not eligible for the additional first year depreciation deduction because N and O are related parties and construction of the property by N began prior to September 11, 2001.

Example 9. On September 1, 2001, P entered into a written binding contract to acquire property. On October 1, 2001, P sold its rights to the property to Q, a related party under section 267(b). Pursuant to paragraph (b)(4)(iv) of this section, the property is not eligible forthe additional first year depreciation deduction because P and Q are related parties and a written binding contract for the acquisition of the property was in effect prior to September 11, 2001.

Example 10. Prior to September 11, 2001, R began constructing an electric generation power plant for its own use. On May 1, 2003, prior to the completion of the power plant, R transferred the rights to own and use this power plant to S, an unrelated party, for $ 6,000,000. Between May 6, 2003, and June 30, 2003, S, a calendar-year taxpayer, began construction, and incurred another $ 1,200,000 to complete the construction, of the power plant and, on August 1, 2003, S placed the power plant in service. Because R and S are not related parties, the transaction between R and S will not be a disqualified transaction pursuant to paragraph (b)(4)(iv) of this section. Accordingly, S 's total expenditures of $ 7,200,000 for the power plant qualify for the additional first year depreciation deduction. S 's additional first year depreciation deduction for the power plant will be $ 2,400,000, computed as $ 6,000,000 multiplied by 30 percent, plus $ 1,200,000 multiplied by 50 percent. The $ 6,000,000 portion of the total $ 7,200,000 unadjusted depreciable basis qualifies for the 30-percent additional first year depreciation deduction because that portion of the total unadjusted depreciable basis was acquired by S after September 10, 2001, and before May 6, 2003. However, because S began construction to complete the power plant after May 5, 2003, the $ 1,200,000 portion of the total $ 7,200,000 unadjusted depreciable basis qualifies for the 50-percent additional first year depreciation deduction.

Example 11. On September 1, 2001, T acquired and placed in service equipment. On October 15, 2001, T sells the equipment to U, an unrelated party, and leases the property back from U in a sale-leaseback transaction. Pursuant to paragraph (b)(4)(iv) of this section, the equipment does not qualify for the additional first year depreciation deduction because T, the user of the equipment, acquired the equipment prior to September 11, 2001. In addition, the sale-leaseback rules in paragraphs (b)(3)(iii)(A) and (b)(5)(ii)(A) of this section do not apply because the equipment was originally placed in service by T before September 11, 2001.

Example 12. On July 1, 2001, KK began constructing property for its own use. KK placed this property in service on September 15, 2001. On October 15, 2001, KK sells the property to LL, an unrelated party, and leases the property back from LL in a sale-leaseback transaction. Pursuant to paragraph (b)(4)(iv) of this section, the property does not qualify for the additional first year depreciation deduction because the property was constructed for KK, the user of the property, and that construction began prior to September 11, 2001.

Example 13. On June 1, 2004, MM decided to construct property described in section 168(k)(2)(B) for its own use. However, one of the component parts of the property had to be manufactured by another person for MM. On August 15, 2004, MM entered into a written binding contract with NN to acquire this component part of the property for $ 100,000. The manufacture of the component part commenced on September 1, 2004, and MM received the completed component part on February 1, 2005. The cost of this component part is 9 percent of the total cost of the property to be constructed by MM. MM began constructing the property described in section 168(k)(2)(B) on January 15, 2005, and placed this property (including all component parts) in service on November 1, 2005. Pursuant to paragraph (b)(4)(iii)(C)(2) of this section, the self-constructed component part of $ 100,000 manufactured by NN for MM is eligible for the additional first year depreciation deduction (assuming all other requirements are met) because the manufacturing of the component part began after September 10, 2001, and before January 1, 2005, and the property described in section 168(k)(2)(B), the larger self-constructed property, was placed in service by MM before January 1, 2006. However, pursuant to paragraph (b)(4)(iii)(A) of this section, the cost of the property described in section 168(k)(2)(B) (excluding the cost of the self-constructed component part of $ 100,000 manufactured by NN for MM) is not eligible for the additional first year depreciation deduction because construction of the property began after December 31, 2004.

Example 14. On December 1, 2004, OO entered into a written binding contract (as defined in paragraph (b)(4)(ii) of this section) with PP to manufacture an aircraft described in section 168(k)(2)(C) for use in OO's trade or business. PP begins to manufacture the aircraft on February 1, 2005. OO places the aircraft in service on August 1, 2005. Pursuant to paragraph (b)(4)(iii)(A) of this section, the aircraft meets the requirements of paragraph (b)(4)(i)(B)(2) of this section because the aircraft was acquired by OO pursuant to a written binding contract entered into after May 5, 2003, and before January 1, 2005.

(5) Placed-in-service date -- (i) In general. Depreciable property will meet the requirements of this paragraph (b)(5) if the property is placed in service by the taxpayer for use in its trade or business or for production of income before January 1, 2005, or, in the case of property described in section 168(k)(2)(B) or (C), is placed in service by the taxpayer for use in its trade or business or for production of income before January 1, 2006 (or placed in service by the taxpayer for use in its trade or business or for production of income before January 1, 2007, in the case of property described in section 168(k)(2)(B) or (C) to which section 105 of the Gulf Opportunity Zone Act of 2005 (Pub. L. 109-135, 119 Stat. 2577) applies (for further guidance, see Announcement 2006-29 (2006-19 I.R.B. 879) and § 601.601(d)(2)(ii)(b) of this chapter)).

(ii) Sale-leaseback, syndication, and certain other transactions. -- (A) Sale-leaseback transaction. If qualified property is originally placed in service after September 10, 2001, or 50-percent bonus depreciation property is originally placed in service after May 5, 2003, by a person and 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 property is treated as originally placed in service by the taxpayer-lessor not earlier than the date on which the property is used by the lessee under the leaseback.

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

(C) Sale-leaseback transaction followed by a syndication transaction and certain other transactions. If a sale-leaseback transaction that satisfies the requirements in paragraph (b)(5)(ii)(A) of this section is followed by a transaction that satisfies the requirements in paragraph (b)(5)(ii)(B) of this section, the placed-in-service date of the property is determined in accordance with paragraph (b)(5)(ii)(B) of this section.

(iii) Technical termination of a partnership. For purposes of this paragraph (b)(5), in the case of a technical termination of a partnership under section 708(b)(1)(B), qualified property or 50-percent bonus depreciation property placed in service by the terminated partnership during the taxable year of termination is treated as originally placed in service by the new partnership on the date the qualified property or the 50-percent bonus depreciation property is contributed by the terminated partnership to the new partnership.

(iv) Section 168(i)(7) transactions. For purposes of this paragraph (b)(5), if 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 transferred property is treated as originally placed in service on the date the transferor placed in service the qualified property or the 50-percent bonus depreciation property, as applicable. In the case of multiple transfers of qualified property or 50-percent bonus depreciation property in multiple transactions described in section 168(i)(7) in the same taxable year, the placed in service date of the transferred property is deemed to be the date on which the first transferor placed in service the qualified property or the 50-percent bonus depreciation property, as applicable.

(v) Example. The application of this paragraph (b)(5) is illustrated by the following example:

Example. On September 15, 2004, QQ acquired and placed in service new equipment. This equipment is not described in section 168(k)(2)(B) or (C). On December 1, 2004, QQ sells the equipment to RR and leases the equipment back from RR in a sale-leaseback transaction. On February 15, 2005, RR sells the equipment to TT subject to the lease with QQ. As of February 15, 2005, QQ is still the user of the equipment. The sale-leaseback transaction of December 1, 2004, between QQ and RR satisfies the requirements of paragraph (b)(5)(ii)(A) of this section. The sale transaction of February 15, 2005, between RR and TT satisfies the requirements of paragraph (b)(5)(ii)(B) of this section. Consequently, pursuant to paragraph (b)(5)(ii)(C) of this section, the equipment is treated as originally placed in service by TT on February 15, 2005. Further, pursuant to paragraph (b)(3)(iii)(C) of this section, TT is considered the original user of the equipment. Accordingly, the equipment is not eligible for the additional first year depreciation deduction.

(c) Qualified leasehold improvement property -- (1) In general. For purposes of section 168(k), qualified leasehold improvement property means any improvement, which is section 1250 property, to an interior portion of a building that is nonresidential real property if --

(i) The improvement is made under or pursuant to a lease by the lessee (or any sublessee) of the interior portion, or by the lessor of that interior portion;

(ii) The interior portion of the building is to be occupied exclusively by the lessee (or any sublessee) of that interior portion; and

(iii) The improvement is placed in service more than 3 years after the date the building was first placed in service by any person.

(2) Certain improvements not included. Qualified leasehold improvement property does not include any improvement for which the expenditure is attributable to:

(i) The enlargement of the building;

(ii) Any elevator or escalator;

(iii) Any structural component benefiting a common area; or

(iv) The internal structural framework of the building.

(3) Definitions. For purposes of this paragraph (c), the following definitions apply:

(i) Building has the same meaning as that term is defined in § 1.48-1(e)(1).

(ii) Common area means any portion of a building that is equally available to all users of the building on the same basis for uses that are incidental to the primary use of the building. For example, stairways, hallways, lobbies, common seating areas, interior and exterior pedestrian walkways and pedestrian bridges, loading docks and areas, and rest rooms generally are treated as common areas if they are used by different lessees of a building.

(iii) Elevator and escalator have the same meanings as those terms are defined in § 1.48-1(m)(2).

(iv) Enlargement has the same meaning as that term is defined in § 1.48-12(c)(10).

(v) Internal structural framework has the same meaning as that term is defined in § 1.48-12(b)(3)(i)(D)(iii).

(vi) Lease has the same meaning as that term is defined in section 168(h)(7). In addition, a commitment to enter into a lease is treated as a lease, and the parties to the commitment are treated as lessor and lessee. However, a lease between related persons is not considered a lease. For purposes of the preceding sentence, related persons are --

(A) Members of an affiliated group (as defined in section 1504 and the regulations thereunder); and

(B) Persons having a relationship described in section 267(b) and the regulations thereunder. For purposes of applying section 267(b), the language "80 percent or more" is used instead of "more than 50 percent."

(vii) Nonresidential real property has the same meaning as that term is defined in section 168(e)(2)(B).

(viii) Structural component has the same meaning as that term is defined in § 1.48-1(e)(2).

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